New Business Start-Up Guide

A Resource for Entrepreneurs

Abbott, Stringham & Lynch
Certified Public Accountants and Business Advisors

Contents

Contents (continued)

Introduction

Congratulations on your venture to become a business owner!

This **New Business Start-Up Guide** provides logical steps to follow to get you started; although you can vary the order according to your circumstances. The general steps in the **Guide** are useful for starting a business anywhere in the world. However, the **Guide** is intended to be a checklist and tool for start-ups specifically in Silicon Valley. For example, Chapter Three gives instruction for registering with regulatory agencies in Silicon Valley and California. Many federal, California, and local tax and regulatory requirements are included. Be advised that there may be new regulations or rules specific to your situations that are not included in the **Guide.** We recommend you involve an attorney, a CPA, a banker, and a business insurance agent.

Abbott, Stringham & Lynch (**ASL**), has an **Emerging Business Group** which can guide you with best practices for your new business. With over 700 business clients, we have observed and cataloged best practices for start-up companies. Our services include accounting, tax, business valuation, and business advisory services. We have access to subject matter experts, affiliates, and library resources that can provide help and best practices for financial, legal, personnel, insurance, marketing, and administrative issues. Since our founding in 1977, our firm has served as an advisor to hundreds of start-up businesses which became mature, thriving companies. Let us help you along the way to your business success.

Please be aware that the links included are current as of January 2016.

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Chapter One

Determining the Business Viability

You have probably already conceptualized your new business. Before you plow ahead and possibly waste a lot of time and money there are six essential steps to determine the viability of your business. Get help if you need it, but don't skip these six steps.

1. Define your Business Purpose from the Customer's Perspective

Think long and hard to answer this fundamental question: What is the big need, problem, or desire you are solving? Describe your purpose from the eyes of your customer. Who are your customers? Why will they want your product or service? What are you providing that they can't already get from competitors? To be successful, your business must be about customers, not you. What is it to them? This concept is the most important element in your planning. Boil it down to a sentence or two. This is your mission statement, so wordsmith the sentence until you get it just right. You need to get this right, because investors, lenders, and customers will want a precise explanation of the solution you can bring.

2. Describe Your Business

Write down how your business will operate. At this point, you only need a paragraph or two. Be concise. Describe how you will accomplish your business purpose above. For example, what are the key products or services? Where will you get the products? Who or how will you provide the services? Location of business and customers? How will you make money, or get paid? Going through this exercise will help you refine your business concept. You may think of complementary ideas; or find faults that cause you to reconsider whether to go forward. Either way, this exercise is worth the effort.

3. Understand Your Market

The objective here is not to develop a full-fledged marketing plan. Rather, it is to ensure that you have identified your market for the product or service; and considered some strategies and tactics to reach your customers. Try to answer these questions: How big is your potential market? You need a general idea. Find out about the industry. What are the barriers to entry? Who will buy your product or service? Are there sufficient and willing buyers? Is the market underserved now? Estimate the dollar potential you have. How will you identify and sell to your customers? You can look at the success of similar businesses, or talk to potential customers. Identify your competition and consider whether there is enough market to go around.

4. **Determine Cash Viability**

This step is a rough, preliminary calculation. Make sure your business pencils-out on a napkin from the get-go. The premise is: **Cash is king**. There are two aspects to consider:

- <u>Is there prospective profitability</u>? Will revenues exceed expenses in due time? Is there an ample gross profit margin? Estimate overhead costs. Is there still enough margin left over for an acceptable bottom-line profit?
- <u>What about start-up and asset costs</u>? After analyzing profitability above, evaluate start-up costs. Some businesses can start on a shoestring; others require a large capital investment in equipment, facilities, research, and development. Do you have the capital? Do you really think investors or lenders will be willing to provide the funding for your idea? Is the business still profitable after considering depreciation and recovery of the development costs?

5. **Identify Challenges**

What are the challenges your business could face? Be honest in your assessment. Are you sufficiently motivated? Are you ready to work long hours and weekends? Do you have moral support from family and friends? How is your health? Entrepreneurs typically make huge investments in time and energy. Do you have what it takes? Your attitude and drive is a key factor in the success of your business. Do you need help? Can you find the right team to go forward? Getting the right people on the bus is critical to your success. Identifying challenges is not meant to discourage you. Small business opportunities abound. Dun and Bradstreet (D&B) reports that more than 90% of American businesses employ 50 or fewer employees; and over half of those employ from one to four employees. The American dream attracts millions to small business. With that dream come challenges. Just be aware of them. Review the list of *Top Five Challenges Facing Start-ups Today* in **Exhibit A.** After you have reviewed the list, sit back, ponder, and apply the smell test. Consider these questions: Does the new business have the smell of success? Do you really believe in it? Is it completely reputable? Will customers still need or want your product or service during a recession? If not, can you weather the storm? The most important part of the smell test is the question: Does it feel right to go forward? If so, go for it!

6. **Write your Vision and Key Strategies**

After you complete the first five steps above, it's time to write your vision. Your vision answers the question: What is your business going to look like in three to five years? What are you trying to build? What are the key benchmarks you are after? You can estimate your revenues, or both revenues and expenses, or use other benchmarking criteria that are key indicators of what you are trying to achieve. Your vision may be a sentence or a paragraph. Under the vision, list the five or six key strategies that will get you there.

Chapter Two

Planning Your Business

If you completed the first six steps above, congratulations! Now you have completed the basics of a simplified business plan, which is sometimes called an **Executive Summary.**

1. Prepare an Executive Summary

Here is the recommended outline for your one to three page Executive Summary:

A. Business purpose
B. Business description
C. Market description
D. Cash viability analysis
E. Challenges
F. Vision and Strategies

The best practice is to have two **Executive Summaries:** (1) One is the first section of your complete business plan. This should be no longer than three pages. (See section 7 in this chapter). (2) The second Executive Summary is a one page document that is provided to investors. It crystallizes your business in the most concise terms and will give you confidence and focus. This is the crisp business overview that a potential funder, partner, team member, or other key player can grasp in 5 minutes. Otherwise, your audience will be confused and frustrated trying to figure out what your business is, leaving no desire to explore further. You have one chance and a brief amount of time to make a good first impression. Most entrepreneurs are way too verbose. They spend too much time writing a 50 page business plan, when they should have concentrated on an extraordinarily concise Executive Summary. Get the one page Executive Summary down pat so it rolls right off your tongue. The words make all the difference. If you are successful with your Executive Summary, funders will be happy to give you direction on what else they want in terms of an expanded business plan. You may want to prepare a *PowerPoint* presentation. If so, keep it to ten or fifteen slides with no more than a few brief concepts or pictures per slide. Entrepreneurs often try to put too much information and verbiage on a slide. Limit the technical detail. The slide deck is not a design document. Most of the focus should be on the business.

2. Investigate Funding Needs and Options

You can't succeed in your start-up unless you can fund your business one way or another. Even the best ideas die on the vine because the business lacked resources to bring the ideas to fruition. With your executive summary, you are ready to explore your funding options. You need a fundamental understanding of the funding world to help you complete your business plan (Section 7 below). It may not be necessary to raise millions of dollars to make your business successful. You may be able to get started and survive for a few months or even years on a shoestring budget. Some keep their day job initially and work on the start-up in their spare time, preferring to avoid the risk of shooting for the stars. You might find a small niche market without a lot of competition that will provide a comfortable living for many years. For others who are thinking big, competitive market conditions may dictate raising millions of dollars quickly. Determine your goals and anticipate the amount you need, the time frame, and the types of funding you will go after. See **Exhibit B** for *Sources of Funding*. See the next step, in Section 3 (p.5), for an analysis of equity vs. debt financing. Below are some typical funding phases, sources and amounts. Of course, every company is different so your situation may vary.

Typical New Business Phases and Funding Sources

Phase	Sources	Amounts
1. Start-up, Bootstrapping (Inception up to 2 yrs)	Personal resources Friends & Family Crowd Funding	\$10,000 - \$150,000
2. Early Stage, Seed money (1st yr to 3rd yr)	Angel investors	\$25,000 - \$1 million
3. Mid-stage (2nd yr to 5th yr)	Super Angel investors Institutional sources	\$500,000 - \$2 million
4. Later-stage, A, B, C rounds (2nd yr to 10th yr)	Venture Capital (VC)	\$2 to \$5 million and up

Consider VC funding if your goal is to create a break-through product with large sales and growth potential, and you want to sell the company or go public. Many VCs are looking for companies who expect to generate annual sales of at least \$50 million within five years with the potential of many times that amount. You would likely need in excess of \$10 million to \$20 million over the life of the company to fund such growth. VCs invest that kind of money. Angel investors do not. Furthermore, angel investors generally don't invest seed money in businesses that will eventually need more than \$20 million in VC funding. That is because the dilution that will occur with the A, B, and C rounds of VC funding makes it very unlikely that such early stage investors will make much, if any money.

Because of the large capital investments, VCs usually end up with control of large enterprises. Today, some VCs make early or mid-stage investments of \$500,000 or more. If your business will be a smaller scale, or if maintaining control is important to you, or you want to create a family business, then you probably don't want to seek VC funding. In this scenario, try to raise sufficient funds from friends, family, and angel investors to bring the company to a level of profitability that will sustain moderate growth without the need for VC money.

3. Consider Equity vs. Debt Financing

Generally, the more risky the venture, the more difficult to obtain satisfactory debt financing. Unless you have access to mortgage or other secured lending, it is difficult to obtain institutional funds for a start-up without revenues and profits. Therefore, for some start-ups, the only alternative is to seek equity (ownership) capital from investors willing to accept the risks. Entrepreneurs who can bootstrap their businesses with loans from friends and family are lucky.

Be aware that once you add additional owners, especially unsophisticated investors, your life becomes much more complicated. Stock option plans and convoluted cap tables are time-consuming and distracting. Be wary of crowd funding, especially if it involves selling equity to many small investors. Unsophisticated investors sometimes have unreasonable expectations which can make your life miserable. If you can swing it, sole ownership is a great way to go. Here are some factors to consider in choosing equity or debt financing.

Advantages and Disadvantages
Of Equity and Debt Financing

Attribute	Equity	Debt
Risk	Spread among investors	Rests on owner if personally guaranteed
Repayment	Generally not required to be repaid	Must be repaid, usually on a regular schedule
Assets encumbered	Pledge of assets not required	Usually requires mortgage on assets as security
Rewards of success	Shared among investors	Enjoyed by owner
Flexibility in structuring operations	Generally high degree of flexibility	Often restricted by loan agreement and debt covenants
Choices of entities	Limited to corporation, LLC, or partnership	Can be any form
Complexity of ownership: multiple shareholders, preferred stock, stock option plans, etc.	Complex: may be expensive for legal, auditing, and tax services; time consuming, may divert business focus	Not complex
Motivate employees	Issuing stock or options to employees may incentivize them. Or, it may create a false hope and resentment	No equity incentive. Can motivate employees with bonuses, retirement plans, or phantom stock

4. Choose Type of Entity

In choosing an entity type, consider these and other relevant factors: (1) nature of the business, (2) number and relationship of the founders, (3) amount and nature of assets to be contributed at inception, (4) participation of the founders in the management of the business, (5) capacity and inclination of the founders to deal with administrative burdens associated with the entity, and (6) method of profit distribution to the founders, and (7) personal liability limitations. Choosing the type of entity can be a difficult decision so seek legal and CPA counsel. To help you get started, see the **Exhibit C** *Entity Perspective* Chart for a snapshot view. Review the entity summaries below to give you some background and identify some of the issues you will want to consider.

- Sole proprietorship (or proprietorship): Of all the entity choices, this has the least administrative burden; no separate tax returns, no need for a charter, board meetings, etc. The owner reports operating results on Schedule C of the individual Form 1040 tax return. Any complexities with regard to record keeping and accounting are driven by the nature of the business, not the business form. The owner holds title to property and is personally liable for all obligations of the business. The owner's personal assets can be seized to satisfy debts. The business is limited to two sources of capital: contributions from the owner or loans. Because a sole proprietor is not an employee of the business, net income from the business is subject to self-employment tax, which is paid with the individual tax return.

- Partnerships: Generally, for tax purposes, if two or more owners share revenues, expenses, and profits, and you are not a corporation or LLC, then you have a partnership. The business files a partnership tax return, and partners receive a form K-1, which is used to report their share of income or loss on their individual tax returns. Partnerships can range from simple to complex, depending on the agreement. Partnerships provide tremendous flexibility in tax reporting; however, complex tax accounting rules can make the cost of administration high. A partner's share of earned income in the partnership is subject to self-employment tax, which is paid with the individual tax return. There are two types of partnerships:

    1. General Partnerships: These are associations of two or more persons as co-owners. Co-owners personally share the risks and rewards. Each partner is jointly and severally liable for the partnership's obligations. Like proprietorships, a partner's personal assets can be seized to satisfy debts of the partnership. Tax gains and losses "pass through" to the partners individually. Sources of capital are limited to general partners and loans. Proprietorships and general partnerships have no California state registration requirements, but see Chapter Three #2 to consider registering for legal reasons. Be aware that California requires limited partnerships, LLCs, and corporations to register to do business in the state.

4. **Choose Type of Entity (continued)**

2. Limited Partnerships: These are like a general partnership, except that one or more of the partners (i.e., the limited partners) have limited participation in the venture's risk. This form of organization is a legal device that enables limited partners to be passive investors, and normally limits their liability to the extent of their investment. It enables the general partners to manage and control day-to-day operations. A general partner's assets can be seized to satisfy debts of the limited partnership. A limited partnership is a pass through entity, although inactive partners may be required to defer "passive losses" until passive gains are earned, or until dissolution. Limited partnerships can raise capital from multiple investors who want to limit their risk.

- Limited Liability Companies (LLCs): LLCs combine the best attributes of limited partnerships and S corporations. These attributes include (1) treatment as a "pass through" entity for tax purposes (if the entity elects to be treated as such), and (2) limiting the member's liability to one's investment. LLCs can raise capital from "members" who want to limit their risk. California charges a gross receipts fee based on the revenues of the LLC, which can amount to thousands of dollars. An LLC member is not an employee. Generally, if the member is actively involved in the business, the member's share of the earned income is subject to self-employment tax. Self-employment tax is paid with the individual tax return. Many attorneys recommend you start with an LLC, and if it looks like the business is going to take off, you can always convert to a C corporation.

- Corporations (C-corporations): C Corporations are common for start-ups expecting to grow quickly and raise venture capital. (See Chapter 3, Section 1 Re: incorporating in Delaware.) Corporations characterized as "artificial persons" with the ability to hire employees, enter into contracts, acquire assets, etc. The shareholders (owners) generally limit their liability to the investment in the corporation. Since corporations are not "pass through" entities, corporations pay income taxes at their own level. Losses of C-corporations are not passed through to shareholders, but may be carried back or carried forward to other tax years, unless limited in certain circumstances. C-corporations can go public. There is a potential of "double taxation" of profits in a C-corporation: once on corporate profits, and once to the shareholders when a dividend is paid or upon liquidation. Corporations can avoid double taxation by paying salaries to the extent of profits, but be aware of unreasonable compensation issues. C-Corporations can raise capital by selling different classes of stock or issuing debt. C-corporations generally present more advantages than other entities relating to compensation. For example, income can be shifted to the individual through salaries, fringe benefits, reimbursements, and other items that are deductible to the corporation and may or may not be taxable to the individual. This shifting of income can be used to minimize the combined tax burden of the corporation.

4. Choose Type of Entity (continued)

Corporations (C-corporations) (continued):

Employee status enables the shareholder/employee to qualify for certain fringe benefits, such as medical and disability insurance, medical reimbursement plans, meals and lodging, and group term life insurance up to $50,000. In addition, shareholder/employees are eligible for retirement plans that can provide tremendous tax benefits.

- S-corporations: An S-corporation is a corporation with the legal characteristics of a C-corporation. Therefore, S-Corporations, like C-corporations need articles of incorporation, bylaws, board of directors, and meetings of board of directors. The major difference is that S-corporations file an election with the IRS to be taxed as a "pass through" entity. The S-election is a way to avoid the double tax that C-corporations experience. Unlike in a C-corporation, profits and losses generally flow to the shareholders' individual tax returns, via Form K-1 reporting. California taxes S-corporation net income at the greater of 1.5% or $800. Similar to partnerships, shareholder loans to an S-corporation can increase the shareholder's tax basis for purposes of deducting losses. However, loans from third parties, such as banks, do not increase the shareholder's tax basis even if the loans are personally guaranteed by the shareholder. So, S-corporation losses may not be deductible, if the shareholder doesn't have basis. S-corporations may sell stock to a maximum of 100 shareholders and are limited to one class of stock. One of the attractions of an S-corporation is that nonwage income and distributions passed through to the shareholders are not subject to self-employment tax or payroll tax. However, the IRS may challenge the distribution if it is in lieu of compensation which would have been subject to payroll taxes. In Silicon Valley, S-corporations are rarely the choice for investors who are not actively involved in the business.

5. Select a Name

This is tougher than it seems. Some entrepreneurs want to be creative and cute. That's fine. Put all your potential names on a list, and then consider these important factors.

- Choose a name that clearly communicates your product or service. Try out the name on friends, family, and potential customers. Should it have a geographic tie? Is the name scalable nationally and globally if your business takes off? The name is a key element of your start-up's branding and success. There is a process to selecting the optimal name. So don't short change the effort to get it right. Contact Mark Sheffield at ASL to learn the best resources to help you find a name that will help and not hinder your success.

5. Select a Name (continued)

- Be aware of trademark law, which regulates the right to use a name. If you pick a name similar to that trademarked by a competitor, you could get sued. It is best to select a safe name and avoid the lawsuit hassle. You can search the federal trademark registry maintained by the U.S. Patent and Trademark Office at www.uspto.gov/ebc/index tm.html. In addition, you can do a search through companies like Trademark Express or Thompson and Thompson. Some start-ups hire a search firm for a comprehensive search, which costs around $300. You can also contact the State of California Secretary of State to do a name search for registered businesses. Use a trademark attorney for expert advice in this tricky area.

- You may need to comply with the county's fictitious business name requirements. See Chapter Three, Section 3 for registration information.

- Check to see whether your business and product names are available on-line as domain names. If an online presence is important, it might impact your final name selection. Check with any domain name registrar, as listed at www.internic.com. You may have some recourse if your name is owned by a cyber-squatter who is only holding the name to sell. For more information go to www.icann.org.

6. Protect your Intellectual Property (IP)

Intellectual property (IP) rights, including patents, trademarks, copyrights and trade secrets, can secure your company's interest in its important inventions and creative assets. Until you legally get these in place, anyone will be able to produce or use your product. Patents and trademark registrations must be applied for through the US Patent and Trademark Office (USPTO). Copyrights can be registered through the US Copyright Office, although such registration is not always essential. Trade secrets should be documented internally, first as to their existence and second as to steps taken to maintain their secrecy. Consult an experienced IP attorney for guidance and legal help in these areas to make sure your company is adequately protected. Ensure that employment and consulting agreements call for assignment of IP rights.

Consider patenting your company's products, processes, formulations and aspects of service delivery that are new and that provide your company with a significant competitive advantage. Consider registering trademarks used in promoting your company, its products and its services. Apply copyright notices to all material made publicly available and consider registering copyrights of works that account for significant revenue to your business, especially if past experience gives you cause to fear copying. Consider taking steps to protect the secrecy of your company's business information, products, processes, formulations, and service delivery mechanisms.

7. Draft a Complete Business Plan

After selecting a name, and entity type, and preparing an executive summary, you should consider drafting a complete business plan. It is not mandatory, and many successful businesses have been launched without one. However, investors and lenders may request a complete plan. Find out what they need and want. Experienced entrepreneurs, banks, and investors generally agree that you should develop a complete business plan. It's a best practice. The value is in the process. It will help you make decisions and think about things you might not have considered. The best-selling business plan software is *Business Plan Pro* by Palo Alto Software, Inc. (www.paloalto.com). The standard edition is $100. Sample plans for certain industries are available for free. The software integrates with *Marketing Plan Pro* and *Web Strategy Pro* software to create a comprehensive business plan and corresponding internet strategy.

Another business plan application is *Automate Your Business Plan* for $80 at www.business-plan.com. This software is designed for novices and is a stand-alone program. It is currently being used in SBA Business Information Centers across the U.S. Other software plans which may work well for you are: *BizPlanBuilder, www.jian.com* and *My Business Analyst, www.mybusinessanalyst.com.*

The complete business plan should include the following:

A. Executive Summary of three pages, maximum (see Chapter Two, Section 1)
B. Overview: Product, Company, Management Team, External Team
C. Market Analysis: Total Available Market (TAM); Segmented Addressable Market (SAM); Share of Market you can reach (SOM); Industry Analysis; Competition; Market Dynamics.
D. Business Road Map and Strategy: Go-to-Market Strategy; Sales Strategy; Pricing Strategy; Top 10 Benchmark Customers
E. Financials: Current Financial Statements and Cap Table; Sales and P/L forecasts; Balance Sheet forecasts. ASL would be happy to help with this.

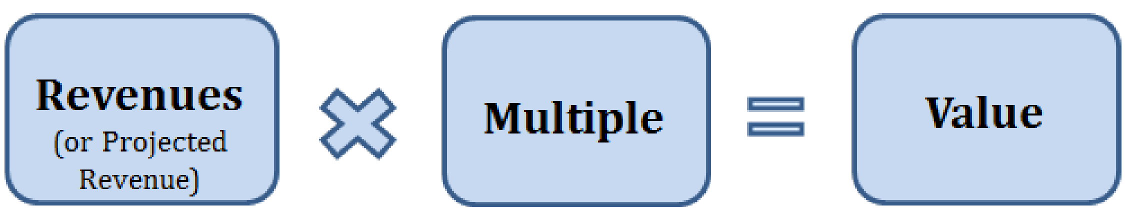
8. Value a Start-up: Investment Value

You should value your start-up if you plan to exchange equity for funding. Valuing a start-up is different from valuing an ongoing business (see Section 9 on page 14 for valuing an ongoing business). Oversimplifying, the value of a start-up is the subjective amount an investor will invest relative to the ownership percentage they will receive. This is called **investment value**. As a founder, you might disagree with the investment value. That's Ok. You don't have to take their money. Investors have their own formulas, calculations and rules of thumb. There is no magic, gold-standard computation to calculate investment value. The definitive investment value is the amount a willing founder and investor agree on.

Here are three typical approaches for determining investment value:

1. Multiple of Revenues: Mostly used in tech start-ups.
2. Investor Return Expectation: Mostly used in non-tech start-ups.
3. More sophisticated methods: Involves more advanced calculations; used to value both tech and non-tech start-ups.

- <u>Multiple of Revenues</u>: There are certain industries where the value of a start-up is based on a multiple. This simple rule-of-thumb calculation is used to estimate investment value:



In certain high-technology industries in Silicon Valley investors are principally looking for market share or market share potential. Annual revenues (or projected revenues if there is no revenue yet) is the key indicator of market share. There may be some service industries that could use this method as well if profitability is somewhat predictable. Caution! These multiples are highly volatile. They go up and down depending on the economy, market fluctuations, and availability of investment capital.

<u>Industry</u>	***<u>Revenues Multiple</u>***
Software	2x – 3x
Biotech	2x – 4x
SaaS	4x – 6x
Cloud	5x – 8x
Big Data	8x – 12x
Social	10x +

8. Value a Start-up: Investment Value (continued)

- Investor Return Expectation: This is a simplified method used for non-tech start-ups or tech start-ups where there is no industry multiple of revenues rule of thumb. Typically these include traditional businesses outside of the technology sectors previously mentioned.

  This method is a function of projected annual profit and the investor's expected return as follows:

$$\frac{\text{Profit *}}{\text{Investor Return Expectation (IRE)}} = \text{Value}$$

Definition of Investor Return Expectation (IRE): The IRE is the investor's annual required rate of return to invest. The return investors require or expect varies depending on the risk. Investors in stable companies will accept a much lower return on investment than an investor in a start-up. To illustrate this concept, here are some typical IREs:

Type of Company	*Investor Return Expectation (IRE)*
S & P 500 Companies	6.7% **
Profitable Private Companies	15% to 25%***
Start-up Companies	33% to 115%****

Examples of Value: Assuming the business is earning $1 million of profit per year, (or the start-up projects $1 million of profit per year), and using the following IREs here are some calculated values:

Type of Company	*Formula*	*= Value*
S & P Company	$1 mil/6.7%	= $14.9 mil
Private Company	$1 mil/20%	= $5 mil
Start-up	$1 mil/50%	= $2 mil

* Some label this formula: Income/Risk = Value. We think the terms *profit* and *investor return expectation (IRE)* are more descriptive and useful.

** Over the past 85 years, the price/earnings ratio for S&P 500 stocks has averaged 15. Inverting the fraction, the earnings/price ratio is 1/15 = 6.7%. This is the historical, average IRE for S&P 500 stock buyers.

*** Many private company investors expect a 15% to 25% return on companies that already have profit. Investors perceive a higher risk than with public companies, partly because the investment is not as liquid.

**** In this case, start-ups have not generated any profits yet. To offset this risk, angels and VCs typically want between 33% to 115% annual return on their investment (which equates to a 10X return on investment over three to eight years). This higher expectation is reasonable because the risk of losing their investment is much higher than with profitable public and private companies. Because there is no history of profits to base the value on, investors look at projections.

8. Value a Start-up: Investment Value (continued)

Calculating a Partial Investment: The investment value formulas above illustrate how investors value an entire business. The investment of capital into a start-up in exchange for a partial interest necessitates a differentiation between pre-money and post-money value. For example, if an investor agreed with the pre-money $2 mil start-up valuation above, a typical offer for 20% of the company is $500,000 calculated as follows

$2 mil pre-money value + $500,000 new money = $2.5 mil post-money value

$2.5 mil x 20% = $500,000

Variations on Start-up Values: Here are some different values for start-ups based on different assumptions:

Start-up Investor Return Expectation (IRE)		***Formula***	***= Value***
100%:	Because chance of $1 mil profit is so slim	$1 mil/100%	= $1 mil
33%:	Prospects of $1 mil profit are excellent	$1 mil/33%	= $3 mil
50%:	Good prospects with exponential growth upside so the investor might project $2.5 mil profit	$2.5 mil/50%	= $5 mil

Increasing Investment Value: In general, you can increase your start-up's investment value by convincing the investor of any of the following:

1. The expected rate of return should be reduced (because of lower risk)
2. Projected profits will be higher
3. The projected growth rate will be higher

- More sophisticated methods: There are more advanced methods to value start-ups and determine investment value including the VC Method, Scorecard Method, and Risk Factor Summation Method. These methods can be more complex in calculating future growth opportunities. They may also consider other factors such as a company's management team, technology, market size, competitive environment, and comparative start-up companies' valuations in that particular niche. ASL can help with all of these methods.

  Contact Jeff Faust, Director of Valuation Services, at ASL for help with valuing your start-up.

9. Value an Ongoing Business: Fair Market Value

Traditional methods of valuing businesses other than start-ups produce a **fair market value** result, which is different from the investment value approach illustrated in section 8 above. Fair market value is used to grant stock options or sell equity to employees. Below are three main categories of traditional valuation approaches. Valuation experts use one or a combination of these approaches to calculate the fair market value on an ongoing business.

Traditional Valuation Category	Methods	Description
Income approach	Discounted Cash Flow (DCF) Capitalization of Earnings	These methods focus on the income generating capacity of a business in a much longer time horizon than the investment value approach above.
Market Approach	Comparable Transactions Guideline Public Company	Used to determine what the market is paying for businesses in a particular industry.
Asset Approach	Restated Net Worth Replacement Cost	These methods look at how much money has been spent to build a company or asset and what the company could get if it liquidated.

Contact Jeff Faust, Director of ASL's Valuation Services, for help in valuing your ongoing business.

10. Negotiate Early Stage Financing

Now that you have a complete business plan and valuation, it's time to meet with potential funders.

Here is what you need for your angel investor or super angel investor pitch:
(See Chapter Five, Section 10 for VC Funding)

<u>Angel investor pitch</u>:

A. Executive Summary (see Chapter Two, Section 1)
B. Business Plan (see Chapter Two, Section 7)
C. Ten page summary or slide-deck presentation with bullet points
D. Executive Biographies of team members

Be passionate, concise, and clear. Be sure to involve an experienced attorney to help you with the negotiations and term sheet.

Chapter Three

Registering with Regulatory Agencies

Before you can legally hang your shingle, you need to deal with the bureaucracy. The government wants to make sure they can identify you if someone complains about your product. It is a way to protect the public from harmful products or services. Also, the registration requirements enable the government to tax your business.

1. Select Your State of Domicile

After you have chosen your business entity type (see Chapter Two, Section 3), decide where to incorporate or register that entity. If you chose a corporation, and you plan to raise $5 million or more in venture capital, consider incorporating in Delaware. Many Silicon Valley VCs prefer Delaware incorporations; in fact, they may insist on it before they invest. These VCs favor Delaware because: (1) Delaware has a predictable and well-developed body of corporate law, (2) they perceive that director and officer liability is more protective than in California, (3) complying with corporate formalities is efficient in Delaware, and (4) they are familiar and comfortable with Delaware protocol. Some attorneys today say it doesn't matter so much anymore because the corporate law in Delaware and California is now virtually the same. Talk to your attorney. Be aware that incorporating in Delaware, or Nevada, or any other state, does not save you taxes if your business is based in California. California-based businesses must register and file tax returns in California even if domiciled in Delaware or Nevada or another state. If you incorporate in Delaware, you must maintain a Registered Agent in the State of Delaware, follow the Delaware registration laws and pay a small annual franchise tax to Delaware. Most California based start-ups that are not pursuing VC money incorporate in California, or domicile their LLC or other entity in California. It avoids having to register in a second state.
For Delaware, see www.corp.delaware.gov/howtoform.shtml).

2. File Organization Documents With California

The filing process is different depending on the type of entity you select. The instructions below will help you understand what is involved for your type of entity. Contact a qualified attorney for legal advice and help before submitting the forms.

- Corporation:

  A. File Articles of Incorporation with the State of California.

2. File Organization Documents With California (continued)

i. The State of California provides forms for writing the Articles of Incorporation or you can create your own. The State also provides instructions for writing the Articles at the following URL:

http://www.sos.ca.gov/business-programs/business-entities/filing-tips

Here are links for the forms for a general stock corporation, a close corporation, and a professional corporation.

General stock corporation:
http://bpd.cdn.sos.ca.gov/corp/pdf/articles/arts-gs.pdf

Close corporation (up to 35 shareholders):
http://bpd.cdn.sos.ca.gov/corp/pdf/articles/arts-cl.pdf

Professional corporation (to engage in a profession):
http://bpd.cdn.sos.ca.gov/corp/pdf/articles/arts-pc.pdf

You can also refer to examples from *Nolo Press* or *Legalzoom* to understand what is included in the Articles of Incorporation. You may want to consult an attorney for assistance with writing the Articles of Incorporation.

ii. Mail the Articles to the following address:

Secretary of State
Business Entities
P.O. Box 944260
Sacramento, CA 94244-2600

Include a $100 check or money order for filing the Articles of Incorporation made payable to the Secretary of State.

iii. Within 90 days of filing the Articles of Incorporation, complete a Statement of Information online at https://businessfilings.sos.ca.gov.

Include a $25 fee, payable by credit card (Visa or MasterCard only). Remember to file this form annually even if there are no changes. There is a hefty fee for failure to file.

2. File Organization Documents With California (continued)

- Limited Liability Company:

   A. File Articles of Organization (Form LLC-1) with the State of California.

      i. Write the Articles of Organization. The State of California provides instructions for writing the Articles at the following URL: http://bpd.cdn.sos.ca.gov/llc/forms/llc-1.pdf. You can review examples of Articles of Organization from *Nolo Press* or *Legalzoom*. You may want to consult an attorney for assistance with writing the Articles of Organization.

      ii. Fill out the form online, then print and mail to:

      Secretary of State, Document Filing Support Unit
      P.O. Box 944228
      Sacramento, CA 94244-2280

      Include a $70 check for filing the Articles of Organization, made payable to the Secretary of State.

   B. After you have filed the Articles of Organization, file a Statement of Information.

      i. Instructions for writing the Statement are provided by the State of California at: http://bpd.cdn.sos.ca.gov/llc/forms/llc-12.pdf, where it can be viewed, filled in, and printed from your computer.

      ii. Print and mail the Statement of Information to:

      Secretary of State, Statement of Information Unit
      P.O. Box 944230
      Sacramento, CA 94244-2300

      Include a $20 check for filing the Statement of Information, made payable to the Secretary of State.

2. **File Organization Documents With California (continued)**

- Limited Partnership:

  A. File a Certificate of Limited Partnership (Form LP-1). The State of California provides instructions for writing the Certificate of Limited Partnership at the following URL: http://bpd.cdn.sos.ca.gov/lp/forms/lp-1.pdf
  You may want to consult an attorney for assistance with writing the Certificate of Limited Partnership.

  B. Fill out the form online, then print and mail to:

  Secretary of State, Document Filing Support Unit,
  P.O. Box 944225
  Sacramento, CA 94244-2250

  Include a $70 check for filing Form LP-1, made payable to the Secretary of State.

- General Partnership:

  A. Consider filing a Statement of Partnership Authority (Form GP-1). The State of California provides instructions for writing the Statement of Partnership Authority at the following URL: http://bpd.cdn.sos.ca.gov/gp/forms/gp-1.pdf

  You may want to consult an attorney for assistance with whether to register the partnership and with writing the Certificate of General Partnership.

  B. Fill out the form online, then print and mail to:

  Secretary of State
  Document Filing Support Unit
  P.O. Box 944225
  Sacramento, CA 94244-2250

  Include a $70 check for filing Form GP-1, made payable to the Secretary of State.

2. File Organization Documents With California (continued)

- Limited Liability Partnership:

   A. File an Application to Register a Limited Liability Partnership (Form LLP-1), once general partnership status is granted. The State of California provides instructions for filling out the Applications to Register a Limited Liability Partnership at: http://bpd.cdn.sos.ca.gov/llp/forms/llp-1.pdf

   You may want to consult an attorney for assistance with writing the Application to Register a Limited Liability Partnership.

   B. Fill-out the form online, then print and mail to:

   Secretary of State
   Business Entities, P.O. Box 944228
   Sacramento, CA 94244-2280

   Include a $70 check for filing Form LLP-1, made payable to the Secretary of State

3. Obtain a Federal and State Employer Identification Number

- Federal identification number: Owners of new businesses in California need to obtain a federal employer identification number. This number, also called a federal EIN (or FEIN), is the equivalent of a Social Security number for an individual. Most businesses, aside from sole proprietors, need a FEIN. Sole proprietors with no employees can use their own Social Security number instead of a FEIN. The FEIN is needed to have employees, to file income taxes, and to meet bank requirements.

  The process to obtain a FEIN is as follows:

   Go to http://www.irs.gov/pub/irs-pdf/fss4.pdf and fill out IRS Form SS-4. Then call the IRS Business & Specialty Tax Line at (800) 829-4933 from 7:00 am to 10:00 pm local time, Monday through Friday. Relay the information from the completed form over the phone to the IRS representative, who will then give you your FEIN.

   There is no fee for completing an IRS Form SS-4.

3. Obtain a Federal and State Employer Identification Number (continued)

- California identification number: In addition to a FEIN, a state employer identification number is required of all businesses operating in California with wages that exceed $100 in the calendar quarter.

  The process to obtain a State of California employer identification number is as follows:

  Go to https://eddservices.edd.ca.gov/tap/ and fill out the e-services form online.

  Additionally, you can a fill out form DE 1 – Rev. 75 (1-11) at http://www.edd.ca.gov/pdf_pub_ctr/de1.pdf and mail to: EDD, Account Services Group (ASG) MIC 28, P.O. Box 826880, Sacramento, CA 94280-0001

  There is no fee for completing a form DE 1- Rev. 75 (1-11).

4. Register a Fictitious Business Name

If you are going to run your business under any name other than your legal name, you need to register as a fictitious name. This process ensures that consumers have access to the true identity of the owners of a business. California requires a business that uses a fictitious business name to register that name with the county clerk where its primary business site is located.

The process to obtain a fictitious business name in Santa Clara County is as follows:

A. First you should determine if anyone else has registered your desired name. You can research fictitious business names online for free at http://www.clerkrecordersearch.org/.

B. Once you have decided on an available fictitious business name, complete an application at: http://bit.ly/20cEeVZ

   Mail the printed form, a $40.00 check payable to the Clerk-Recorder's office, and a self-addressed stamped envelope to the following address:

   Clerk Recorder's Office
   70 West Hedding Street, East Wing, First floor
   San Jose, CA 95110

4. Register a Fictitious Business Name (continued)

C. Publish the fictitious business name statement in a general circulation newspaper within 30 days of the filing date.

This link contains a list of general circulation newspapers in Santa Clara County: http://www.scscourt.org/forms_and_filing/forms/PB-4000.pdf

Call the newspaper for specific information on how to publish your fictitious business name. You will have to pay the newspaper a fee for publication. You must publish the legal notice a total of four times (once a week for four consecutive weeks).

D. File an affidavit with the county clerk that indicates the publication of the statement within 30 days after the completion of publication (The newspaper may file the affidavit for you or you may deliver the affidavit to the county clerk).

5. Obtain a Local Tax Registration Certificate

Most cities require all businesses to register with that city's tax collector. The websites on the next page provide the forms and information to register. A small annual fee is usually required.

The steps are as follows, for example, for the City of San Jose:

- Go to http://www.sanjoseca.gov/index.aspx?NID=2812
- Follow steps for Business Tax
- Mail or deliver the form with payment to:

City of San Jose
Finance Department
Revenue Management 13th Floor
200 E. Santa Clara Street
San Jose, CA 95113-1905

5. Obtain a Local Tax Registration Certificate (continued)

San Jose	200 E. Santa Clara St, 1st Flr Tower, San Jose, CA 95113 408-535-7055 http://www.sanjoseca.gov/DocumentCenter/View/11998
Campbell	70 North First Street, Campbell, CA, 95008 408-866-2117 http://ca-campbell.civicplus.com/35/Doing-Business
Cupertino	10300 Torre Avenue, Cupertino, CA 95014 408-777-3308 http://www.cupertino.org/index.aspx?page=175
Gilroy	7351 Rosanna Street, Gilroy, CA 95020 408-846-0221 http://www.cityofgilroy.org/cityofgilroy_files/business/business_license/Business_Lic_App.pdf
Los Altos	1 North San Antonio Road, Los Altos, CA 94022 650-947-2760 http://www.losaltosca.gov/financeit/page/business-license-application
Los Altos Hills	26379 Fremont Road, Los Altos Hills, CA 94022 650-941-7222 http://www.losaltoshills.ca.gov/docs/browse/doc_download/381-02-business-license-application-form
Los Gatos	110 East Main Street, Los Gatos, CA 95030 408-354-6834 http://www.town.los-gatos.ca.us/421/Business-Licenses
Milpitas	455 East Calaveras Boulevard, Milpitas, CA 95035 408-586-3102 http://www.ci.milpitas.ca.gov/business/biz_license_app.asp
Monte Sereno	18041 Saratoga-Los Gatos Rd, Monte Sereno, CA 95030 408-354-7635 http://www.montesereno.org/index.php?src=gendocs&ref=Businesses&category=Main
Morgan Hill	17555 Peak Avenue, Morgan Hill, CA 95037 408-779-7237 http://ca-morganhill.civicplus.com/index.aspx?nid=577
Mountain View	500 Castro Street, Mountain View, CA 94041 650-903-6317 http://www.ci.mtnview.ca.us/civica/filebank/blobdload.asp?BlobID=2262
Palo Alto	285 Hamilton Avenue, Palo Alto, CA 650-329-2441 http://www.cityofpaloalto.org/business/business_licenses_and_permits.asp
Santa Clara	1500 Warburton Avenue, Santa Clara, CA 95050 408-615-2310 http://santaclaraca.gov/Modules/ShowDocument.aspx?documentid=1001
Saratoga	13777 Fruitvale Avenue, Saratoga, CA 95070 408-868-1260 http://www.saratoga.ca.us/cityhall/admin/forms/business_license_forms.asp
Sunnyvale	650 West Olive Avenue, Sunnyvale, CA 94086 408-730-7620 http://sunnyvale.ca.gov/Portals/0/Sunnyvale/FIN/Application.pdf

If your business is located in the unincorporated area of Santa Clara County, there is no business license requirement.

6. **Obtain a California State Seller's Permit**

- You must obtain a seller's permit if you are engaged in business in California and intend to sell tangible personal property that would ordinarily be subject to sales tax if sold at retail. If you do not hold a seller's permit and will make sales during temporary periods, such as Christmas tree sales and rummage sales, you must apply for a temporary seller's permit.

  The state seller's permit will allow you to collect sales taxes from customers to cover any sales tax that you'll owe to the state.

  The process to obtain a State Seller's Permit is as follows.

    Register online at https://efile.boe.ca.gov/ereg/index.boe.

    There is no fee for obtaining a State Seller's Permit.

    You may want to consult an attorney for assistance with filling out the State Seller's Permit information.

- You must obtain a use tax account (in addition to obtaining a state seller's permit) if you have received more than $100,000 in gross receipts from business operations in any calendar year. What is use tax? Use tax applies when sales tax does not. When a business located in California makes a purchase of tangible merchandise to be used, consumed or stored in California from an out-of-state vendor who does not collect California sales tax on the purchase, the purchase is liable for use tax. This happens frequently when a business buys something over the internet.

The California State Board of Equalization lists the conditions that mandate a use tax account at http://boe.ca.gov/info/reg.htm.

To register, go to https://efile.boe.ca.gov/ereg/index.boe and click *"Register a business activity with BOE."* There is no fee for obtaining a use tax account.

7. Obtain other Federal, State, County and Local Business Licenses as Required

This is the tricky part. There are innumerable laws and regulations that may pertain to your business. For example, there are environmental regulations and obscure local regulations. You may have to obtain licenses from other companies. It is impossible to list all the potential licenses you might need in this guide, but this section will alert you to some of the common license requirements and point you in the right direction.

- Federal Licensing: Most federal licenses are designed to protect the public in certain industries that are regulated on a national level. Most small businesses are not subject to federal licensing requirements.

- State Licensing: Whether you are subject to California licensing requirements depends on the business. The fees can be nominal or substantial. The types of licenses or permits may depend on education, experience, an examination, or bonding. For example, attorneys, CPAs, cosmetologists and real estate and insurance agents all require a state license.

- Local Licensing or Permits. Almost all businesses are required to obtain a local registration permit in the county or city in which they operate (see Section 4, starting on page 20). For many businesses, this simply entails completing a form and paying a fee. Special requirements may apply to certain types of businesses, such as those engaged in liquor, food, and transportation. Often municipalities will require contractors to be licensed and bonded before they will issue building permits or conduct any necessary inspections.

The easiest way to find out what licenses are required is to go to the CalGOLD (California Government: On-Line to Desktops) website for information regarding business license/permit requirements. The website is: http://www.calgold.ca.gov/

Entering your business type, the county, and the city will tell you what city, county, state, federal, and other permits are required. You will have already obtained some of the permits by following the steps in Sections 1 through 5 above. This website is a good checklist for other permits and licenses that may be necessary for your type of business. Failure to obtain the appropriate federal, state and local licenses and permits may result in significant penalties, including the closing of your business. Licensing can be a complex and frustrating process, but it is essential that you comply with the appropriate regulations.

8. Register with the County Assessor's Office

You may have to file a property tax statement. See Chapter Five, Section 8, Property Taxes.

Chapter Four

Setting Up Operations

1. **Choose a Business Location**

   Depending on what type of business you have, site selection can play an important role in the success of your company. Some businesses survive or die based on the location alone. For other businesses, location is not too important. Examples include wholesalers, service businesses who do all their work at the customers' sites, mail order companies, and Internet-based businesses. If you plan to operate your business primarily from your home, contact ASL for tax advice.

   When choosing **a location** for your business, consider these factors:

   - Economics. Call a commercial broker to determine how much rents are going for. Square footage rates are usually quoted in cost per year. To calculate the monthly rent divide by twelve. A **triple net lease** is a lease agreement on a property where the tenant or lessee agrees to pay all real estate taxes, building insurance, and maintenance (the three 'nets') on the property in addition to any normal rent fees. In such a lease, the tenant or lessee is responsible for all costs associated with the repair and maintenance of any common area. In a **full-service lease (gross lease)** the landlord or lessor agrees to pay for taxes, insurance, and maintenance. Consider whether an expensive location would pay off. How much can you really afford? When you do your business plan, determine your rent budget and try to hold to it.
   - Determine the facility features your business will need. Tenant Improvements (TIs) can be very expensive.
   - Proximity to the market. Can customers get there easily? Is there enough parking? Will more customers come if you locate to similar businesses? Does the reputation of the neighborhood affect your customer base?
   - Availability of labor. Will employees want to work at your location?
   - Traffic flow. Consider accessibility to transportation arteries. This may be important to both your customers and employees.
   - Proximity to competition. This may be important in certain situations.
   - Physical suitability and adequacy of utilities.
   - Parking facilities (safety at night).
   - Municipal services (adequate lighting).

2. Comply With Zoning Laws

Local zoning laws and ordinances regulate activities by area or districts. Different districts may be zoned for heavy-industrial, light-industrial, commercial office, residential, or mixed use. Never sign a lease until you know if the area is zoned for your business activity. However, you could sign a contingent lease, pending zoning approval. Don't assume the previous tenant was in compliance. They may have been "grandfathered" in under older zoning laws that are not applicable to new tenants. Even if you have a home business, you may be subject to zoning restrictions.

Zoning laws may have **parking requirements**. You might have to provide more parking than the previous tenant did. Also, there might be traffic flow issues. These things sometimes surface when there is a change in tenant.

Also, be aware of **signage regulations**. Local officials can be very particular about the size, appearance (such as neon or flashing), placement (mounted, on a pole, or hanging), and even the language (foreign) on signs. Check the regulations before you spend money on signs. Reputable sign manufacturers know the rules and they get permits as required.

Sometimes you can get an exemption from zoning requirements. If you can present a compelling case for the need and benefits your business provides to that district, you may be able to convince the zoning board to give you a conditional use permit.

Home businesses also have to be careful not to violate local zoning laws. Because home businesses have boomed in popularity, many cities have adopted zoning laws to govern them. Some cities are tolerant of home-based businesses for authors, artists, attorneys, accountants, real estate brokers, insurance brokers, piano teachers. Contact your city's planning or zoning department for specific rules. There may be rules against posting signs and limiting customer traffic. You may need a permit, depending on the city.

To determine whether a business location complies with zoning regulations, contact the city zoning office. San Jose and Santa Clara zoning offices are below:

San Jose
Department of Planning, Building, and Code Enforcement
200 E. Santa Clara Street
San Jose, CA 95113
(408) 535-7800 www.sanjoseca.gov/planning

Santa Clara
Planning & Inspection
Kevin L. Riley, Director of Planning & Inspection
Economic Development Team
(408) 615-2450 http://santaclaraca.gov/index.aspx?page=247

3. **Consider Federal, State, County, and City Incentives**

There are numerous government incentives to consider upon setting up your operations. See http://www.businesownerspace.com/content/business-incentives.

Here are some of the incentives:

- Federal grants, tax credits and tax incentives
- Foreign Trade Zone incentives in Santa Clara, Monterey, San Benito and Santa Cruz Counties
- Water Efficient Technology rebates of up to $50,000
- San Jose Storefronts Initiative: a grant to help small businesses lease vacant spaces by offsetting the cost of City permits, fees and taxes.
- California Competes tax credit to encourage businesses to come to or stay in California.
- Other California tax exemptions, credits and incentives.

4. **Negotiate a Lease**

Commercial leases can be complex and tricky to negotiate. Market conditions can swing widely, resulting in anxious landlords or tenants with huge differences in terms among leases even in the same building. Significant improvements or modifications are often required. Terms are almost always negotiable, and you need to pay attention to the details. Remember that lease costs may be one of your largest expenses. The choice of your location and the negotiation of your lease could impact the success of your company. Make sure you get competent help and that you understand the bias of any brokers or advisors. ASL can introduce you to competent agents who can help you find space and negotiate a lease. Here are some lease conditions to carefully evaluate:

- Lease term and rent increases and method of calculation
- Triple net lease (net lease) or full service lease (gross lease)
- Security deposit and conditions for the return
- Responsible parties for compliance with codes, security, and safety
- Renewal options
- Early termination penalties
- What is included in square footage rented, common space, etc.
- Sign restrictions
- Planned tenant improvements
- Maintenance and janitorial responsibilities
- Whether subleasing, or assigning the lease is allowed
- Whether arbitration is required in a dispute
- Who pays for Americans With Disabilities Act (ADA) requirements

5. Negotiate Contracts

Now that you are setting up operations, you will be entering into legal agreements. Such contracts are legally enforceable so you can be sued if you don't keep up your end of the bargain. Be sure to use the services of a competent attorney as necessary. Here are some elementary considerations for entrepreneurs to be aware of:

- Don't sign anything you don't understand. Unsigned contracts can be revised.
- Put all contracts in writing.
- Use standard contracts if possible. *Nolo* offers many different standard contracts. Standard contracts can be modified to fit your situation.

6. Obtain Insurance

Two forms of insurance are mandatory for businesses with more than one employee: worker's compensation (below) and unemployment insurance (see Chapter 5, section 6). Other insurance policies below are not required by law, but may be essential to your business. Decide what coverage is reasonable for your comfort level. Occasionally, the cost of a particular insurance policy may mean that *no* insurance in that area is the better value.

Always shop for the best insurance value by comparing price, quality and cost estimates (including deductibles). Consider investigating the financial stability of the insurer. Major U.S. insurance companies are rated each year; as a general rule, businesses should avoid placing their coverage with companies with less than an "A" rating.

Spreading your insurance coverage over a number of insurance agents or carriers may lessen your leverage in obtaining better rates or service. It can also result in redundant coverage, or coverage with liability gaps. Periodically review your company's insurance coverage as your business needs change. ASL can introduce you to insurance brokers that can help you shop for insurance and minimize your costs.

- Workers' compensation in California is compulsory. Insurance is required of all employers. If an employer is enjoined from doing business, there is a penalty of $1,000 per employee, with $10,000 for compensable cases. Intentional failure to insure is a felony. Failure to obey a stop order injunction is a misdemeanor, subject to a fine of up to $10,000, imprisonment for up to sixty days, or both. The injured worker may receive workers' compensation and also may sue the employer in civil court.

  More information about workers' compensation in California can be obtained at:
  Department of Industrial Relations
  Division of Workers' Compensation
  455 Golden Gate, 9th Floor
  San Francisco, CA 94102
  (415) 703-4600
  Fax: (415) 703-4716
  www.dir.ca.gov

6. **Obtain Insurance (continued)**

- Property Coverage: Commercial property insurance may cover buildings, computers, equipment, furniture and inventory against loss caused by fire and other perils.

- Commercial General Liability: Coverage insures a business against accidents and injury on its premises, as well as exposures related to its products. No matter how diligently you remove all possible hazards from your business, you could be sued successfully for accidents resulting from simply the carelessness of a customer. General liability insurance is your last line of defense against devastating claims for things over which you may have little or no control.

- Commercial Business Automobile Liability: Commercial general liability insurance generally does not cover liability arising out of the ownership, maintenance or use of automobiles. Two coverages to consider are non-owned automobile liability and hired auto liability to provide defense against lawsuits stemming from employees using their own personal automobiles on company business (non-owned automobile liability) and employees renting vehicles in the corporation's name (hired automobile liability).

- Umbrella / Excess Liability: Such policies provide insurance in addition to the limits provided by the insured's commercial general liability, automobile liability, workers compensation / employer's liability and perhaps other liability coverages. For example, a corporation with limits of $1 million in general liability might have an additional $2 million in umbrella / excess coverage limits.

- Professional Liability / Errors & Omissions Liability (E&O): E&O policies protect against liability for committing an error or omission in the performance of your professional duties and/or the performance of your product. E&O policies are designed to cover financial losses (non-tangible losses) rather than liability for bodily injury or property damage (tangible losses).

- Foreign Package Coverages: Consider coverage for foreign workers to cover benefits required by laws in the applicable jurisdiction, or repatriation expense should an insured need to be airlifted back to the U.S. for immediate medical care.

- Directors & Officers Liability: Directors and officers are fiduciaries entrusted with the management of corporations. As such, they must exercise due care in managing corporate affairs. Should their negligence result in loss for the corporation, its shareholders or others, they can be held personally liable. A directors and officers liability policy can be obtained as protection in the event of suits brought against the directors and officers.

6. Obtain Insurance (continued)

- Employment Practices Liability Insurance: EPL coverage protects employees, partners, directors & officers against a broad spectrum of employment related claims including wrongful termination, sexual harassment and discrimination. New programs also offer professional risk management & legal services which help control the exposure.

- Fiduciary Liability: A fiduciary is any person who exercises discretionary control or authority over the management or disposition of funds in the administration of a pension or welfare plan. The Pension Reform Act of 1974 or ERISA imposed standards and permits the indemnification of trustees and fiduciaries ONLY by insurance plans. Thus, corporations cannot indemnify these individuals.

- Internet / Cyber Liability: Internet technologies and e-Business opportunities present many new and complex risks. There is vulnerability to network disruptions, security breaches, introduction of computer viruses, electronic espionage, and personal data theft. Additional risks include infringement of copyright, trade mark, trade secrets, privacy violations, libel and slander, errors or omissions that can cause financial damage to third parties and software code infringement. Start-ups with a Website or e-Business will need to address these exposures.

- Patent Infringement: More appropriately referred to as "Intellectual Property Injury," this coverage will respond to claims alleging infringement of patent; copyright or trademark; misdesignation of origin; or misappropriation of trade secrets or proprietary information. Pricing, terms and conditions are dependent upon, but not limited to, type of company, revenues, litigation history, internal controls and financial condition. Sometimes a patent search will be required before coverage will be afforded. The application process can be onerous.

- Patent Enforcement: A relatively new insurance product designed to pay outside legal expenses to pursue patent infringers for legal actions within the United States. Can include the costs of expert witnesses and other outside costs. Lengthy and expensive application process.

- Loss of Project Research & Development: Technology companies face a unique exposure to loss of research and development efforts. Such a loss could delay your product's entry into the marketplace and potentially threaten its viability. Loss of Project coverage can reimburse a firm for additional expenses required to reconstruct lost R&D.

- Earthquake and/or Flood: There are a variety of options for earthquake and/or flood coverage. Generally these coverages have a high deductible to make it more affordable while still insuring for a major catastrophe.

Chapter Five

Running Your Business

1. Open a Bank Account and Get a Business Credit Card

It is important to separate your business transactions from personal or other businesses. Separation facilitates the accounting and helps show the government that you really do have a business and not just a hobby you are trying to write-off for tax purposes.

The easiest way to create separation is to open a separate bank account. You might as well do this up front because you need to track expenses from the beginning. If you use credit cards, then get a separate card for your business. You can have the card in your individual name, since start-ups may not be eligible for a credit card. You can indicate the business name on the first line of the address of your card. Do not use your business bank account and business credit card for personal purposes. It causes accounting problems and is a huge red-flag to the IRS if they see personal transactions running through your accounts.

2. Set Up an Accounting System

Your accounting system can be maintained within your business, in the cloud, or you can hire an accountant or accounting service to keep necessary business records for you. The nature of your business, the volume of transactions, and your comfort level with the process will influence the type of system you adopt.

- <u>Entry-level systems</u>: If you have various types of assets and liabilities in the business, such as receivables, payables, fixed assets, inventory, etc. you will need a general ledger system. There are several entry-level accounting systems to consider, such as *QuickBooks* and *Peachtree.* You might want to consider *QuickBooks Online*, which would give you the option to access your records from anywhere. Cloud computing is gaining popularity. *Quicken* is acceptable if you have a straightforward business with only revenues and expenses. Be aware that *Quicken* is not a double-entry, general ledger system. Since it is not a general ledger system, it is very easy for errors to occur. If you prefer *Quicken,* be sure someone prepares a monthly or annual "proof of cash." The proof of cash reconciles your beginning checkbook balance plus revenues, less expenses to your ending checkbook balance.

2. Set Up an Accounting System (continued)

- Mid-level systems: If you expect your business to grow rapidly, consider installing a higher-end accounting system at the beginning to avoid having to do a conversion later. Some of the recommended software packages for medium-sized businesses are *Peachtree Quantum, QuickBooks Enterprise, MAS 90* or *MAS 200,* and *Microsoft Dynamics.* We would also recommend that you consider *Intacct* for cloud computing (Software as a Service).

3. Make Tax Elections

There are several elections to be made or qualifications to consider as a new business. Here are some of them:

- S Corporation Election: The election of S corporation status is one of the most critical elections available to corporations and their shareholders. The timing of the election is critical.

- Elect to be taxed on a cash basis or accrual basis: This decision depends on whether you expect the business to be profitable and the nature of operations. You can be cash basis for tax and accrual basis for financial statements (if more profitable financial statements will attract lenders or investors). Generally accepted accounting principles (GAAP) requires accrual basis unless you disclose the exception.

- Section 1244 Stock: Although not an election, every new corporate business should consider qualifying the stock under Section 1244, which allows eligible stockholders to treat a stock loss up to $100,000 as an ordinary loss rather than as a capital loss for tax purposes. The qualifications must be met up front.

- Section 1202 Stock: Although not an election, Section 1202 allows stockholders to exclude from gross income 50% to 100% of gain from the sale or exchange of qualified small business stock acquired and held for more than 5 years. Consider issuing stock that meets the criteria.

4. Implement Governing Principles and Internal Controls

We have observed hundreds of start-ups over the years and have noted that the key to a start-up's business success is excelling at five governing principles. These principles, described in more detail in **Exhibit D,** are:

- Retain Competent Individuals
- Set the Tone-at-the-Top
- Capture Relevant Information
- Do a Risk Assessment
- Implement Controls

4. Implement Governing Principles and Internal Controls (continued)

With regard to the fifth principle above, **implement controls**, every business needs basic internal controls. Do not make the mistake of failing to control your funds from embezzlement or theft. What could be more deflating for a young business? As the owner, at a minimum you should do the following:

- Control all expenditures: Approve and sign all checks. Avoid delegating this responsibility. Never sign blank checks. You need to control the bank account until the business is large enough to implement more extensive controls. Make sure you are the only one who can approve wire transfers. Review the payroll before releasing it.

- Open and review the monthly bank statements: Scan the statement for unusual items. Make sure receipts and expenditures are what you expected.

- Control revenues: The nature of your business will determine how you do this. The point is, you need to establish accountability as soon as revenue is earned and cash comes in the door. Make sure every sale is numbered and recorded. If you don't do that, you may not even be able to determine how much you have lost.

- Other internal controls: If the owner handles all of the company's financial transactions, preventing embezzlement is simple. But as the start-up grows, additional controls need to be implemented. Consider such controls as employee fidelity bonds, controlled-access storerooms, budgeting, increased supervision and review and testing for accuracy. Good internal controls do not have to be complex. In fact, the more straightforward the controls, the more likely they will remain effective.

Controlling and safeguarding investor's funds must be a priority. Always remember that even trustworthy individuals can be tempted to take advantage of ineffective internal controls by stealing, embezzling, or committing fraud. Avoid trouble by setting up good internal controls now and sticking to them. ASL can help you establish a good system of internal controls.

5. Understand Personnel Issues

Many businesses begin with only one person, but eventually, most grow large enough to warrant hiring one or more employees. Meeting payroll requirements is only a small portion of the legal requirements that go with hiring that first additional employee. Once you hire employees, you open yourself up to a whole host of regulations. Make sure you have access to a human resource specialist. Talk to ASL and we can give you some recommendations. Here are some issues to consider:

- Compulsory Employee Records: As long as they are in business, employers are required to keep two forms on file for every employee: a W-4 and an I-9.

5. Understand Personnel Issues (continued)

Employee's Withholding Allowance Certificate (W-4) Forms can be obtained from your accountant or payroll consultant, or from the IRS website www.irs.gov.

- Employment Eligibility Verification (I-9) Forms can be obtained from the Superintendent of Documents, U.S. Government, Washington, DC, available at www.uscis.gov.

- Hiring Practices: It is against the law to discriminate against any applicant or employee based on his or her race, color, religion, national origin, sex, age or disability. Employment applications should avoid any direct questions about such factors and should also avoid questions about marital status or union affiliation. This includes questions that indirectly solicit such information, such as the candidate's place of birth or ancestry. Because interviews are basically extensions of the application process, they are also subject to anti-discrimination laws.

  Be sure to do background checks and reference checks. Conduct reference checks over the phone because former employers are often reluctant to provide negative information in writing.

- Personnel Policies: If your business has more than one employee, you should consider formulating personnel policies, aka a personnel manual. The lack of written policies about job evaluations and promotions, for example, could expose your company to legal action. Policies to be considered include job descriptions, compensation, fringe benefits, working hours, overtime, vacation policy, sick leave, maternity leave, leaves of absence, paid time off, evaluations, and promotions. Consider that employees in California are entitled to paid sick leave. Your human resource specialist can help you with drafting a personnel manual.

- Alternatives to Employees: A start-up business may not have the volume of business to justify the expense of a full-time work force. You might consider contract labor, employee leasing, outsourced services, and part-time employees. The use of contract labor can reduce the cost of fringe benefits and payroll taxes. However, if the contractors are de facto employees, you may be exposed to a significant risk. If the IRS or FTB characterizes those workers as employees, the business and sometimes even the owner may be liable for unremitted payroll taxes and penalties of up to 100% of the taxes. The liability can even extend to unremitted federal and state income tax withholdings. The rules are complicated. Be sure to contact ASL for guidance in this area.

- Safety Standards: For more information about occupational safety in California:
  Occupational Safety & Health
  Department. of Industrial Relations
  455 Golden Gate Avenue, 10th Floor
  San Francisco, CA 94102
  (510) 286-7000, Fax: (510) 286-7037
  www.dir.ca.gov

5. **Understand Personnel Issues (continued)**

- Workplace Postings: California requires employers to post certain information. Check the rules for companies in your industry at: www.dir.ca.gov/wpnodb.html

- Employer Law Resources: The California Chamber of Commerce provides some employer law resources with membership: www.calchamber.com

6. **Set Up a Payroll System**

Because payroll tax rules are cumbersome, and the penalties for late payments and misfilings are very punitive, we recommend that you use *Paychex, ADP* or another payroll service. The costs associated with such services are usually far outweighed by the personnel and management time required to operate the payroll system in-house.

The annual federal government has strict requirements and schedules regulating payroll tax deposits and income reporting. Failure to file the proper forms with the Internal Revenue Service or to make appropriate monetary deposits may result in stiff penalties or fines. The laws affecting payroll and bookkeeping requirements frequently change. The federal communication, *Employer's Tax Guide (Circular E Publication* 15), notifies businesses of regulation changes.

For requirements in California, you should obtain the California Employer's Guide (DE-44) published by the Employment Development Department. A recent 2015 copy can be found here: www.edd.ca.gov/pdf_pub_ctr/de44.pdf.

A summary of the payroll tax reporting forms is shown in **Exhibit E**. Because payroll may be your largest business expense, you should have a general understanding of the rules. Here are some important things to know even if you use a payroll service.

- Federal Payroll Tax Deposit Rules: The federal tax deposits consist of the federal withholding, Social Security withholding, employer match, and Medicare withholding. Failure to comply with government tax deposit rules will result in stiff penalties. Deposits are required as follows:

    - Monthly Depositor**:** Under $50,000. Due the 15th of the following month.

    - Semi-weekly Depositor: Over $50,000. Due the following Wednesday if paid Wednesday, Thursday, or Friday. Due the following Friday, if paid Saturday, Sunday, Monday, or Tuesday.

    - One-Day Rule**:** Accumulated employment taxes of $100,000 or more are due the next banking day, regardless of the employer's deposit status.

    - Penalties**:** Penalties of 2% to 15% may apply if you do not make required deposits on time. You can be held responsible for failure to timely deposit payroll taxes even if you use a payroll service.

6. Set Up a Payroll System (continued)

- California Payroll Tax Rules:

  - Unemployment Insurance (UI) is paid by employers. UI provides temporary payments to individuals who are unemployed through no fault of their own.

  - Employment Training Tax (ETT) is paid by employers. ETT provides training funds to empower workers, promote business, and boost California's economy.

  - State Disability Insurance (SDI) is deducted (withheld) from employees' wages. SDI provides temporary payments to workers who are unable to perform their usual work because of a pregnancy or a non-occupational illness or injury (work-related disabilities are covered by workers' compensation). SDI also includes Paid Family Leave (PFL), which provides benefits to workers who need to care for a seriously ill family member or to bond with a new child.

  - California Personal Income Tax (PIT) is withheld from employees' wages and credited toward the amount due for the employees' annual California state income tax.

For specific information, call EDD's toll-free number at 888-745-3886 or visit your nearest Employment Tax Office.

- Information Returns (1099s): In addition to payroll taxes, businesses are also required to report other types of income and payments to the IRS. **Information returns** (commonly called 1099s) must be filed if you make certain types of payments to all non-corporate entities in the course of your trade or business. The most common payments for which you will have to file are: Interest of $10 or more; Dividends of $10 or more; Rent of $600 or more; Royalties of $10 or more; Non-employee services of $600 or more; Subcontractor payments of $600 or more, whether or not services are provided in combination with material and equipment.

  The above list is **not** all-inclusive, so consult with your accountant if you are unsure if a payment must be reported. Also be certain that you understand the reporting due dates. Penalties can also be assessed for failure to furnish a tax identification number for each payee. Withholding of income tax is mandatory at a 28% rate on amounts paid to persons who do not furnish their tax identifying number to you.

  Maintain records throughout the year to enable you to prepare the information returns. Doing a little bit of work each month is far easier than doing it all at the end of the year.

6. Set Up a Payroll System (continued)

- Federal Unemployment: The Federal Unemployment Tax Act (FUTA), with state unemployment systems, provides for payments of unemployment compensation to workers who have lost their jobs. Most employers pay both a Federal and a state unemployment tax.

  To determine your quarterly liability for FUTA: *Add the first $7,000 of each employee's annual wages you paid during the quarter, multiply that amount by .006.* If the tax reported on the Federal Unemployment Tax Return (Form 940) less deposits for the year is more than $100, you must deposit all of the tax by January 31. If it is less than $100, you may pay the taxes with Form 940.

- California Unemployment: Most states, similar to the federal government, also have an unemployment tax. The Employer Tax Rate for California Unemployment varies by company. Refer to the Notice of Contribution Rates (Form DE2088) you receive from the California Employment Development Department.

  Your Unemployment Insurance (UI), Employment Training Tax (ETT), and State Disability Insurance (SDI) tax rates are combined on a single rate notice (DE-2088). The DE 2088 will be mailed to you in December. Employers will have 60 days from the December 31 mailing date to protest any item on the DE 2088 except SDI and ETT, which are specifically set by law.

  For information on California's unemployment laws, contact the Employment Development Department at the following address:

  Employment Development Department
  800 Capitol Mall, MIC 83
  Sacramento, CA 95814
  (888) 745-3886
  www.edd.ca.gov

- Fringe Benefits: Fringe benefits which qualify for exclusion from gross income are exempt from income tax and Social Security tax withholding (FICA and payment of Federal Unemployment Tax). All other benefits are subject to these taxes. A common non-qualifying benefit which is subject to tax is the automobile allowance. However, actual business auto expenses (not an allowance) are not taxable. Other fringe benefits excluded from these taxes are no additional cost services, qualified employee discounts, working condition fringe benefits, and de minimis fringe benefits.

7. Maintain Proper Records

Good record keeping is everything! Save valuable time and energy in the future by setting up a basic filing system now before your business gets too far down the road. Devise a filing system and policies for both electronic and paper files. If you do nothing else, get a fireproof, lockable, filing cabinet and label files to organize your documents. Some records can be maintained electronically. Be prepared to provide information as required to the IRS or California regulatory agencies. Many employers fail to realize the importance of record retention.

8. Pay Your Taxes

- Income Taxes: Everybody knows how complicated income taxes can be. The rules are not always logical, because they are often motivated by politics, lobbying, government incentives, or crisis economics. So don't try to understand the logic. We have two strong recommendations in this area: (1) Get competent tax advice, and (2) Pay your taxes.

  Although many new businesses often overlook it, regular tax planning often results in significant tax savings. Because most management decisions have tax consequences, planning for your business' income tax return should begin well before the yearly tax due date. You should know how your day-to-day operations affect your taxable income. Be aware that business decisions such as investments in property, equipment, and inventory; acquisitions and mergers; ownership changes; equity or stock contributions or stock compensation; and business relocation can have significant tax consequences.

  Generally, every business must pay taxes on its income in quarterly installments. The quarterly installments are estimates and you will either owe or be entitled to a refund when you file the tax return after the end of the year.

  If the business does not have taxable income, then no quarterly installments are required.

  You don't need to start making estimated tax payments until you become profitable. Even then, estimated taxes are not required until businesses expect to owe at least $1,000 in federal taxes for any particular year. Generally, this means that you would have profits of $3,000 to $7,000. Be aware that California requires an $800 minimum payment.

8. Pay Your Taxes (continued)

- Property Taxes: Santa Clara County imposes a property tax on business property, such as real estate, improvements, equipment, furniture, and a separate tax on vehicles. You must file a Business Property Statement (Form 571L) by April 1 of each year if:

  A. The Assessor's office has sent you a property statement, OR

  B. You have taxable personal property with a total cost of $100,000 or more located within Santa Clara County as of January 1 of each year even if no property statement is sent to you. To obtain the property statement contact:

  Assessor Business Division – General Information
  70 West Hedding Street, East Wing, 5th Floor
  San Jose, CA 95110
  email: busdiv@asr.sccgov.org

  Phone: 408.299.5400 Fax: 408.298.9441

- Sales Taxes: Retail sales are subject to state, county and local district sales taxes. It is paid all at once, so it is referred to as a state sales tax. It's up to California to distribute the collected taxes to the counties and districts in the state. The sales tax rules are complicated. See Chapter Three, Section 5 for sales tax registration information. Be sure to check with your accountant to avoid problems in this area.

9. Obtain Additional Loans

Once your business is off the ground, you may find the need for additional financing. A growing business may need a loan to expand, for example. As with start-up financing, to obtain a loan from a bank, you need to present the commercial lending officer with evidence of your ability to repay the loan. Before you begin the loan application process, you should be able to clearly state your reasons for wanting a loan, how much you need (and for how long), and identify how the loan will help your business.

A **financial statement** is a loan officer's primary tool in assessing your financial strength. A financial statement summarizes financial information about your business' assets, liabilities, and cash flows. Some bankers will also ask for your business plans and objectives, a marketing plan, financial forecasts, and data on your business's ownership and history.

Your CPA can assist you in planning for your loan, and in preparing the loan request paperwork. Additionally, your CPA should be willing to accompany you to the bank for meetings with the loan officer, and to aide in the negotiations of terms of the loan agreement.

9. Obtain Additional Loans (continued)

Always be honest about your financial situation. If some of the information the bank requests of your business is unfavorable, include documentation of management's plans to overcome the problem. Your CPA can help you to compile the data, prepare a business plan, and present information to selected lenders.

You only get one chance to make a great first impression, so it's wise to have an independent third party, such as a CPA, evaluate your financial statements and other financial documents for presentation to the bank.

The 5 **C**'s of Lending a banker, or lender, will consider are:

1. **C**haracter
2. **C**apital
3. **C**ondition (of the company, industry and economy)
4. **C**apacity
5. **C**ollateral

A typical Credit Package usually consists of the following items:

- Two full years financial statements (both Balance Sheet and Income Statement); and current year-to-date financial statements.
- Three years of company tax returns, or CPA-prepared financial statements.
- Three years of personal tax returns.
- Accounts receivable aging report.
- Accounts payable aging report.
- Entity/Organization documents, i.e. Articles of Incorporation, Organization Agreement, etc.

10. Raise Additional Venture Funding

If you need additional funds to grow the business there are many sources. Consider private equity, or venture capital. See **Exhibit B** for possible funding sources. One of the best ways to get in front of these investors is to be introduced by a CPA, lawyer, banker, angel investor, or social network contact. 90% of VC's deal flow comes from trusted providers who filter deals. Have them send an email introduction. If you have a website, it should be interesting and compelling. Your pitch should answer these four questions. Then follow the outlined steps:

1. What big hairy problem am I solving?
2. How big is the potential market?
3. What is the barrier to entry?
4. Do we have the right team?

10. **Raise Additional Venture Funding (continued)**

- Prepare a packet to include:

  A. Cover letter (include your pitch — 4 questions from above).
  B. One page Executive summary (see Chapter Two, Section 1).
  C. Realistic assumptions and forecasts. (See Chapter Two, Section 7, E).
  D. Customer references (be prepared for them to be called).
  E. Executive biographies (2-3 per page).

- Make a successful pitch:

  A. Dress appropriately (for your business and your audience).
  B. Prepare for the unexpected.
  C. Be concise & clear.
  D. Prepare to back up every claim.
  E. Confidence sells.
  F. Passion is a key ingredient.
  G. Practice, practice, practice.
  H. Actively listen.
  I. Take constructive criticism.
  J. Don't be discouraged.
  K. Attend VC taskforce pitches to observe (and critique them).

- Negotiate an agreement:

  A. Get appropriate legal and financial help.
  B. Listen to counsel from trusted advisors.
  C. Raise more money than you think you need.
  D. Try to orchestrate a bidding war.
  E. Consider the downsides carefully.
  F. Negotiate from strength.

- Be aware of the typical VC timeline:

  A. Looking for a 10X return on investment in five to eight years.
  B. Always looking for an Exit. Most funded companies get acquired, but they would really like an IPO.
  C. Looking for a company to get to (an average) $50 Million in revenue in five years.

10. Raise Additional Venture Funding (continued)

- Watch for potential pitfalls:

A. Investors are in it for the money; it's about business, not about you.
B. Investors will replace a CEO on a whim, (if the VC agreement allows this — watch for it).
C. Investors are expecting an exit event — ASAP.
D. Investors can be brutal micro managers.
E. Don't expect investors to help the business; although some will
F. Civility matters — Don't do business with rude or bad-mannered individuals.
G. Don't make a decision based on short term cash needs.

11. Monitor Your Financial Forecast

Monitor the actual revenues and expenses generated by your business compared to your financial projections that you created in your business plan. React quickly to correct negative variances in your company's revenue to keep your business on track. Your plan will probably need to be revised and updated periodically during your initial years of operations to adjust for unexpected costs or unexpected gains.

12. Create a Marketing Plan

A **marketing plan** is also an important part of new business start-up. This goes beyond the market analysis you may have done as part of your business plan. Marketing does not have to be "big and expensive" in order to be successful. In fact, a successful marketing plan will be small and flexible enough to be used as a management tool and as a reminder document.

Use your business plan to structure your initial marketing plan. In your marketing plan, state what specific steps you will take to fulfill the objectives in your business plan. Determine how you will bring in new business. Will you use online advertising, telemarketing, television, radio commercials, or direct mail? How frequently?

12. Create a Marketing Plan (continued)

The most common types of marketing and sales methods are:

- Location: For some retail stores, location is the most important consideration in reaching your market. You might identify a need in a certain area.
- Internet and Social Media: These days, an internet presence is a virtual necessity, even for traditional businesses. Website search engine optimization is important. Don't ignore social media marketing, which should be an integral part of your marketing plan. To use this medium effectively, study your target customer demographics. There are several hundred social media sites, with the numbers increasing daily. These sites vary in their interests and services provided, as well as in their user base. Think about your target customer and their characteristics in detail, and look at how your competitors are implementing their social media marketing strategies. Start engaging in "listening" at the sites where you see most of the activity for your prospective customers. Social media takes many forms, including sites for networking and socializing (i.e., Facebook, LinkedIn), news (i.e., Twitter, Digg), bookmarking (i.e., Delicious), videos (i.e., YouTube), and blogs (i.e., Technorati), to name a few. Yelp is helpful for service providers. You don't need to begin by developing and implementing a comprehensive and intense plan. You can start small and identify one or two key areas where you want to start establishing a presence, and evolve your strategy from there. A lot of information is available on the web that includes the statistics for the various sites, such as web traffic and user demographics, to help you decide which social marketing venue is the best for you. There are also numerous marketing consulting firms that can research the market for you, and present a complete plan that includes traditional marketing elements as well as social media. Most importantly, recognize the value of social media and commit to including it in your marketing and sales strategy.

- Direct mail: Brochures, catalogs, and sales letters may be effective in some circumstances. Response rates to direct mail are often less than 1%.
- Relationship marketing: For some businesses, like professional services, this is a proven technique for finding clients. To be effective, go where potential customers are, and consistently have lunch or meet with networking contacts.
- Sales force: A sales force is most effective for higher-priced items, not items below $1,000; unless an inside sales force is employed such as in a retail store.
- Yellow pages advertising: Some companies still find success in printed yellow pages, although it is hard to know which of the many yellow page alternatives is best.
- Telemarketing: This works best if someone already has expressed an interest, for example, by responding to a direct mail ad. Cold-call telemarketing can alienate customers.

12. Create a Marketing Plan (continued)

- Space advertising: You can advertise in periodicals or on the internet. This works best in conjunction with other methods. It is useful in branding and creating awareness. Targeting customers in a trade journal can be quite effective.

- Other advertising: Consider radio, television, YouTube, signage, etc.

13. Consider Other Resources

Here are some other resources that may be helpful:

- Score: Free mentoring as well as workshops and seminars.

  www.svscore.org

  http://www.svscore.org/ws_2.shtml

- National Small Business Association

  www.nsba.biz

- U.S. Small Business Administration

  www.sba.gov

- SVForum

  http://www.svforum.org

Conclusion:

We hope you found this Guide useful. We welcome your comments or suggestions about our New Business Start-Up Guide. If you discover a phone number or address to be in error, or if we have overlooked useful information, please let us know for future editions.

If you have questions about any of the topics discussed in this guide, please do not hesitate to contact us: Mark Sheffield: msheffield@aslcpa.com (408) 377-8700.

Exhibit A

Top Five Challenges Facing Start-Ups Today

1. **Pivoting:** Entrepreneurs of the past wrote a long business plan, developed a product over one or two years, and hoped they could sell it. Today, because change is so rapid, flexi-planning is the best practice. This is called pivoting, which is evaluating and changing strategies and tactics every three months as necessary. Iterative and incremental development is a best practice to ensure continuous improvement especially in technology and software companies. The cousin to pivoting is promptly executing. Today's speed of business and explosion of entrepreneurs means you can count on somebody else having already thought of your idea. To succeed today, it's about pivoting, execution, speed, and iterative development.

2. **Understanding Funding Options:** There are more funding options today than ever before. Should you take VC or angel money now or later? Do you understand how dilution works with each round of financing? Is sharing ownership with employees advisable? Don't make peer-pressured decisions you might regret later.

3. **Having a Unified Vision:** Are you creating a life-style company or a company to sell? Is the team in agreement? Can everyone on the team articulate the vision? A positive attitude and a unified team without contention in the ranks is critical for success. Create a culture of civility, with everyone on the team focusing on what's best for the company.

4. **Forming the Right Team**: We recommend three officers to fill the roles of CEO (to create a vision and lead the team), CTO (to develop your product or service), and COO (to manage people, operations, and customers). Advisors or contractors can temporarily fill two other essential functions: CFO (to raise money and manage finances), and CSA or "Chief Start-up Advisor" (to identify needs and connect you to resources to help your start-up succeed).

5. **Coping with Administration:** It is easy to overlook accounting, personnel management, planning, and the morass of rules and regulations for tax reporting, human resources and legal issues. Find someone to pay attention to this stuff to free up the time of the officers to focus on priority matters at hand, and save pain in the future.

Exhibit B

Sources of Funding

Personal Resources

- Savings
- Retirement funds -IRA and 401(K)
- Insurance policy loans
- Home mortgage
- Home equity line of credit
- Credit cards
- Personal line of credit from bank
- Sale of assets and investments
- Loans secured by personal assets
- Stock margin loans
- Sublease living space
- Tax credits, deductions, and incentives
- Whistleblower awards (2010 Dodd-Frank Act)
- Patent or other infringement litigation
- Consulting fees for services
- Royalties or fees for technology

Friends & Family

- Relatives
- Business colleagues
- Social media contacts
- Friends past and present
- Neighbors
- Associations' members

Government Grants & Incentives

- Small Business Innovation Research (www.sbir.gov)
- Small Business Administration (www.sba.gov)
- Federal government grants (www.usa.gov):
    - Dept. of Energy
    - Dept. of Defense
    - Army
    - Navy
    - Air Force
    - Defense Advanced Research Projects Agency
    - Missile Defense Agency
    - Office of the Secretary of Defense
- City or County new-business incubators
- City, County, or State new business incentives
- City and County tax incentives
- State incentives (Chapter four)

Specialty Financing

- Crowd funding (eg. www.kickstarter.com)
- Peer-to-peer (www.fansnextdoor.com)
- Factoring (selling receivables)
- Royalty based (www.royalty-capital.us)
- SaaS (www.saas-capital.com)
- Convertible debt
- Customer financing

Angel Funding

- Angel investors
- Super angel investors
- Strategic investors
- High net-worth individuals

Venture Capital

- Venture capital firms
- Public pension funds
- Corporate pension funds
- Insurance companies
- High net-worth individuals
- Family offices
- Endowments
- Foundations
- Fund-of-funds (pooled investment vehicles)
- Sovereign wealth funds

Business & Corporate Funding

- Corporate venture capital
- Corporate funding or loans
- Private equity
- Business incubators
- Partnership
- Alliances
- Joint development

Banking & Finance

- Asset based lending
- Unsecured loans
- Equipment leases
- Small Business Administration(SBA) loans
- Loans guaranteed by other individuals
- Loans brokered and packaged by specialists

Exhibit C

Entity Perspective:

What type of entity works for you?

<table>
<tr><th>Attribute</th><th>C-Corporation</th><th>S-Corporation</th><th>Partnerships</th><th>LLC</th></tr>
<tr><td>Pass-through tax treatment (do entity and owners avoid "double taxation" on earnings?)</td><td></td><td>✓</td><td>✓</td><td>✓</td></tr>
<tr><td>May the entity have more than 100 owners?</td><td>✓</td><td></td><td>✓</td><td>✓</td></tr>
<tr><td>May the entity have owners other than individuals, estates and certain trusts?</td><td>✓</td><td></td><td>✓</td><td>✓</td></tr>
<tr><td>May the entity own subsidiaries?</td><td>✓</td><td>Only a Qualified Sub-Chapter S (QSUB)</td><td>✓</td><td>✓</td></tr>
<tr><td>California tax treatment</td><td>Subject to California Franchise tax. Minimum tax $800, tax rate 8.84%</td><td>Subject to 1.5% tax on net income or minimum yearly tax of $800 whichever is greater</td><td>Limited partnership must pay annual minimum tax of $800, general partnerships do not</td><td>Minimum tax $800, plus annual fee based on gross revenue
<u>Annual Revenue</u> <u>Fee</u>
$0 - $250K $0
$250K - $500K $900
$500K - $1M $2,500
$1M - $5M $6,000
$5M and over $11,790</td></tr>
<tr><td rowspan="2">Methods of available accounting</td><td rowspan="2">Accrual method, except if gross receipts are less than $5MM and except for personal service corporations</td><td>Cash method OK, unless it's a tax shelter</td><td>Cash method okay, unless it has a C-corporation partner and gross receipts of more than $5MM or it’s a tax shelter</td><td>Cash method okay, unless it's a tax shelter</td></tr>
<tr><td colspan="3">S corporations and individually-owned partnerships primarily engaged in service activities are allowed to use the cash method of accounting when average annual gross receipts are $10 million or less.</td></tr>
<tr><td>Tax year</td><td>May select any fiscal year if not a personal service corporation</td><td>Generally must use fiscal year of majority interest partners or make §444 election</td><td>Generally must use fiscal year of majority interest partners or make §444 election</td><td>Generally must use fiscal year of majority interest partners or make §444 election</td></tr>
<tr><td>Treatment of distributions to owner</td><td>Not deductible by corporation; generally ordinary income to shareholder; distribution of appreciated property results in gain recognition by corporation</td><td>Generally nontaxable to extent of basis in stock; distribution of appreciated property results in gain recognition</td><td>Nontaxable to extent of basis in partnership; disproportionate distribution of Sec. 751 assets may trigger gain</td><td>Nontaxable to extent of basis in partnership; disproportionate distribution of Sec. 751 assets may trigger gain</td></tr>
<tr><td>Salary to owner deductible</td><td>Yes, must be "reasonable"</td><td>Yes, must be "reasonable"</td><td>Yes, but as guaranteed payments which can be subject to S/E tax if general partner</td><td>Yes, but as guaranteed payments which can be subject to S/E tax if general partner</td></tr>
</table>

Exhibit C (continued)

Entity Effects on Individual Taxpayer

Attribute	C-Corporation	S-Corporation	Partnerships	LLC
Self-employment income to owners	No	No	General Partners - Yes; Limited Partners - No	Dependent upon nature of LLC
Qualified retirement plans for employee-owner	Payments are deductible if plan is nondiscriminatory	Payments are deductible if plan is nondiscriminatory	Payments to a Keogh Plan or SEP are deductible	Payments to a Keogh Plan or SEP are deductible
Life insurance for employee-owner	Premiums for first $50,000 group-term life are deductible and not taxable to employee	Premiums are not deductible. Reportable on partner K-1s.	Premiums are not deductible. Reportable on partner K-1s.	Premiums are not deductible. Reportable on partner K-1s.
Health care for employee-owner	Payments are deductible	Deductible by S-corporation as compensation: 100% deductible by more-than 2% shareholder	Typically deductible by partnership as guaranteed payment: 100% deductible by member	Typically deductible by LLC as guaranteed payment: 100% deductible by member
Limited liability for owner	Yes	Yes	General Partners-No; Limited Partners - Yes	Yes

Exhibit D
Five Governing Principles for a Start-up

1. **Retain Competent Individuals.** We recommend you start with a Board of Advisors, two or three of the smartest and most experienced serial entrepreneurs you can find. Then retain (1) **competent management** and (2) **competent Board of Directors' members**. **Management** institutes policies and practices to attract, develop, and retain competent individuals who support the start-up's values and objectives. Establish performance measures and incentives and enforce accountability. The **Board of Directors** defines authority and reporting lines. Careful counseling in a boardroom setting among wise board members usually results in farsighted business decisions. Be sure to leave some openings for investor-appointed board members. Effective governing is largely about finding and retaining competent individuals from the top on down.

2. **Set the Tone-at-the-Top.** The Board of Directors formalizes a written code of conduct (code of ethics) which establishes the start-up's integrity and values. The code is communicated regularly and adhered to by all employees and advisors. The code acts as a compass to keep the start-up aligned with its values. In addition the Board clarifies and solidifies the business purpose and vision in writing (see Chapter 1, Section 1 and Section 6).

3. **Capture Relevant Information.** Management ensures the discovery of important, relevant information about trends, competition, the industry, the market, and customers to support planning, strategizing, and assessment of opportunities and risk. Just as important is to communicate relevant information. Management instigates a system to communicate important, relevant information to the board, advisors, employees, and external parties as appropriate. The entire team needs to be on the same page.

4. **Do a Risk Assessment.** The board and management identifies risks which could hamper the start-up's success, such as cybersecurity risk, intellectual property infringement, regulatory risk from not complying with foreign and domestic laws, reputational risk from negative social media or ill-advised strategies, and fraud risk. It is a sad day when a fragile start-up gets broadsided by something they did not anticipate and plan for.

5. **Implement controls.** The board ensures that controls are implemented to mitigate risk. For example, external controls such as insurance could be acquired for various types of risk. Internal controls such as IT controls and financial controls help reduce risk. (See Chapter 5, Section 4). Management monitors the controls and activities with ongoing evaluations, reviews, and measurements to ascertain the effectiveness of external and internal controls.

Exhibit E-1
2015 Individual Tax Rates and Brackets

Federal

	Single:
Tax Rate	**Taxable Income**
10%	$0 to $9,225
15%	$9,226 to $37,450
25%	$37,451 to $90,750
28%	$90,751 to $189,300
33%	$189,301 to $411,500
35%	$411,501 to $413,200
39.6%	$413,201 or more

	Married Filing Jointly or Qualifying Widow(er):
Tax Rate	**Taxable Income**
10%	$0 to $18,450
15%	$18,451 to $74,900
25%	$74,901 to $151,200
28%	$151,201 to $230,450
33%	$230,451 to $411,500
35%	$411,501 to $464,850
39.6%	$464,851 or more

	Head of Household:
Tax Rate	**Taxable Income**
10%	$0 to $13,150
15%	$13,151 to $50,200
25%	$50,201 to $129,600
28%	$129,601 to $209,850
33%	$209,851 to $411,500
35%	$411,501 to $439,000
39.6%	$439,001 or more

	Additional Federal Taxes			
Tax Rate	**Tax Description**	**Single Head of Household**	**Married Filing Jointly**	**Married Filing Separately**
0.90%	Medicare tax on earnings	Over $200,000	Over $250,000	Over $125,000
3.80%	Net investment income surcharge on modified adjusted gross income	Over $200,000	Over $250,000	Over $125,000

California

	Single:
Tax Rate	**Taxable Income**
1%	$0 to $7,850
2%	$7,850 to $18,610
4%	$18,610 to $29,372
6%	$29,372 to $40,773
8%	$40,773 to $51,530
9.3%	$51,530 to $263,222
10.3%	$263,222 or $315,866
11.3%	$315,866 or $526,443
12.3%	$526,443 or more

	Married Filing Jointly or Qualifying Widow(er):
Tax Rate	**Taxable Income**
1%	$0 to $15,700
2%	$15,700 to $37,220
6%	$37,220 to $58,744
7%	$58,744 to $81,546
8%	$81,546 to $103,060
9.3%	$103,060 to $526,444
10.3%	$526,444 or $631,732
11.3%	$631,732 or $1,052,886
12.3%	$1,052,886 or more

	Head of Household:
Tax Rate	**Taxable Income**
1%	$0 to $15,700
2%	$15,710 to $37,221
6%	$37,221 to $47,982
7%	$47,982 to $59,383
8%	$59,383 to $70,142
9.3%	$70,142 to $357,981
10.3%	$357,981 or $429,578
11.3%	$429,578 or $715,962
12.3%	$715,962 or more

Exhibit E-1 (continued)
Business Tax Rates

C-Corporation Tax

Federal		California
15%	$0 - 50,000	8.84%
25%	$50,001 - 75,000	
34%	$75,001 - 100,000	
39%	$100,001 - 335,000	
34%	$335,001 - 10,000,000	
35%	$10,000,001 - 15,000,000	
38%	$15,000,001 - 18,333,333	
35%	$18,333,334 or more	

S-Corporation Tax

Federal	California
No Tax (Taxed to owner)	1.5%

Limited Liability Company Tax

Federal	California
No Tax (Taxed to owner)	$800

California LLC Fee	
Gross Receipts	**Fee**
$0 - 249,999	$0
$250,000-499,999	$900
$500,000 - 999,999	$2,500
$1,000,000 - 4,999,999	$6,000
$5,000,000 or more	$11,790

Exhibit E-2

Federal & California Payroll Tax Rates for 2015 & 2014

Federal

	2015	2014
FICA (Social Security)		
Tax rate on employee	6.20%	6.20%
Tax rate on employer	6.20%	6.20%
On wages not to exceed	$118,500	$117,000
Maximum deduction per employee	$7,347	$7,254
Maximum employer contribution per employee	$7,347	$7,254
Medicare tax rate on employee/employer	1.45%	1.45%
Additional Medicare Tax on employee's taxable wages in excess of $200,000 0.90%		
Maximum deduction per employee	No limit	No limit
Maximum employer contribution per employee	No limit	No limit
Self-Employment Tax		
Taxable wage base	$118,500	$117,000
Tax rate	12.40%	12.40%
Medicare tax on self-employment income:		
over $118,500/$117,000 to $200,000	2.9%	2.9%
over $200,000	3.8%	3.8%
Maximum tax	No limit	No limit
Federal Unemployment Tax (FUTA)		
Gross federal tax rate	6.0%	6.0%
Less credit for California SUI (if contributions are made timely)	(5.4%)	(5.4%)
Add CA credit reduction rate	1.2%	1.2%
Net federal tax rate	1.8%	1.8%
On wages not to exceed (per employee)	$7,000	$7,000
Maximum tax per employee	$126	$126

California

	2015	2014
State Disability Insurance (SDI)		
Tax rate on employee only	0.90%	1.0%
On wages not to exceed	$104,378	$101,636
Maximum employee contribution	$939.40	$1,016.36
State Unemployment Insurance (SUI)		
Tax rate on employer (Employers are notified by state of the rate applicable to them or call the EDD at (916)653-7795 for the current rate)	1.5% to 6.2%	1.5% to 6.2%
Employment Training Fund Tax	0.1%	0.1%
On wages not to exceed (per employee)	$7,000	$7,000

Income Tax Withholding

Other irregular compensation payments are subject to minimum income tax withholding at flat rates of 25% (or 39.6% if pay over $1 million) for federal and 6.6% (or 10.23% for bonuses and earnings from stock options) for California. Other types of payments reportable on Form 1099 are subject to a 28% back up withholding rate for federal purposes and 7% for California if the payee's Social Security Number is not known.

Withholding on regular wages should be taken from the 2015 tables in the Employer's Guide provided by taxing authorities.

Deposits of Taxes

Be sure to read carefully the IRS Notice 931 for federal payroll tax deposit requirements. There are heavy penalties for making late deposits.

Withholding on taxable fringe benefits, including automobiles, is required

Deposits of pension withholding

Separate deposits are required for non-payroll (Form 945) income tax withholding. Generally, the deposit rules are the same as for payroll withholding.

Deduction for Self-Employment Tax

One-half of the self-employment tax is deductible in computing taxable income and self-employment income.

Exhibit E-3

Payroll Tax Deposit Requirements Summary

RULES FOR FEDERAL TAX DEPOSITS

All employers are required to deposit all federal taxes through electronic funds transfer (EFT).

Quarterly Depositor - An employer who has an accumulated tax liability of **less than $2,500.00** for the entire quarter may **deposit or remit the amount with a timely filed Form 941. (This is the one exception to the mandatory EFT.)**

Monthly Depositor - An employer is a monthly depositor for 2015 if the amount of employment taxes reported on Form 941 for the period July 1, 2013 to June 30, 2014 was **$50,000 or less.** Deposits are due **on the 15th of the following month.**

Semi-Weekly Depositor - An employer is a semi-weekly depositor for 2015 if the amount of employment taxes reported on Form 941 for the period July 1, 2013 to June 30, 2014 **exceeded $50,000.** Payroll tax deposits for payroll checks dated on **Wednesday, Thursday, and/or Friday** are due **on** or **before the following Wednesday.** Deposits for payroll checks dated on **Saturday, Sunday, Monday, and/or Tuesday** are due **on** or **before the following Friday.**

One Day Depositor - Employers with an accumulated tax liability of **$100,000 or more** on any day **must deposit** within **one banking day of the payroll check date.** When a **monthly depositor** is subject to this rule, the employer **immediately** becomes **a semi-weekly depositor** for the rest of 2015 and all of 2016.

RULES FOR CALIFORNIA TAX DEPOSITS

Category of depositor	Deposit due
Quarterly:	
A. If your Personal Income Tax withheld during one or more months of a quarter is less than $350	**Remit payment quarterly**
B. If your Personal Income Tax withheld during one or more months of a quarter is more than $350	**15th of the following month**
Monthly:	
A. You are a federal Monthly depositor and your Personal Income Tax withheld is less than $350 during one or more months of a quarter	**Remit payment quarterly**
B. You are a federal Monthly depositor and your Personal Income Tax withheld is more than $350 during one or more months of a quarter	**15th of the following month**
Semi-weekly:	
A. You are a federal Semi-Weekly Depositor and your Personal Income Tax withheld is less than $350 within the pay period	**Remit payment quarterly**
B. You are a federal Semi-Weekly Depositor and your Personal Income Tax withheld is $350 to $500 within the pay period	**15th of the following month**
C. You are a Semi-Weekly depositor with a Wednesday, Thursday, and/or Friday check date and the Personal Income Tax withheld is more than $500	**Following Wednesday**
D. You are a Semi-Weekly depositor with a Saturday, Sunday, Monday, and/or Tuesday check date and the Personal Income Tax withheld is more than $500	**Following Friday**
One-day:	
A. You have a federal tax deposit in the amount of $100,000 or more and the Personal Income Tax withheld is $350 or less	**Remit payment quarterly**
B. You have a federal tax deposit in the amount of $100,000 or more and your Personal Income Tax withheld is $350 to $500 within the pay period	**15th of the following month**
C. You have a federal tax deposit in the amount of $100,000 or more and the Personal Income Tax withheld is more than $500	**Next banking day**

Exhibit E-4

Payroll Taxes Summary

Payroll Tax Forms and Reporting Deadlines

Federal Forms	Due Date	Description
Form 940 Employer's Annual Federal Unemployment (FUTA) Tax Return	1/31	To report wages subject to FUTA
Form 941 Employer's Quarterly Federal Tax Return	Qtrly - 1/31, 4/30, 7/31,10/31	To report wages subject to federal income tax, social security and Medicare
Form 944 Employer's Annual Federal Tax Return	1/31	To report wages subject to federal income tax, social security and Medicare **if tax liability for the year is less than $1,000 - employers must be notified by the IRS to qualify**
Form 945 Annual Return of Withheld Federal Income Tax	1/31	To report federal income taxes withheld from non-payroll payments (e.g. pension distributions, military retirement, backup withholding)
Form W-2 Wage and Tax Statement	1/31	To report employee wages and withholding to the SSA
Form W-3 Transmittal of Wage and Tax Statements	1/31	Transmittal form to report employee wages and withholding to the SSA
Form W-4 Employee's Withholding Allowance Certificate	If claiming exempt, must file new form each year by 2/15	To claim the appropriate withholding allowances for payroll income tax withholding
Form 1096 Annual Summary and Transmittal of U.S. Information Returns	2/28	Transmittal form for all 1099s
Form 1099 (MISC, INT, DIV, many others)	1/31 (to recipient)	Information returns to report payments to individuals and businesses (e.g. payments to independent contractors for services, interest, dividends, sales proceeds, cancellation of debt, and many more)
Form 8109-B Federal Tax Deposit Coupon	N/A	**Form obsolete - electronic payments are required for all taxpayers after 12/31/10**

State Forms	Due Date	Description
DE 9 Quarterly Contribution Return and Report of Wages	Qtrly - 1/31, 4/30, 7/31,10/31	To reconcile tax payments made with wages reported on DE 9C
DE 9C Quarterly Contribution Return and Report of Wages (Continuation)	Qtrly - 1/31, 4/30, 7/31, 10/31	To report wages subject to UI, ETT, SDI and PIT wages and withholding
DE 88 Payroll Tax Deposit	Varies	To report and pay UI, ETT, SDI and PIT withholding
DE 34 Report of New Employee(s)	Within 20 days of each new hire start date	To report all newly hired employees
DE 542 Report of Independent Contractor(s)	Within 20 days of making payments totaling $600 or more or entering into contract to do so	To report independent contractors to whom payments totaling $600 or more were made or with whom a contract for $600 or more was entered
DE 4 Employee's Withholding Allowance Certificate	As needed	To claim a different marital status or different number of allowances than claimed for federal withholding purposes

FUTA = Federal Unemployment Insurance Tax
SSA = Social Security Administration
UI = Unemployment Insurance
ETT = Employment Training Tax
SDI = State Disability Insurance
PIT = Personal Income Tax

Exhibit F

New Business Checklist

Instructions: This is a checklist to help management of new businesses identify issues for consideration. It is easy to overlook important matters when you are in the entrepreneurial trenches. Use this checklist to find issues that may not be adequately addressed.

Management and Organization

1. ☐ Have you defined the culture of your company? Do you have core values? What do you stand for? Do new employees, customers, lenders, and business partners know?

2. ☐ Have you succinctly defined your business from the customer's perspective? Do you have a mission statement that conveys this business purpose?

3. ☐ How do you capture ideas for productivity and profit? Is there a record of ideas? Do you follow up on the ideas? Are you interested in ideas from all employees? If so, how do they know that?

4. ☐ Is there a positive atmosphere in the company? How do you ensure that?

5. ☐ Are you thinking big enough? Have you considered how you can leverage your idea through franchising or other means?

6. ☐ Have you taken steps to protect your intellectual property and other proprietary information, such as customer lists, product files, and computerized records?

7. ☐ Do you have written goals and objectives?

8. ☐ Do you have a written vision for the business? Have you identified the challenges?

9. ☐ Does management have prioritized responsibilities so they are not drawn too much into others' projects?

10. ☐ Do you have an organization chart with clearly defined responsibilities and reporting structure?

11. ☐ Do you have regular, short, "stand-up" meetings, to have responsible individuals report on progress on their goals?

Exhibit F (continued):

12. ☐ Do you have an effective procedure for identifying company needs and for finding and selecting individuals to hire?

13. ☐ Have you complied with registration and licensing requirements with all applicable regulatory agencies? Do you have systems in place to timely file tax returns and required reports?

Revenue Cycle

14. ☐ Do you have a marketing plan?

15. ☐ Are there sales management reports?

16. ☐ Do you have a sales kit including basic information about the company's products, such as visuals, testimonials, and a catalog?

17. ☐ Do you have a credit policy with credit standards, cash discounts, or sales terms? Do you have someone assuming the role of credit manager?

18. ☐ Do you sufficiently monitor customer payments and past-due accounts? Do you have a collection policy?

19. ☐ Do you classify customers according to volume, profitability, and credit history?

20. ☐ Do you have a cash management program to maximize collections, interest income, and safeguarding of revenues?

21. ☐ Are you maximizing technology for marketing, budgeting, invoicing, customer master file maintenance, accounts receivable, and analysis of write-offs?

22. ☐ Do you have sufficient internal controls to protect from loss of revenue?

23. ☐ Do you have a revenue budget? Do you regularly compare your actual revenue to the budget and to the prior period (month or year) revenues?

Production Cycle

24. ☐ Do you have an effective inventory management system? If you provide services, do you have an effective system to capture your labor costs?

25. ☐ Do you need a perpetual inventory system? For services, do you capture labor costs on a daily basis?

26. ☐ Do you restrict access to your inventory and valuable equipment?

Exhibit F (continued):

27. ☐ Do you have adequate production budgets and reports?

28. ☐ Can you identify your gross margin and indirect costs by product?

29. ☐ Is obsolescence an issue? If you provide a service, do you have excessive unbilled time?

30. ☐ Do you have a capital asset plan for purchasing or replacing equipment? What are the expected equipment costs? Do you have a budget? When do you need the equipment? Do you have sufficient capital? Have you compared the costs of leasing vs. purchasing? What about expected repairs and maintenance?

31. ☐ Have you sufficiently planned your space requirements? Lease costs? Energy costs?

Expenditure Cycle

32. ☐ Do you have a system for management approval of expenditures?

33. ☐ Do you obtain competitive bids?

34. ☐ Do you take advantage of cash discounts, payment terms for no extra cost, quantity discounts, etc.?

35. ☐ Do you have clear travel and entertainment and expense reimbursement policies for employees? Do you insist on adequate supporting documentation?

36. ☐ Do you have adequate internal controls for safeguarding of checks and cash, and access to bank information?

37. ☐ Do you have an expenditure budget? Do you regularly compare your actual expenditures to your budget and to the prior period (month or year) expenditures?

Payroll

38. ☐ Do you have an effective executive compensation structure based on productivity?

39. ☐ Do you have an effective employee compensation structure that will retain qualified employees and reward the highest levels of productivity?

40. ☐ Have you considered a qualified retirement plan (such as 401(K) plan?

Exhibit F (continued):

41. ☐ Do you have adequate HR help for hiring, firing, performance evaluation, and employee policy manuals, etc.?

42. ☐ Is your payroll system bullet proof? It needs to be. Have you prioritized the payment of payroll taxes and all things employee related? Nothing can get you in trouble faster than payroll issues. Have you automated your personnel records, vacation time, sick pay benefits, etc.?

Financial Management

43. ☐ Do you prepare cash flow forecasts to determine cash needs?

44. ☐ Are funds in the company's banks within the federally insured limit at all times?

45. ☐ Does the company have an investment policy? Do the owners regularly review the monthly investment statements?

46. ☐ Does the company regularly consider the most favorable financing available?

47. ☐ Are there sufficient internal controls over cash and investments?

Risk Management

48. ☐ Does the company have an adequate risk management plan? Consider insurance coverage, self-insurance, and valuation of assets in case of loss, whether insurance is for cash value or replacement cost, etc.

49. ☐ Consider insurance for:
    a. Business interruption
    b. Property damage
    c. Umbrella liability
    d. Fidelity insurance
    e. Cyberspace

50. ☐ Does the insurance broker have malpractice insurance? How was the broker selected and evaluated? Does the company have minimum quality ratings for its insurers (such as A.M. Best rating of A- or above)?

51. ☐ Is insurance concentrated with one carrier to ease settlements and lower costs?

52. ☐ Does the company regularly compare proposals from other agents or brokers?

Exhibit F (continued):

External factors

53. ☐ Does the company regularly consider economic trends:
    a. Global economy impact on commodities supply and foreign markets demand?
    b. National economy effect on anticipated inflation or recession?
    c. Local economy impact on labor availability and costs and sales?
    d. Related industries impact on commodities supply and customers?

54. ☐ Does the company regularly consider the effects of pending government regulation or deregulation?

55. ☐ Has the company considered the effects of competition from:
    a. Overseas competitors?
    b. National competitors expanding into the company's market?
    c. Additional local competitors?
    d. Technological change?

56. ☐ Has the company considered the potential changes in demand resulting from:
    a. A switch by customers to substitute products?
    b. Price resistance in the market?

57. ☐ Has the company considered the effects of possible strikes on:
    a. The company?
    b. Suppliers?
    c. Customers?
    d. Distributors?