

## Starting Your Own Business

### Part I -- Developing a Business Plan

#### Doing It on Your Own

This is the first in a series of articles that will look at the legal and business issues that arise when a new business is started.

There is an old joke about any group of two or more data processing people being a company, and one data processing person being a consulting firm. After working for other people during your career, usually in a "Dilbert-like" environment, you often may think about starting your own company and being your own boss.

A significant part of my practice is counseling people who want to start a new business, and who have to deal with the issues of choosing a form of organization, considering how the form of organization will impact their personal tax situation, drafting shareholder or partnership agreements and employment agreements, and protecting intellectual property to be used in the business. These issues come up right at the beginning, and if they are not dealt with at that time, the lack of planning may result in some adverse consequences down the line.

#### It's a Lot Different in Russia

About five or six years ago, as the Soviet Union was unraveling, a group of about twenty Soviet government administrators came to Philadelphia to observe how businesses were operated in the U.S. The promoters of the trip asked me to meet with the group and discuss the legal aspects of starting a business in the United States.

I began my talk to the Russians (through a translator) by describing the way that U.S. entrepreneurs would get together to establish business. My description was very simple -- usually two or three people get together, have a business idea that they think can be profitable, and draw up a business plan to describe the idea. In addition to describing the business, the business plan covers the potential market for the product or service, the costs of establishing the new business, the source of capital necessary to cover organization and start-up costs, the anticipated cost of delivering the service or products, management information, breakeven analysis, and the profit anticipated after the business gets off the ground. Once the business plan is prepared, the entrepreneurs raise or contribute any necessary capital to get the business started, find a location to conduct the business, and start selling the product or service.

The Russians started talking and gesturing, and it was obvious that they were troubled by my description. Several of them commented that I had left out a key step. I had not described how the people obtained the consent of the government to start the new business. I explained that in the U.S., people do not have to get government consent to start a business. The Russians looked incredulous. They started arguing with me that I must be either lying or dense in not understanding that no one can start a business without first getting governmental approval.

I became a bit defensive, and told them that I was living here and they were not, and if I told them that new businesses did not need government consent, I would know that. (So much for friendly international relations.) One of the group then stated that I could not be telling the truth, because how would the government collect taxes if the government is not part of the process of allowing the new business to go forward? That comment explained part of their inability to understand my description.

I acknowledged that the government is part of the process, because a new business needs to get an employer identification number from the IRS and it needs to get necessary governmental licenses and permits to conduct its business. I also explained how businesses had to pay payroll taxes and file sales and income tax returns.

The Russians reacted to this by claiming that I had misled them, as I now had acknowledged that governmental approvals were required after all. I could not get through to them that these governmental approvals were for the most part perfunctory, and had to be granted. They looked at me as if I were from the moon when I told them that a corporation could be formed, governmental requirements met, and a business started, within a few days from the decision to proceed with the new business. I asked them how long it took in the Soviet Union to obtain governmental approval to start a business. They told me that it took at least six months, assuming that one could obtain the approval at all.

After this experience with the Russians, I have a much better understanding of what the economic reformers in Russia and eastern Europe are up against in trying to adapt their government-controlled economies to a capitalist system. I also am more thankful that my grandfather had the brains to get out of Russia in 1914, although his motivation was not economic - he just wanted to avoid serving in the Czar's army.

### Why a Business Plan is Needed

One well-known Philadelphia attorney represents many new ventures and is involved in venture capital transactions for new or growing companies. He will not agree to represent a new client, as a business start-up, unless the client first provides him with a business plan. From his perspective, a business plan is so critical to the success of a new business, that it is a waste of his time to get involved with a new company unless the principals of that company have prepared a business plan.

Business plans can be simple and straightforward. For start-up companies, the primary goals to be achieved by a business plan are:

1. Describe the business. Obviously, if you are looking for capital, you have to explain to prospective investors or lenders what the business is about. Your ability to describe the business well will tell the prospective investor or lender a lot about you and the proposed business. The description should be clear, organized, in good English, and readily understandable by people unfamiliar with the business. The description also should convey information about your enthusiasm about the business, and your ability to sell or market the product or service. If you cannot describe the business in a clear manner, or convey readily the business idea in a favorable light, it is questionable whether you will be able to effectively sell or market the product or service you intend to offer to customers. Lesson: if you can't explain it, you can't sell it.

2. Show that the principals have analyzed the business's operations and risks. It is essential in the business plan to show that the principals understand the business that they propose to commence. No one will be interested in investing in a new business where the principals have not shown a complete and thorough understanding of the business, the market for the company's products or services, the employees who will be needed, the sources of supply of key materials or components for any product intended to be sold, the point at which the business can be operated at breakeven, the financing needs to get the business started and carry it through the time when it can be self-supporting, and the anticipated competition and other risks that will have to be dealt with in starting and running the business. If the prospective investors or lenders perceive important aspects of the operation of the business, or risk factors, not discussed in the business plan, they will not have any confidence in the principals. Conversely, if all material operational issues have been considered, and risks are appropriately identified and addressed in the plan, the prospective investors or lenders will have much more confidence in the principals' ability to successfully start the business and run it profitably. Lesson: smart capital does not provide investment capital or loans to goofs.

3. Avoid giving away or disclosing confidential or proprietary information that could be used by others to the detriment of the business. This problem is like walking on the top of a fence. While the principals of a new business must provide sufficient descriptive information in the plan, they also must be wary of disclosing information that could be used by a potential competitor. To some extent this issue can be dealt with by restricting the people or companies to whom such business plan is shown, noting prominently on the face of the business plan document that it is not to be copied or reproduced for any purpose without the consent of the preparers, or disclosed or shown to any persons or companies other than the named recipient, and that it contains confidential and proprietary information. It is advisable to obtain a confidentiality letter agreement from anyone who will receive the business plan or other confidential or proprietary information relating to the company or its contemplated products or services. This letter agreement identifies the confidential material, provides for the recipient of the material to maintain the information in confidence and not to disclose or use it for any purpose other than consideration of the proposal being made by the company, and provides for all documents, including the business plan, to be returned to the company. Lesson: loose lips sink ships, or don't trust anyone other than your mother (and watch her closely).

4. Compel the principals to rigorously analyze their business idea and proposed methods of operation. The preparation of a business plan is a lot of work. It requires careful drafting, analysis of the business, identification of operational risks and issues, preparation of pro forma financial information about the business, and the determination of capital needs to get the business off the ground and provide essential income to the persons starting the business. The process of preparing the business plan itself is an important prerequisite to getting a successful business started. Lesson: plan it, or blow it.

#### Outside Assistance in Developing and Writing a Business Plan

Because of the critical importance of the business plan, there are many business consultants and companies that specialize in assisting a company in developing and writing its business plan. In some cases, a good accountant with an understanding of the business can help with the drafting of the plan. The accountant should be particularly helpful with the preparation of the projected operating statements, or pro formas, that are needed to substantiate the financial viability of the company's business idea. A good accountant can also review the underlying assumptions on which the financial projections are based, and adequately describe and provide support for those assumptions in the plan.

There are also many software programs on the market that assist in business plan preparation. I have not personally reviewed or had any experience with these programs, except for one shareware program I downloaded from a library of programs maintained by my on-line service provider. The downloaded program was beyond terrible. Don't trust business plan software that misspells more than five words in the section headings! Some of the available reputable programs (usually accompanied by a manual that explains business plan preparation) are:

Smart Business Plan 5.22  
American Institute for Financial Research  
900 Perimeter Pk., Ste. G  
Morrisville, NC 27560  
800-578-9000; <http://www.smartonline.com>  
Price: \$150

BizPlanBuilder Interactive  
JIAN Tools for Sales  
1975 W. El Camino Real  
Mountain View, CA 94040-2218  
800-346-5426; <http://www.jianusa.com>  
Requires Windows 95  
Price: \$100

Business Headstart 2.1  
Planet Corp.  
106 Pleasant St.  
Worcester, MA 01609  
800-366-5111; <http://www.planet-corp.com>  
Price: \$50

Business Plan Pro 2.0  
Palo Alto Software  
144 E. 14th Ave.  
Eugene, OR 97401  
800-229-7526; <http://www.palo-alto.com>  
Price: \$85

Business Plan Write  
Business Resource Software  
2013 Wells Branch Pkwy., Ste. 305  
Austin, TX 78728  
800-423-1228; 512-251-7541  
Fax: 512-251-4401  
<http://www.brs-inc.com>  
Price: \$130

Trial versions of some of the above programs can be downloaded from the listed Internet sites. My personal view is that using a software program to prepare a business plan is probably not adequate by itself, and that the most one should expect from using one of these programs is that it will help the principals of the company understand the process of developing the plan, and provide enough organizational support to enable them to get an initial draft of a plan together. The plan should then be refined and revised by reviewing it with business plan consultants and other advisers, such as accountants, attorneys, and friends with experience in venture capital transactions. Once the plan is put together, and assuming that the process does not undermine the principals' belief in the viability of the business, the principals will now be ready to start the business, or raise the seed capital to start the business.

The next article in this series will focus on the choice of a form of organization for the new business, and the tax and liability considerations that impact that choice.