

**THE
BUSINESS
LEGAL
LIFECYCLE**

**How to Successfully Navigate
Your Way from Start Up to Success**

US EDITION

JEREMY STRETEN



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For Abigail and Benjamin

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Foreword

May 28th, 1979 was a very important date for me – it was the opening day of my first business. Well, that was 14 businesses ago, and what an adventure it has been. Mustering up the courage to pull the trigger was tough enough, and without an ample supply of grit, determination and loads of perseverance this would have been an impossible task. Hindsight reveals self-employment and entrepreneurialism was no doubt the right choice, but no one told me how difficult it was going to be. Had they, I may still be someone else's top executive. I'm thrilled that everyone remained silent.

As I traveled through the various stages of business I was fortunate to have wise counsel. I was a magnet for mentors; maybe it was because wiser businessmen felt sorry for me and they witnessed the errors of my ways first hand. Or possibly my willingness to subject myself to the scrutiny of others gave them permission to guide me. I'm to this day not certain the reason but am nonetheless grateful for their openness.

What if I had a copy of *The Business Legal Lifecycle* by my friend Jeremy? I can't even imagine where I could be today. There were so many hurdles to overcome in the early days when I was so green at every turn. There were so many unanswered questions about my team, the name, structures, mission, vision, and values. Let me be honest: I wasn't even sure how to go about selecting a name. And, when I did select a name, what was I to do to protect it legally? There were so many fears creeping into my mind as it related to the best type of insurance, what would be employees' and managers' roles and responsibilities, and many other issues. It was almost debilitating.

A colleague suggested one day that I get legal representation, possibly even hire a law firm on retainer. This was a daunting challenge because until this point in my life I had no reason for legal input or representation. The truth of the matter was I was grinding it out day and night, attempting to make all the right decisions on my own. I didn't even know where to begin, and furthermore who could I trust? What would they charge, and how would I know what was fair to pay? Once I did select an attorney, I was always nervous to call. The receptionist always had the same response, 'He will call you back at his earliest convenience.' I truly believe I never got him on the phone one time the first go around. What's up with that? I needed him then.

What a goldmine of information is in this book, *The Business Legal Lifecycle*. Jeremy walks you through the various stages of business just at the right time.

He helps you through very important decisions like borrowing money, leasing your space, and the difficulties of insurance of various types. In the early days, I had no one to explain how to involve investors and explain the benefits or consequences. The list goes on and on as to the value of this book. There are suggestions and comprehensive plans as to how best to operate your business from a legal perspective.

At some point, I started thinking about selling my businesses and retiring, but I didn't know where to start. There were so many facets to selling: Was it a stock sale or asset sale? Was it all cash or earnout? How did I structure the deal to maximize the tax benefits and protect my estate? Was I solvent or could I be facing bankruptcy? Where was my guide, teacher and instructor to help with all these important questions? Well, here is the solution: *The Business Legal Lifecycle*.

Bottom line, I strongly suggest you take the time to read this thoroughly thought out strategic mindmap of how to operate a successful business legally.

Aaron Walker

Author of *View From The Top*

Preface

As an attorney and a business owner I am often frustrated with the legal industry as a whole. All too often, advice from attorneys is boring and repetitive with no thought for the client's actual situation. What happens more often than not is that clients are scared of going to their attorney, scared of being told that they need to spend tens of thousands of dollars to do everything that they need to do. There is no commercial advice given and legal advice becomes unworkable in the real world. This frustration led to the creation of the Business Legal Lifecycle, a concept to shift legal advice away from the simple 'do everything at once' approach to a more commercial set of instructions for every business owner to use.

This book is all about demystifying the legal processes and unlocking the often confusing world of legal advice for business owners. My aim is to give business owners a reference guide to be able to use in business, to give guidance on legal terms, and to give a clear direction of where a business is and should be going. The 13 phases of the Business Legal Lifecycle have been developed to solve these issues and give business owners a clear path for their business.

I originally wrote this book for the Australian market. I have worked with Keathel Chauncey and the team at Fresh Legal Perspective PL to help me adapt the concepts and theories to the laws of the United States. I could not have done this without your hard work and guidance, and am forever indebted to you for your assistance.

As with anything in life, business owners are on a journey of discovery. In writing this book, I have developed a deeper understanding of the Business Legal Lifecycle in general and discovered new and interesting ways to look at businesses. The examples I have given are designed to give that clarity to business owners to be able to identify whether they have encountered a similar problem in the past or as a beacon saying to a business owner that they are not alone and that issues that they face in business are normal. Moreover, I want to give you the knowledge and confidence to tackle problems head on and know that other business owners have been there before and there is always light at the end of the tunnel.

In writing this book I have researched other business books and legal processes and have also undertaken an extensive review of the business owners that I have dealt with over the years. I have examined where businesses did things correctly and where they did not, and I have developed the phases of the Business Legal Lifecycle as a guide to where the most successful businesses did things correctly.

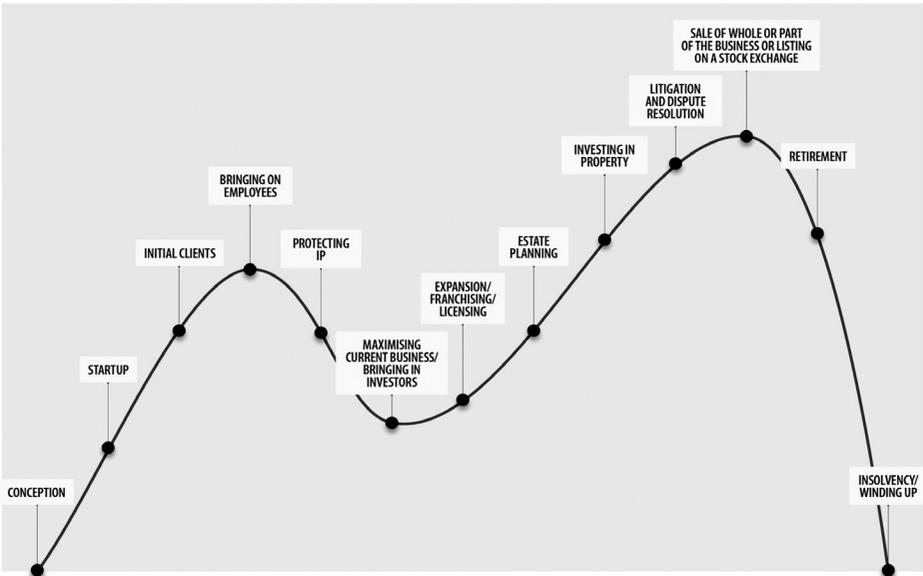
Your journey as a business owner will be fraught with danger but it should be a journey that is interesting and allows you to develop many different skills.

Whether you are a small, medium or large business owner, you will at some stage of your business life have many different roles; embrace them and learn from your mistakes and also from your successes. This book has been designed for you to establish and build a successful business.

Introduction

Business owners are in business to take control

When you first start out in business, you need to do everything yourself to keep your business going. You need to be the marketer, strategist, salesperson, manager and even the cleaner. Staying in control of all aspects of your business is vitally important to its ongoing success. As your business grows and develops, it is critical that you are aware of the changes and cycles that it will go through. All businesses go through very predictable and repetitive cycles that are both positive and negative. They are all very important and you need to be proactive and ready to take action when the time comes. I have examined not only what successful business owners have done well, but also where business owners have failed, in order to work out what went wrong. This led me to develop the 'Business Legal Lifecycle' based on my experiences as an attorney working with over 5200 business owners and their businesses.



The main problem I observe is that many business owners don't know what they need to do with regards to the legal side of their business. They often don't establish the appropriate structure for their business and do not know when certain legal processes of the business should be undertaken. I developed the Business Legal

Lifecycle to guide businesses through what legal steps they need to take and when they need to take them.

Experiences

As a young corporate attorney during the 2000s it was drilled into me that a business should have every single legal document in place before it starts to trade. Part of this is due to the increasingly litigious nature of our society, and part is due to the commercialization of legal businesses.

Crossing the t's and dotting the i's before you start trading is critical in order to make sure that you are ready for the challenges that you will face as a business owner.

What we see from many business owners

All too often, a business owner, struggling to get their product off the ground, engages with clients and starts employing a team without having the resources or the time to implement all the necessary steps at the beginning of their journey. Setting up your business properly from day one is crucial as the decisions you make at the start will have huge impacts down the track, and could be the difference between success, failure and even bankruptcy.

The Business Legal Lifecycle was developed to help business owners overcome the challenges and protect yourself from the risks that you will face at different stages of your business's development. When your business is about to transition to the next phase, it is critical for you to understand what your legal options and obligations are so as to ensure that the transition from one stage to the next is successful.

The aim of the Business Legal Lifecycle

The aim of this book is to demystify the legal processes, explain the different legal practices, and demonstrate why they are necessary through the use of real-life examples. I will also attempt to fight my inner attorney by doing all of this in plain English! The focus of this book is not specific to any particular type of business and can be used by all types of businesses and business owners.

It should be used by entrepreneurs, existing business owners, accountants, attorneys, financial planners, business mentors, business coaches, mortgage brokers, business brokers, real estate agents and other professionals as a guide to the legal aspects of a business.

It may be that some steps occur in a different order or certain events trigger the phases slightly differently, but from my experience, both as a business owner and as an attorney, successful businesses generally follow a predictable pattern as presented in the Business Legal Lifecycle.

How to use this book

Before we begin, a word of warning: specific businesses and business owners have requirements that are unique to their particular circumstances. This book is a general discussion on the phases of the Business Legal Lifecycle, but it should not replace the advice that you, as a business or business owner, receive from your professional team of advisors which is specific to your own particular circumstances.

I have included many different case studies and examples to show how following the phases in the Business Legal Lifecycle can help your business grow into an asset that can either be sold, passed on/inherited or be used as a lifestyle business (a business set up to fund your ideal lifestyle as opposed to a larger type business). I have not included any names and some of the details have been changed for privacy. The effect of what happened in each case study or example, whether it is positive or negative, is very real. Ideally, you should read this book from cover to cover at least once and I encourage you to flag chapters that are especially relevant to you and scribble notes as you go. You may discover things that you have done correctly (or incorrectly) and, as you reach each transition to a new phase in your business, I encourage you to continually revisit the book to ensure that you follow the correct processes and seek the appropriate advice from your consultants.

What is the Business Legal Lifecycle?

Starting a new business is an exciting venture for any entrepreneur. I know from my personal experience of starting three businesses that sometimes you get swept up in the excitement and resist getting bogged down in important, but let's face it, often boring, legal matters. There is a long list of considerations that a business owner needs to think about when starting a business, with initial start-up costs typically being the driving factor behind making decisions.

This is one of the reasons that the Business Legal Lifecycle was developed: to ensure that you are aware that you need to start thinking about implementing the different legal processes from the very beginning.

The different phases of the Business Legal Lifecycle are:

- (a) Phase 1 - Conception
- (b) Phase 2 - Start-Up
- (c) Phase 3 - Initial Clients/Customers
- (d) Phase 4 - Bringing on Employees
- (e) Phase 5 - Protecting Intellectual Property
- (f) Phase 6 - Maximizing your Business/Bringing in Investors
- (g) Phase 7 - Expansion/Franchising/Licensing or
Buying an Existing Business
- (h) Phase 8 - Estate Planning
- (i) Phase 9 - Investing in Property
- (j) Phase 10 - Litigation and Dispute Resolution
- (k) Phase 11 - Sale of Whole or Part of your Business or the
Listing on a Stock Exchange
- (l) Phase 12 - Retirement
- (m) Phase 13 - Insolvency/Winding Up

Each phase of the Business Legal Lifecycle will have a different impact on your efficiency and profitability. Consequently, you may decide not to go through a particular phase, or another phase may present itself earlier for you. Your company may enter into litigation much earlier in its lifecycle, or you may decide to invest in property sooner than others typically do. Some business owners decide never to franchise their business.

The phases of the Business Legal Lifecycle were created as a general guide based on our experience in dealing with business owners and the stages we see them experience during the life of their business. Whether you follow the cycle exactly or not, the book is designed to give you an idea of where your business is currently situated and where it is headed.

A word on contracts

Throughout the book I use various terms that refer to a contract, such as: a company's articles, a lease, agreements with your team and so forth. These are all forms of contracts which are very important legal documents. There is an old saying in the legal profession, 'in any dispute there is your belief as to the truth, there is the other side's view on the truth and then the actual truth is somewhere in the middle.' This is especially true if you do not have a contract in writing as each party to the contract will have a different interpretation of the agreement. In the ever-increasingly litigious nature of our society, putting a contract in writing is imperative for any agreement so that all parties can agree upon the terms and conditions.

CHAPTER 2

Phase 2 – Start-Up

The Start-Up phase commences the moment you take the plunge and start your business. This may include setting up the entity to operate your business, signing a lease for your premises or borrowing money to invest in your business. If you have not successfully completed the Conception phase of the Business Legal Lifecycle, the Start-Up phase will be the scariest phase as you are not in control of all aspects of your business. Problems and pitfalls will pursue you on a daily basis and prevent you from getting to the next phase (Initial Clients).

Generally, a business in the Start-Up phase will be opportunity-driven and action-orientated as the business owner will react strongly to different ideas and pressures and try to be all things to all people at all times. You need to accept that, as a business owner, you will be constantly stressed during this phase. This is completely natural as you take your first steps into the business world without the ‘safety net’ of paid employment.

If you follow the Business Legal Lifecycle, then you can start up your business correctly which will save you a lot of money. After successfully navigating your way through the Conception phase, there are a number of matters you need to consider as the Start-Up phase has the most variables and options of all of the phases of the Business Legal Lifecycle.

Important considerations during this phase are:

- Setting up the correct structure for your business
- Creating your brand
- Funding your business until your first client is obtained and pays you for your services
- Defining your responsibilities
- Deciding where you are going to operate your business from
- Entering into a lease that is on commercial terms
- Managing crises

- Dealing with management issues without having management experience

Dangerous ways of thinking during this phase are:

- Rushing your new business, product or service to the market too quickly
- Trying to be all things to all people
- Not recognizing and accepting errors or mistakes
- Pushing on despite insufficient funds to cover the initial cash flow for the new business, product or service

During this phase I will discuss concepts such as structuring the ownership of your business, entering into a lease for the premises from which the business will operate, the director's responsibilities, considerations if you want to be a franchise, taking out loans, and insurance. While this seems like a lot to consider early on in the process, these steps are crucial in order to establish a business properly and to complete the Start-Up phase.

I have left out a number of aspects that are ordinarily recommended by attorneys as I want to focus on only the most essential elements needed to get your business off the ground at this cost-prohibitive stage. I can't emphasize strongly enough how critical it is to obtain advice from your key advisors (accountant, financial planner and attorney) on these issues.

Your goals and circumstances are unique to you, and there is no 'one size fits all' model. Anyone who tells you otherwise does not understand what is required to establish a successful business.

2.1 Structures

A structure is a separate legal entity to operate your business. It can be seen as the vehicle or entity that you are using to purchase or establish the new business, product or service. A structure may also refer to multiple vehicles or entities; for instance, a builder may set up one entity to run their construction company, another to own the assets of the business, another to own the real property assets that are being constructed, and one to operate a different business associated to the other vehicles or entities in the one structure.

Setting up the right structure for your business at the outset is crucial to its future. Often when clients first come to see me, they have been speaking to other people about setting up their business.

Unsurprisingly, they have decided that they want to 'set up shop' exactly the same way as their friend set up their business. While the advice may be accurate and sound – for the other business – it may not be right for you.

It is crucially important that you obtain independent advice from your advisors about the best structure that needs to be set up based on your unique circumstances. Key questions include:

- What is your current financial and personal situation?
- What structures, if any, do you have in place now?
- What liabilities do your current structures have and can this be used to your advantage in the new business?
- What assets do you own and in what structures?
- What are your long-term strategy and goals; that is, do you want to set up the business to earn an income and be a long-term lifestyle business, or do you want to build a business that you can sell once it is properly set up?
- What is your personal/family situation?
- Are there other unrelated investors from whom you need protection?

The biggest pushback that I see in this phase is when a business owner does a cost vs benefit analysis when setting up the correct structure. Whilst the initial start-up costs may seem high, they are essential to ensure that you:

- Protect any other assets that you own
- Consider your succession planning
- Effectively plan the best tax position for your business

From a legal perspective, each business, and where possible each different aspect of the business, should be a separate vehicle or entity under one overarching structure. This means that should one vehicle or entity fail, then your other vehicles or entities will be protected.

An attorney will only advise you as to the appropriate structure you need for your business from a legal perspective. You also need to obtain tax, accounting and financial advice before setting up the structure to ensure that you have carefully considered all aspects of your business before moving forward.

There are four different common structures that may be suitable for a new business. Which one you choose depends on your situation, your goals, and the model you have chosen. They are:

- (a) sole proprietor
- (b) corporation/company
- (c) limited liability company
- (d) partnership

Don't forget, when setting up a new business you must always evaluate the risks and consider future problems that may arise that are beyond your control. Setting up the right business structure during the Start-Up phase will save you a lot of money and grief down the track.

Sole proprietor

The term 'sole proprietor' refers to a business being operated by a person in their own name, for example Bob Smith trading as Smith's Auto Repair. Operating as a sole proprietor is the most common structure for small businesses in the United States. It often comes as a surprise to many business owners that by operating a business in their own name, they take primary responsibility for all debts and liabilities of the business. As the operator of the business, they are personally liable for any defective work, any injury caused through their business, and for all debts that the business incurs. From a legal perspective, starting a business as a sole proprietor carries the greatest risk.

You must always consider both the short-term and long-term problems associated with operating a business. Events and risks beyond your control may mean that you lose a lot of money in the future that could have been prevented if you set up the right structure in the first place.

From a legal standpoint, being a sole proprietor is an extremely risky way to operate a business. There are other structures that can better protect you and your assets, and minimize the tax payable for the profits from your business.

Corporation/Company

A corporation/company is a separate legal entity from the people behind the business; it ‘shifts’ the risk of liability in many circumstances away from the owners of the business to the corporation/company itself. There are many different types of corporations/companies that you can use in the United States. Each state has its own register of companies, with their own similar rules that vary from state to state. In this section I am giving you a general overview of corporations to give you a basic grounding in what you will need to consider. There is no ‘one size fits all’ approach, so you need to speak to your attorney and accountant to determine which type is right for you.

The three main roles in a corporation/company are directors, officers and shareholders. Directors oversee the corporation/company, appoint and supervise the officers, and are responsible for protecting the shareholders. Officers are the President (or CEO), Vice-President (or COO), Treasurer (or CFO), and Secretary. The people in these roles usually take decisions made by the board of directors and implement them into the day-to-day operations of the corporation/company. Officers each have different roles, and make decisions on procedural matters such as entering into contracts, paying wages, and a variety of other aspects of the business operated by the corporation/company. They are there to ensure that the business is operating profitably, and they also hold responsibility for a number of other aspects of the business: see the overview in section 2.3.

As part of their role, directors and officers may be held liable for debts incurred by the corporation/company. This generally only occurs if they sign a personal guarantee, or if they incur debts on behalf of the corporation/company when they know that the corporation/company is insolvent (more on this in section 13) or if the director or officer breaches their fiduciary duties (more on this in section 2.3). Shareholders, on the other hand, own the business according to the number of shares that they have in the corporation/company. Shareholders are said to have the real control of the business as a majority of shareholders (shareholders who own over 50% of the shares in the corporation/company) can appoint and remove directors from the corporation/company.

You may have heard the phrase, ‘a \$2 company’. This refers to the share capital of the corporation/company. The number of shares each shareholder buys, which can be paid up, or the money ‘owed’ to the corporation/company, generates the share capital. A shareholder’s liability is limited to the amount they still owe for their shares. This means that if you start a corporation/company and buy 10 x \$1 shares in that corporation/company, you are liable to pay the corporation/company \$10, if you have not already paid. The only other situation where a shareholder will be

liable is if a lender or supplier requires a personal guarantee from the shareholders of the corporation/company. This limited liability protects the shareholders from the debts of the corporation/company and means that creditors cannot pursue the shareholders for the debts of the corporation/company.

Corporation's/Company's Articles of Incorporation

Each corporation/company in the United States should have its own articles of incorporation, which essentially state the rules and regulations by which the company will operate. It governs the company's relationship with its shareholders and directors in a general sense and provides a framework for the management of the company.

Shareholders' agreement

A 'shareholders' agreement' is another type of contract between the shareholders that sets out rules in relation to the company's management. This agreement, albeit not compulsory, is generally more comprehensive than articles, and if used, must be drafted with the articles in mind to ensure that there is no conflict between the two documents. Where you have multiple shareholders it is important to consider the different roles that each shareholder performs, and to what extent they can make decisions and agreements that affect the other directors and shareholders. I will discuss the options of shareholders' agreements, and buy/sell option agreements, in sections 6.3 and 8.4.

Limited Liability Company

Operating a business through a limited liability company (LLC) is also very common in the United States. An LLC combines the flexible structure of a partnership (see below) with the benefit for its members of the limited liability of a company. An LLC owns the assets of the business and is liable for its own debts; and the members act as its agents and only have liability up to the amount they have contributed to the LLC. It is a separate legal entity from the members of the LLC and is a registered entity. If you choose to operate your business through an LLC then you need to make sure that you use the name and include the words 'LLC', 'llc' or 'limited liability company' after the name of the LLC.

An LLC structure is a hybrid legal entity that provides flexibility to business owners. The members of the company are not personally liable for the company's debts or liabilities while allowing the members to take advantage of flow-through taxation. An LLC will have its own articles of organization.

Partnership

A partnership is a structure whereby a number of vehicles or entities partner together to operate a new business, sell a product or service, or own an asset.

An un-incorporated partnership is used much less frequently these days due to the fact that the individual partners, as in a sole proprietor structure, remain primarily liable for the debts of the business. There is no separation between the business owner/s and the outside world contracting with the business.

To help shift liability to the entity, you can set up a partnership of trusts, companies or individuals. A partnership of trusts is a popular structure for accountants where their clients are investing in real property, as it has many advantages from a land tax perspective in the United States. Other forms of partnership include Limited Liability Partnership and Limited Liability Limited Partnership. Each of these is used in different circumstances, so you need to speak to your attorney and accountant to ensure that you use the correct entity for your situation.

The partnership agreement

Where entering into a partnership, it is critical that you have a properly constituted and drafted partnership agreement. Like the articles of a company, a partnership agreement sets out the rules governing the relationship between the partners, including defining responsibilities for the day-to-day operation of the business. It is also critically important to plan for the end of the partnership to give partners an appropriate 'exit strategy'.

Trading/business name

It is important that you register any trading or business name as required by your local laws. This will ensure that nobody else can use that name in competition with you. Also, some laws provide that you cannot trade a business without having it registered with the appropriate government body.

It is important to note that each state in the US has its own register of names. If a company registers a name only in Florida and a different company registers the same name only in Texas, both companies will have rights to the name. However, a trademark registered with the United States Patent and Trade Office (see section 5.1 below) will have nationwide protection.

Conclusion

It is common to have a variety of different entities or vehicles within your structure, allowing for the most tax-effective distribution of your income and capital of the business. There is no 'one size fits all' structure for a business.

When setting up a structure, it is essential that you seek complete advice from qualified professionals that caters to your unique situation. Therefore, be careful simply relying on 'friends and family' or 'barbecue' advice when it comes to making important and complex decisions about running your business.

2.2 Leasing Premises

A large number of businesses operate from commercial, industrial or retail premises, often owned by a third party landlord. The relationship between the business owner (the lessee/tenant) and the owner of the premises (the lessor/landlord) is important for the successful running of the business. Being able to effectively operate your business without interference from third parties such as landlords is important for the early success of a business.

As a business owner, you need to ensure that any lease you enter into is on fair commercial terms and is affordable. The exact commercial terms will depend on the premises being let and your particular circumstances. It is essential that you have advice from all of your consultants during the lease negotiations to ensure that you enter into a lease that is advantageous for you and your business.

Far too often I have had to help clients that didn't get timely advice and tried to do it all themselves. The first mistake they made was not realizing they were negotiating with a landlord and/or agent who dealt with these types of matters every day and were expert negotiators. Unless you get the right advice, you may very well find yourself agreeing to terms that will hurt your business down the track.

Important considerations when leasing premises include:

- The amount of rent and when it is payable
- The length of the lease and any options to renew at the end of the initial term. This is essential as you plan for the future
- Whether the rent includes outgoings and/or operating expenses. Outgoings are the expenses generally incurred by the landlord such as

rates, cleaning costs, rubbish removal, maintenance of air conditioning, lifts, escalators, security, repairs and maintenance, insurance premiums and management costs. Operating expenses are consumables generally incurred by the tenant such as electricity, water, gas and are dependent upon the tenant's consumption at the premises

- The type of security you need to provide to the landlord. This may include a bank guarantee, bond/deposit or a personal guarantee and will depend on the type of entity entering into the lease
- Whether there are any incentives, such as rent-free periods or build out contributions paid by the landlord, to induce you to enter into the lease

Commercial leases

It is important to ensure that a commercial lease properly reflects the agreement between the parties as there is no such thing as a standard commercial lease; each lease reflects the different terms and conditions negotiated between the parties.

The process for entering into a commercial lease is a complicated one and it is important that you understand all of the required steps prior to going through the process to ensure that nothing is overlooked.

The process is:

- (a) Finding the property
- (b) Initial negotiations
- (c) Drawing up the lease
- (d) Your obligations as an ongoing tenant

Finding the property

The first step in entering into a commercial lease is locating the property that you want to lease. The crucial element here is to find a property that meets your space and location requirements; these initial aspects of the search will help you to determine what commercial property is right for your business. The appropriate property for any business will vary greatly depending on the type of business, its target audience, the requirements of local authorities and the business owner. You need to speak to an appropriate commercial agent to determine all of these factors and find the right property for your business.

Initial negotiations

After you find the right premises you would ordinarily contact the letting agent or the owner if no agent is appointed. They will have a letter of offer or agreement to lease for you to complete and sign. This document usually contains the salient features required for the lease, including the name of the landlord and tenant, the rent and outgoings payable, the commencement date, the area of the premises, the length of the lease (with any options to renew), and any incentives that the landlord is offering you to enter into the lease.

It is essential at this point that you seek advice from your consultants, such as attorneys, accountants, financial planners and business mentors, to ensure that the terms are commercially suited for your business and there is nothing untoward in the letter of offer or agreement to lease such as a change that you did not agree to, or where it places an obligation on you to perform a task during the lease that is unusual or unreasonable.

Once you sign this offer or agreement to lease you are bound by the terms of the document. The documentation will usually require that you pay a deposit, which you will need to pay upon signing. If you are unable to obtain professional advice before signing, you should ensure that you read through the document carefully and ask that:

- (a) It be subject to your attorney's approval; and
- (b) That you be entitled to a full refund of any monies paid if you do not proceed with the lease.

The lease

Once you have agreed to the terms of the lease, the landlord will instruct their attorney to prepare the formal lease agreement. This document will set out the terms and conditions upon which you will lease the property.

At this point, if you have not previously engaged an attorney, it is essential that you do so now in order to ensure that all of your requirements are covered in the lease and that you are not left with any onerous requirements or terms to which you have previously agreed in the initial negotiations.

General provisions to be considered

Given that there is no standard commercial lease document, it is important to remember that the terms of a lease will be negotiated by the parties to ensure that

they properly reflect the rights and obligations of each party and that the terms are not too onerous on either party, especially the business owner tenant.

There are various matters that you should consider in entering a lease. These include:

- The initial rent and the method for calculating the rental increases over the term of the lease
- The initial term and how the lease is to be renewed or extended
- Whether local town planning (zoning) laws allow your business to operate from the particular premises and under what conditions
- Your right to transfer or assign the lease if you decide to sell the business, and the expense of doing so
- Whether you can sublet the premises
- Who pays for:
 - o keeping the premises in good repair including structural improvements
 - o rates and taxes
 - o outgoings and other charges
 - o all the additions, improvements, and fixtures made during the lease
- The types of insurance required and who obtains each type of insurance
- Restrictions on the removal of fixtures and fittings
- Your obligation to remove partitions and reinstate the premises after expiry to its original condition
- The consequences of failing to pay rent
- Your right to end the lease before it expires
- The process of resolving any disputes with the landlord
- Whether any specific legislation applies to your lease and the obligations it places on each party

- Special obligations if you are in, for example, a business park, shopping mall or multi-story building
- Payment of a security deposit, bank guarantee and/or the terms of any personal guarantee

Obligations as an ongoing tenant

Too often, business owners do not maintain their obligations during the term of the lease which may have serious consequences for both the owner and the business. Some of the major areas in which I have seen business owners fail in maintaining their obligations as an ongoing tenant include failing to:

- Comply with the conditions of the lease and any rules set out by the landlord
- Give notice in time to renew the lease
- Understand their rights if they stay on as a tenant without renewing the lease
- Obtain the landlord's consent if they wish to change the type of business they run
- Understand the landlord's right to end the lease early

Before you take possession and undertake any works on leased premises you should take photos or a video of the premises as a record of the condition that the premises were in at the time you took possession. This is critical, because by the end of the lease, which may be three, five or 10 years after you take possession, a dispute may arise with the landlord as to the original state of the premises which is usually the level to which you have to reinstate the premises at the end of the lease. Photographic evidence from the start of the lease is the best evidence to ensure that you can comply with this requirement.

2.3 Directors' and Officers' Responsibilities

If you are a director or officer of a corporation/company, you need to be aware of the rules, regulations and responsibilities regarding those roles in the corporation/company. This section is focused on the United States laws relating to directors' and officers' responsibilities. These general principles also apply in most of the countries that allow business owners to set up corporations/companies to operate their business.

Corporation/company directors and officers are subject to common law and statutory duties in the United States. These duties are designed to promote good governance of corporations/companies and ensure that directors and officers act in the interests of the corporation/company – including putting the corporation’s/company’s interests ahead of their own.

As mentioned earlier in section 2.1, one of the advantages, from a legal perspective, of a corporation/company structure is that a separate legal entity operates the business and, in most circumstances, protects the individuals behind the corporation/company from any personal liability.

However, abuse of this protection has seen unscrupulous directors and officers hide behind the corporation/company to incur debts that they know cannot be paid. The law has developed over time to protect third parties dealing with these unscrupulous directors and officers.

The two primary fiduciary duties of a director are:

(a) Duty of Care

A director is obliged to keep themselves properly and completely informed as to the company’s affairs and cannot claim ignorance of their own making (e.g. failure to undertake proper enquiries). All decisions must be made from an informed position to ensure they are active in the decision making process. What this means in practice depends on the circumstances.

(b) Duty of Loyalty – The duty to act in the best interests of the company as a whole

A director will breach this obligation if they are found to have subjectively failed to give proper consideration to the company’s interests as opposed to their own interests.

A number of defenses may be raised by directors to allegations of breaches of duties. For further advice on breaches of duties, I strongly recommend speaking to your attorney to discuss what actions should be taken to protect yourself.

2.4 Becoming a Franchisee

One option when starting a business is to purchase an existing business in the form of a franchise. This is distinct from the ‘Expanding Your Business, Franchising and Licensing phase’ (discussed in section 7) because, rather than starting up your

own business and brand, you are purchasing an existing franchise. Usually, the franchise will have all of the aspects of the business already established, so when you buy a franchise you are also buying that system to operate your business.

What happens when you want to invest in a franchise?

To invest in a franchise, the franchisee (you) must first pay an initial fee for the rights to the business, training in the business model, and the equipment required to operate the franchise to the franchisor (owner). After the business is set up, the franchisee will generally pay the franchisor a regular royalty payment (such as a percentage of gross sales or fees) for the continued use of the franchise model. These payments are commonly to be made on a monthly or quarterly basis. When you buy a franchise you are effectively buying a brand that should be protected by a registered trademark and gives you the right to trade using that trademark.

After the franchise agreement has been signed, the franchisee will open a franchise business which replicates the business model of the franchisor. Generally, as a franchisee you will not have as much control over your business as you would over your own business, so you need to be prepared to do things the franchisor's way, not yours. Usually, the franchisor will assist the franchisee where necessary to ensure that the reputation of the business trademark and model are maintained.

Control of the franchise

Generally, the franchisor will require that the same business model is used by all the franchised businesses. This may include using the same uniforms, business processes, and signs or logos particular to the business itself. These help to identify the business and keep the brand consistent to the outside world. The franchisee should remember that they are not just buying the right to sell the franchisor's product, but the right to use the successful business process of the franchise.

Often the franchisee will pay an advertisement fee to the franchisor so that consistent advertising can be utilized to a larger audience rather than each franchisee attempting to advertise their business on their own. For example, a franchisee may only be able to afford to advertise in a limited area around their business due to the cost. Where multiple franchisees pool their money together, they can often afford advertising that reaches a much larger market and is therefore more beneficial to all of the franchisees as a whole.

While there are many benefits to investing in an already successful franchise business, there can also be drawbacks. As with any investment, you should do your research thoroughly before you make any purchasing decisions. Often, the franchisor will place a number of restrictions on how you operate the business

and, as such, you should ensure that any franchise agreement is fully reviewed by a competent attorney who can advise you in relation to your rights and obligations under it. It is also critical that you obtain advice from your accountant and financial planner to ensure that you are able to properly operate the business from a financial standpoint.

Conclusion

Purchasing a franchise business is an important business decision. You need to give serious consideration to what you are signing up for and whether you are getting the most out of your investment. Importantly, you need to take advice from financial and business advisors on whether the franchise is viable, and from attorneys on the legal side of the franchise business.

2.5 Borrowing Money

Funding the initial start-up of your business can be difficult. You have just started your business and you immediately begin incurring debts with cash that you do not have. I remember when we started our law firm all we had was an overdraft and a credit card. We decided that we did not want to borrow a lot of money to start the business (otherwise we would just be paying a lot of our future profits to the bank), so we never touched the overdraft and established an internal line of credit with our own money.

However, depending on the type of business that you are starting, obtaining finance may sometimes be a necessary step to ensure that you can operate your business through the phases of the Business Legal Lifecycle. If you are starting a business that has large upfront capital costs such as a food supply business, a stationery business or a glass supplier, for example, you will need to spend money to buy your products before you start to sell them to your customers.

There are a number of options available to business owners to access funding to pay for the upfront start-up costs of their business, including:

- (a) Lending your own funds to the business
- (b) Borrowing money from a bank
- (c) Borrowing money from friends or family
- (d) Debtor finance
- (e) Equipment finance

Lending your own funds to the business

Using your own funds to start your business is obviously a risky proposition; however, if you have the cash, it may be your best option. In choosing this option you don't need to worry about how you are going to pay yourself or your debts, and you will be able to generate a realistic projection of those costs against your income. Ideally, you should prepare a cash flow projection, a full year budget and business plan before you start. Again, at this stage, it is imperative that you obtain advice from key consultants such as accountants and financial planners. You may not be aware of all of the costs that are involved in setting up a business, so it is vital that you properly plan your funding arrangements (if you haven't already done so in the Conception phase).

Borrowing from a bank

If you don't have the cash to fund your own start-up costs, then you need to consider other funding alternatives. Borrowing from a bank is one of the most common methods to fund a start-up business. I am certainly not against banks and, indeed, believe that they are an essential player in setting up and funding your business. However, I have seen business owners work hard to build strong relationships with particular bank managers, only for those bank managers to move on and leave the business owners to deal with a new bank manager and rebuild the relationship from scratch. Or, worse still, because the bank has all of their assets tied up, they use this transition to become stricter in their lending conditions as the personal relationship no longer exists.

From the Case Files

This is exactly the situation that confronted one of our clients with large property holdings. The client had a business in investing and developing large commercial and industrial properties. He owned properties that were valued at over \$60 million and was in debt to one bank that had funded him for over 20 years for approximately one third of the value of his properties. When he became embroiled in a dispute with his business partner, and despite the fact that the properties had significant equity, the bank stepped in and prevented my client from exercising his control over his assets without any reason other than the fact that there was a dispute and the bank did not want it to affect the value of the properties it held as security. This caused my client

to enter into a protracted legal battle that cost both sides close to a million dollars in legal fees.

Another one of our clients is also a property developer with significant equity in a number of properties. The properties range from residential to commercial and industrial and the client had, over a 10-year period, built a strong portfolio of property assets with significant equity and a very good rental return. The client also had a long-standing relationship with his bank and one bank manager in particular. Just before the beginning of the 2008 global financial crisis (GFC), the client entered into a contract to sell one of his properties. Before entering into the contract, the bank manager told him that he could take 50% out of the sale proceeds to fund another project because the bank had sufficient equity in the other properties. At this time the bank manager suddenly left to pursue a different career. The new bank manager told the client that, as a result of the GFC, the bank tightened their lending criteria and changed their mind, taking all of the funds from the sale. The consequence of this was that the client was forced to secure additional funding through the bank at a higher rate and at a significantly higher cost in fees and lost opportunities. In a situation where the client was hoping to free himself from the constraints of the bank, a change of relationship manager and policy meant that he was even more closely controlled by the bank. Had he been able to secure funding from a different bank, the client would have been able to negotiate a much better deal.

Banks love to take guarantees and security over a number of assets (cross-collateralization), especially when you're first starting your business. For example, the bank will commonly require the directors/shareholders/founders to give a personal guarantee and, if you own a house, the bank may ask for security over the house to support the guarantee so that if you default in the repayments, it can sell your home to repay the debt, as really there is no value in selling the struggling business. This represents a considerable risk, especially if you own the house with a spouse or partner because the bank may require a personal guarantee from that person as well.

This should be avoided if possible as, more often than not, your spouse or partner will not be involved in the business and they risk losing their home as a result

of the business going bad. If your bank says ‘no’, keep looking because you will probably be able to find another five banks that will say ‘yes’.

In my experience there are two main strategies when borrowing from banks:

- (a) Build relationships with a number of banks and play them off against each other to obtain the most favorable terms, although this can still have negative consequences if one of the bank managers leaves.
- (b) Engage an experienced and competent mortgage broker who can liaise with different banks and get the best deal on your behalf. Additionally, it is important to also liaise with an accountant and financial planner so that your consultants know what is going on and can give you the best advice.

Borrowing money from friends or family

Borrowing money from family and friends must be seen as the last resort. When borrowing money from a bank, there is always the risk of the bank stepping in and taking control of the business if things turn sour. If you borrow money from someone you know, be prepared that they are likely to want some involvement in your business. You might be shocked to find that you gained a ‘de-facto partner’ instead of a lender. Of course people never enter into the transaction with any malice, but unfortunately things can and do go wrong, not only damaging the business but also the relationship with the family member or friend. If you decide to borrow money from someone you know, it’s imperative that the agreement is properly documented and clear ground rules are established to regulate the lender’s role (if any) in the business so that the relationship is well-managed. Both parties need to understand that they are entering into a serious business transaction; to run the business properly rules are necessary and will be strictly enforced.

From the Case Files

I saw this type of relationship turn sour a few years ago when a business owner came to see me as he had lent money to his son-in-law to start a business. The father-in-law was an elderly gentleman who had worked for a salary all his life and he had built up a strong savings portfolio. He wasn’t, however, aware of what was required to run a business so when his son-in-law approached him to help with a new business venture, he happily agreed. However, there was no agreement or understanding

between them as to what the terms of the lending arrangement were or the level of involvement that the father-in-law had in the business. The father-in-law was concerned that his son-in-law was 'out socializing' instead of working to build the business. He felt that his son-in-law was simply wasting his money and wanted to get his money back. After many discussions he approached his son-in-law accusing him of taking his money and not taking the business seriously. On a positive note, it turned out that the son-in-law had simply been networking and was genuinely trying to build up his business, and that the father-in-law had misunderstood what was going on. Unfortunately, the mistrust caused massive divisions within the family that took years to resolve. Admittedly, this was an extreme case, but it is a real life illustration of how mixing business with family can lead to severe consequences.

On the other hand, I have also seen success stories where this kind of relationship has worked. A client of ours, who had recently retired after 40 years of operating his own business, sought our advice when the person he sold the business to wanted to borrow money from him. The business was a road transport one that had significant overheads in the trucks and machinery used in the business. The new owner had attempted to expand the business into other areas and they had not been successful so he was struggling from an operating cash flow perspective. The new business owner had a house that was virtually unencumbered that they could provide as security for the loan. After many discussions, the client took a commercial stance, engaging independent valuers to value the house and allowing us to properly document the loan.

The documentation clearly set out the rights and obligations of the parties and there was a clear understanding between the old business owner and the new one that the relationship was limited to that of a lender/borrower relationship and the old business owner was to have no involvement in the business.

By dealing with each other professionally and at an arm's length, the transaction proceeded without a hitch and the relationship remains strong.



Borrowing money from family and friends can be risky but with the right advice and proper establishment, it can work.

Debtor finance

Debtor finance, also called ‘invoice discounting’, ‘debt factoring’ or ‘invoice lending’, is where you accept a percentage payment from a bank or debt factoring company on the value of the invoices you have issued to your customers or clients. The debt factoring company then assumes the responsibility to chase payment of the full amount of the invoice and they pocket the difference.

For certain types of businesses that require immediate cash flow to buy stock (e.g. a printing business) this type of finance can be of great assistance, especially in the short-term start-up phase before cash flow is enough to maintain liquidity.

There are a number of issues that can arise with debtor finance:

- You ‘lose’ a significant amount of your profit
- Usually if the debt is not paid within a set timeframe, for example 60 days, you are required to pay the money back to the debt factoring company that has provided it to you. You do not get any of your interest or other cash back and you lose that money
- Your ability to borrow from other lenders may be affected as your book debts will not be available as security for other borrowing options
- Customers may not like dealing with a third party on the payment of their debts

If you opt to use this type of finance, you should ensure that it is a short-term fix to your operating cash flow problems as it will seriously impact upon your profits. Again, it is imperative that you obtain the right advice from your attorney, accountant, financial planner and/or mortgage broker to ensure that all of your circumstances are considered and that it is the right funding option for you.

Equipment finance

Another common funding avenue for business owners is equipment finance, which is commonly used when a business needs a piece of equipment or a vehicle. There are many different options and you need to ensure that you get the best deal for your business in terms of start-up cash flow and value for money.

Your accountant, financial planner and mortgage broker will assist here in getting you the best deal. Beware of the latest deal from a financier or a vehicle dealer, which will usually result in you paying the full price for the vehicle (or piece of equipment) as well as paying interest on the loan.

From the Case Files

A client of ours had a business that had two different premises. It was an accounting firm that had two owners who visited both offices on a regular basis as they had significant clients at both office locations. The different premises were more than 50 miles apart.

This meant that the business owners needed a number of vehicles to travel between the two business premises. The client used the services of a broker on the basis that the purchase price was being paid upfront. This meant that the client, when negotiating the purchase price of the vehicles, was able to receive the lowest available market price and interest rate for the vehicle. This differs to the situation where you might take finance directly from the vehicle company, who will usually have a competitive interest rate but you will end up paying a higher price for the vehicle.

2.6 Insurance

As a business owner, you or your business may be liable for a variety of damages or injuries that occur on your business premises or through the work that you perform. Insurance is an agreement where an insurer undertakes to provide a guarantee for compensation to an injured or wronged person for certain types of damage suffered by that person. It was introduced to help spread the risk for business owners amongst the community and to ensure that injured persons are paid compensation to help them with their injuries.

There are different types of insurance that you will need for your business. If you have leased premises or a franchise agreement, the formal documents will set out the types of insurance that are required. The most common types of insurance that you need to consider are:

- (a) General liability insurance

- (b) Professional indemnity
- (c) Product liability
- (d) Plate glass
- (e) Business interruption
- (f) Inventory insurance

There are other types of personal insurance that will be discussed in section 8 on Estate Planning.

General liability insurance

General liability insurance allows business owners to protect themselves from general claims for injury caused by negligence. For example, if a member of the public injures themselves on your business premises because they slip on water that is on the ground without a warning sign and that should have been cleaned up, the injured person can make a claim for compensation through this type of insurance for any injury or loss (for instance medical costs) that they suffer.

Professional indemnity insurance

This type of insurance is necessary for businesses providing advice or services within specific industries. These can include where a professional has breached an obligation to provide advice by:

- Providing negligent advice
- Not achieving the result required by a contract
- Giving bad financial advice
- Providing incorrect nutritional advice

Professional indemnity insurance can also cover a business owner against claims involving the provision of services, including:

- Incorrectly auditing a company's accounts
- Inappropriate surgical procedures

While some industries have their own specific insurance that covers professional indemnity, this type of insurance is absolutely necessary for the majority of businesses to ensure that they are protected should their advice be deemed a breach of the law or negligent.

Product liability insurance

If your business sells or produces a product, then you will need to consider product liability insurance. This insurance protects a business owner against a claim if your product causes:

- Injury or death
- Property damage
- Emotional distress or psychiatric illness

The point of this insurance is to protect you if there is a fault or failure in your product so that if you are deemed negligent and liable to pay compensation to someone who purchased your product, then you can continue to operate your business as the insurance pays the compensation.

Plate glass insurance

Where a premises has a glass shopfront or uses a lot of glass, a landlord will invariably require the tenant to insure the glass against damage, whether intentional or accidental. For instance, where the business is part of a shopping mall or a strip of shops, damage may be caused by someone throwing a rock or deliberately damaging the glass in your shop or business premises. This type of insurance ensures that the damage is quickly and easily fixed without a dispute between the landlord and business owner over responsibility for the damage.

Business interruption insurance

Where a business is affected by or is unable to trade due to circumstances outside its control (for example a natural disaster), business interruption insurance covers the loss of income for the period throughout which the business is affected, including the repair times. The actual amount that can be claimed will depend on the type of business and the type of loss suffered. An example of a natural disaster that affects a business is flooding; such an event is not the fault of any party but it can affect the ability of a business to trade from its premises by restricting team and customer access. Policies vary widely between insurers and most have extensive exclusions so business owners need to compare policies carefully to understand how a policy's restrictions may affect a claim and to find the one that offers the best coverage for their particular business.

Inventory insurance

Any business that relies on its inventory, stock and/or products for its income should have inventory insurance to cover it for the replacement of stock and

products in the event of a disaster. The purpose of this insurance is to ensure that where the stock or products are damaged through no fault of the business, its employees or the business owner, they can be replaced and the business can continue to trade.

An insurance policy is a contract

When you obtain an insurance policy you are entering into a contract with the insurance company. Before you enter into such a contract you need to obtain competent advice from an insurance broker, an attorney, or both. Any insurance contract will very carefully set out the conditions of insurance and, more importantly, the limitations of that cover, called exclusions. Consult with your attorney in relation to these conditions and exclusions to ensure that you are aware of what exactly your insurance covers and what it does not.

2.7 Conclusion

As we have seen, the considerations that go into the Start-up phase are extensive and require a great deal of advice from a range of different consultants. If all of the matters covered in this section are not considered at this stage, you may find that once you do eventually get around to considering them, you will have incurred additional significant costs because of the delay. A very common example is where a business begins as a sole proprietor, and later it is transitioned into a company, whereby it incurs tax and duty costs for the transfer along with the legal and accountancy costs in doing so.

Similarly, without early advice as to the terms of the lease, you may be two or three years into a five or 10-year lease, and realize that you have agreed to an uncommercial term that will cost you a significant amount of money down the track. As the lease is a binding contract between the business owner and the landlord, it cannot be changed and, if you want to stay in the premises long term, you may have significant issues trying to renegotiate the terms of the lease, even with legal advice.

Evaluating the different aspects of this phase slowly and carefully will ensure that you successfully set up your business on sound financial footing. I have seen many business owners rush their way through this phase and not consider the implications of their actions, incurring them thousands of dollars in unnecessary costs. Once you have successfully navigated your way through Phase 2 – Start-Up, you are ready to proceed into Phase 3 – Initial Clients.

QUESTIONS TO ASK BEFORE YOU PROGRESS TO THE NEXT PHASE:

1. Have you set up the correct structure for your business?
2. If you are entering into a lease, is it on commercial terms that you are happy with?
3. Have you created your brand?
4. Do you have a clear path for funding your business so that you can operate successfully?
5. Do you understand your responsibilities as a business owner?
6. Do you have management experience? If not, where can you turn to get the right advice?