Six Steps to Small Business Success

Start, Manage, and Exit Your Business:

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Forward

Professional Association of Small Business Accountants

(“PASBA”)

The authors, organizers and contributors of this book were brought together when they joined a nationwide network called the Professional Association of Small Business Accountants (“PASBA”). PASBA members are some of the best and brightest small business accounting, payroll, tax, and business advisory experts in the country, with one goal in mind – your small business success.

PASBA is found at SmallBizAccountants.com
Introduction

This book is written and supported by members of the PASBA organization, our members have thousands of years experience operating their own businesses and assisting thousands of other business owners in starting, managing, owning, buying, and selling businesses. The contributing members supported the authors and organizers who wrote various chapters of the book depending on their areas of expertise, so you will notice slight changes in writing style as you move throughout the book.

There are so many things you never learn in a classroom. This book summarizes the lessons learned in the classroom of life, where mistakes can mean the difference between success and failure. Many entrepreneurs fail, not because they have a bad idea, but rather because they don’t have the knowledge and skills it takes to convert their ideas into success. You might say that this book is a series of simple steps or ideas that business owners should find useful as they work to convert their dreams into reality.

If you had an opportunity to list all the credentials of the PASBA organizations members, you will notice something unique. They all have strong experiences and professional accomplishments. However, it is their commitment to the future through their service to education, civic duties, charity, and family that makes them great business advisers. We believe in a saying: “Don’t tell me how much you know until you show me how much you care.” The authors, organizers and contributors have the knowledge, but their success is a direct result of how much they care about their clients and others.

Now you know the authors, organizers and contributors and why they wrote the book. Let’s take a look at how the book is laid out.

The book is divided into six main sections:
• **Pre-Business Planning:** Planning for the life cycle of a small business
• **Start-Up: Finances, Budgets, and Numbers:** What you and your banker need to get started
• **Human Resources: The People Factor:** Managing people
• **Operations: Work Flow, Customers, and Sales:** Managing your office
• **Building a Salable Business and the Sale:** Preparing the business for transition and sale
• **Transitioning to Life after Business:** Helping the owner transition to life after the sale and legacy issues

The unique thing about the six steps of the book is that you can start anywhere in the book depending on where you are in the life of your business. Take a minute to read the next section and you can self-test to see what area of the book you want to read first.
Before You Read This Book

We intentionally designed this book so that you can jump in and start with the chapter that fits where your business is today. Whether you’re just developing a business idea or you’re looking to sell your ongoing enterprise, the sections of the book can be used as you see fit.

Of course, we think everyone can probably gain from reading the whole book, because there are lots of golden nuggets throughout. However, to get the most immediate impact, you might want to ask yourself the following questions to get a sense of where you may need the most help. In general, your answer to the questions will help you determine the steps and chapters of the book that may be of most interest to you. For example, what consumes the most of your time in your current business? Is it managing employees, trying to grow sales, or putting out day-to-day fires? If you decide employees are your biggest problems, then skip to Step 3 on human resources to get some immediate relief. Then you can go back and pick up on other key areas. Now let’s look at the six key steps of the book and examples of day-to-day questions that each step will address.

**Step 1: Pre-Business Planning**

First, there is the excitement of all the planning that goes into starting your own business. A little planning on the front end goes a long way to ensuring the dream you pictured becomes a reality. Many businesses fail because the entrepreneur is a good technician at producing a particular business service or good but not necessarily a good businessperson. So if you are starting a new business, take a few minutes and learn from the experiences of others who have succeeded there. Section 1 will help you answer these questions:

- Do you know what type of business or service best fits your dream?
- Have you selected the right business for you?
• Have you evaluated yourself for small-business success?
• Do you have the right form of doing business (corporation, sole proprietorship, etc.)?
• Do you have the right advisers supporting you?
• Should you look at a franchise, buy another business, or start from scratch?
• Do you have a business plan in place?
• Do you have a strategic marketing plan in place?
• Do you have the correct partnership agreements in place for multiple owners?
• Do you have the right tax structure for your business to minimize income taxes?
• How do you coordinate business and family life?

**Step 2: Start-Up: Finances, Budgets, and Numbers**
Once you start the business, there are certain key fundamentals and tracking mechanisms you must put in place to keep things on track and grow the business. Business success is a constantly moving target, so you have to take the time to learn what your tracking mechanisms and your customers are telling you. Section 2 will help you answer these questions:

• Do you have the right type of financing and business loans?
• Do you know how to read financial statements and understand what they can tell you about your business?
• Do you know what the key operating statistics are for your business?
• Do you know how you compare to industry standards?
• Do you know what your tax liability will be for the current year?
• Have you considered your options for commercial real estate?
• Do you have the right insurance coverage?

**Step 3: Human Resources: The People Factor**
Hiring, training, and firing employees are all necessary parts of running a business. Section 3 will help you answer these questions:

• How do you go about hiring, interviewing, and screening employees?
• Are you paying a fair wage and competitive benefits?
• How are you training your new employees?
• Are you managing staff effectively?
• Do you know the right way to terminate an employee to protect yourself?

**Step 4: Operations: Work Flow, Customers, and Sales**

Daily operations involve numerous decisions about your product, service, and customers. Section 4 will help you answer these questions:

• Do you have systems in place so that your product or service is consistent?
• How do you manage your customers, grant credit, and respond to customer service issues?
• Do you have a sales and marketing plan in place, and do you adjust for market changes?
• Do you know when to expand your business?

**Step 5: Building a Salable Business and the Sale**

Once you have the business running smoothly, you need to plan for the eventual sale. Growing that saleable business takes some planning. Then once you decide to sell the business, there is a whole new set of issues: What is it worth? How do I transfer the customers to the buyer? What about the employees? How do I negotiate the terms of the sale? Section 5 will help you answer these questions:

• Does your business run smoothly without you?
• What is your business worth?
• Have you managed your debt so that you can afford to sell your business?
• How can you minimize the tax consequences of a sale?
• Who are the buyers for your business?
• What do you need to know to negotiate a sale contract, and who should be involved?
• How do you transition your customers to a new owner of your business?
• How do you transition your employees to a new owner of your business?
• What should you expect in the sale documents, and how will you structure the monetary transaction?

**Step 6: Transitioning to Life after Business**

Once you’ve made the decision to sell, how do you manage the transition for everyone involved? How will you adjust to your life after the business? Section 6 will help you answer these questions:

• What do you need to know about wealth management?
• How do you adjust to life after work?
• How do you pass on your values to your kids?
• How do you leave a legacy after you are gone?

Now pick the area that will have the most immediate impact for you, and start reading.

One last thought: Dream big, but always break it down into small steps, because small steps are easy to achieve and a lot of small steps equal one big step and a lot of big steps equal your dream.

Step 1:

Pre-Business Planning

Chapter 1

The Dream:
Running Your Own Business with Integrity

In the introduction, we ended with a statement about your dreams and how you achieve them one small step at a time. This book is all about the decision processes needed to transition through the whole business life cycle from start-up to life after the business.
This chapter is about laying out a plan for your dreams and understanding the morals, ethics, and responsibilities you will need in order to achieve those dreams—by taking steps. In order to successfully achieve all these various steps, there is a common theme that must run throughout your business, and that theme is integrity.

The Dream

When you build something, before you start a project you have a picture in your mind of what the end product should look like and the benefits you will derive from it. Business and life are no different, but most of us ignore that very simple concept. We all should spend some time planning our business and personal lives and decide what our dream of success and wealth really looks like.

It is like running a race and not knowing when you reach the finish line. How exciting is that? Over the years I have noticed that the 10 percent of the population who set goals for themselves out achieve the 90 percent who don’t. Therefore, the very first thing you should do is decide what your dream and goals are.

Once you have the dream, the next step is to break it down into small pieces you can achieve easily and start working toward that dream. Your dreams will change over time and that’s okay. Just let yourself enjoy each small step as you achieve it. If you try to take too big of steps, you will fail and never achieve your dream. As you take each small step, you are one step closer to your dream and a new beginning. Don’t get so intent on achieving your long-term dream that you fail to slow down and smell the roses along the way. We all have our life clock ticking, and the moment that just passed we will never get another chance to relive and replay. Therefore, do it right the first time and enjoy every minute of it.

For example, when I first started my own CPA firm, I thought the world would beat a path to my door because I had worked for a large CPA firm. That simply did not happen, so I began to look at all the steps I needed to put in place to make my firm profitable, such as determining the best way to get in front of people who did not know me. I determined that one way was to be a low bidder on any public bid work. Once I got the job, I superserved and gave the organization more advice and service than they expected. This little step resulted in the organization telling others what a great job I did, which led to more referrals and more competitive fees. The simple message is that it all ties back to lots of small steps, which all point to your dream, and each one gets you a little closer. In some cases you will fail, but you can learn from your failures just the same as your successes.
Integrity: Pieces of the Dream

To achieve your dream you must build integrity into your product, your processes, your customer relations, and everything about your business. Everything—from the quality of your products, to how you treat your employees, to how you treat your customers—has to be first class. When you see a stamp that says UL approved, you know that the Underwriters Laboratories has tested a product and you can trust that product. When people think of your business and your product, they need to have that same feeling of trust and integrity. To get that feeling, you have to understand some of the important steps to ensure quality and customer trust.

Offer Quality

When people do business with you, they assume you will deliver the best product or service at the best price. You are the expert simply by being in business. However, you must realize the customer’s perception of quality is often different from the business owner’s. To understand quality, let’s look at Six Sigma. It refers to the goal of having your quality standards so high that the error rate is approximately three in one million.

Honeywell International Inc. puts the engineers in their nuclear weapons division through this quality training to get the best results possible. If the United States ever has to use a nuclear weapon will you want it to destroy a target as designed or will you just want an above-average chance it will destroy the target? An error rate higher than three per million won’t be acceptable in that scenario, and your customers view your product or service from the same perspective. They expect it to be the very best every time.

Offer Value over Price

Good lumber ain’t cheap, and cheap lumber ain’t good. This is an excellent example of why we should always strive to provide superior products and/or services and not be afraid to price accordingly. If all you have to sell is price, then someone will always beat you at your game. When what you offer is the best, the world will be more willing to put a higher value on that. You also must constantly improve or the world will pass you by.

Help Others in Order to Help Yourself

It matters not whether you are dealing with a customer or an employee; you should always care about them and treat them the way you would want to be treated. If you want the best employees and the best customers telling others about you, then you must truly care about them. If you think about it, when you give others what they want, they will feel good about you and be glad to help you in return. In your mind don’t always
think of everyone from the perspective of “what can this person do for me?” Treat those who can do you absolutely no good the same way you treat those who you think can be a key to your success and you will go far.

The concept is very simple: If you truly care about others it will show in everything you do, and as you help others they will want to work for you and do business with you. Listen twice as much as you talk, and always answer from the viewpoint of the person to whom you are talking. Everyone likes to think they had a great idea. Your job is to drop enough hints so that they come up with the idea you had while feeling like it is theirs. That way everyone wins, because you get what you want and they feel good about how creative they were.

Follow the Rules

Think back to those times when you didn’t want to report some income on your income tax return because you felt you were already paying more than your share to the government. Now put yourself in the shoes of the employees or customers when they see you pocket cash from the business or you tell them you don’t have to report cash sales. What you have really done is told your employees or customers it is okay to not follow the rules. Now they think it is okay to do the same, but they may not take advantage of the tax man—they may take advantage of you. It is always better to follow the rules, and you won’t ever have to defend an action you can’t legally uphold.

Be the Best

To succeed at your dreams and build integrity, you must follow a common set of guidelines. Old habits are hard to break, but dreams and integrity are achieved with a consistent pattern of doing many small things right. By offering your customers quality and good value, helping others, following the rules, and being the best, your dreams of small-business success can come true.

Now that you have the basics, it is time to move on to selection of the business product or service you want to offer. It is always easier to go to work every day if you are doing something you feel good about.
Chapter 2

Pick the Right Business for You

“Reasons people go into business: 41% joined family business, 36% wanted more control over future, 27% tired of working for others, and 5% downsized or laid off.”

—Dun and Bradstreet

How do you know what kind of business you should go into? There are so many different kinds, and the decision can be so overwhelming that most people never go into business for themselves. But if you have a passion for working for yourself, what you decide will affect you for your lifetime. You must spend a significant amount of time deciding on the business you will start. Also you will want to consult with some professional advisers. Many of you reading this book may be past this decision, but if not, read carefully. There is much to consider.

Use Your Experience as an Employee

Many people will start a business in an industry in which they are currently employed. Already having the expertise that is needed to provide the service or product is a great starting point. You will already have contacts and maybe some quick contracts or customers before the doors are even open. If you have a passion for the work you currently perform, creating a business around your passion can make this decision easy. We want to enjoy going to work each day, and it can be very satisfying to own a business where you love doing the work.

As an employee, you can often observe how you would not want to run a business. Perhaps it’s how the product is made, the service performed, or a lack of customer service. You can see how to do it better. This can be a good starting point for your new business. You will quickly find out that being the owner is not as easy as it looks.

I have had many clients start their own businesses and significantly improve the results of their previous employer. One such client was able to build his new business to the point that his previous employer offered to purchase the new company. He did not sell but was proud of his accomplishments in taking what he had learned and improving upon it.
The alternative is to run a business different from where you started in your career. If you want to get a fresh start in a new industry, your learning curve will be steep. Starting over can be a great way to invigorate your career. You might have been working in a dead-end job and need a new challenge. Obviously you will have a lot to learn and a harder decision to make. Many people have done this successfully. Starting over can be exciting, but you will need to find people and resources that you can learn from and rely on for advice.

Determine Your Characteristics for Success

Whether or not you enter an industry with which you are familiar, you need to confirm that you are suited to owning a business. Just because you want to does not mean it is a good idea. We have seen many small businesses fail because the owner did not have the skills required for owning a business. Just having the technical skills to perform your trade or service is not enough. You need to consider all your strengths and weaknesses before starting.

The Small Business Administration (SBA) offers a list of characteristics that successful entrepreneurs possess:

- Persistence
- Desire for immediate feedback
- Inquisitiveness
- Strong drive to achieve
- High energy level
- Goal-oriented behavior
- Independence
- Demanding attitude
- Self-confidence
- Calculated risk-taking tendency
- Creativity
- Innovation
- Vision
- Commitment
- Problem-solving skills
- Tolerance for ambiguity
- Strong integrity
- Reliability
- Personal initiative
• Ability to consolidate resources
• Strong management and organizational skills
• Competitive spirit
• Change agent
• Tolerance for failure
• Desire to work hard
• Luck

Good business owners do not possess all of the above traits, but you will need all of them at some time in your career. You will quickly learn which of these traits you do not possess so you can surround yourself with people who do. To build a successful business you will need a team. Your teammates will complement your weaknesses and you will complement theirs, so the team can have all the above attributes.

Make sure you pick a business you enjoy. You will be working long hours and sacrificing time away from family and friends. Be careful to choose a business that utilizes your natural talents. Don’t start building houses if you can’t work with your hands. If you have an analytical mind, take advantage of it.

STEPS TO SELECTING THE RIGHT BUSINESS

Once you have created a list of business possibilities, how should you narrow the list down to your final choice? What should you consider when making the final decision? In over twenty years of consulting with small businesses, we have found that successful business owners take the following steps when considering new business ventures.

1. **Test your ideas.** Start by running your ideas past other people. You should not look for people who will assume anything you do will be a success, like your mother. But run it by other professionals in a related business or people who may be potential customers. You want people to be honest and open, not just with your idea but how they view your abilities to succeed in your own business.

2. **Identify your customer.** Ultimately the success of your business will depend on how many customers you can attract. Therefore, you need to identify who those people are and what their patronage looks like. The more narrowly defined this group is, the better. By identifying your ideal demographic market, you can more easily start to project your financial results.

3. **Give them what they want.** You need to confirm that your customers are willing to buy what you are selling. Ask them to look at your idea and critique it.
You will not be able to sell them a service or product that they do not want. Listen to their comments and be willing to adapt your ideas to what they need.

4. **Count the cost.** To be successful you will need to understand the amount of money you need to start your business and survive the first year. Create a budget that is flexible and considers the best- and worst-case scenarios. You do not want to be underfunded.

5. **Determine who is on your team.** What are the skills that are required to provide the service or product your business will offer? As the owner, you need to understand your limits and find other people who will complement you.

6. **Consider the short term versus the long term.** How long will your product or service be viable? Is technology changing rapidly? Are you working in a very competitive market? You need to consider the next product line or service that you will need to offer. Before going into business you need to understand how long you need to invest before you realize a return on your investment.

7. **Plan an exit strategy.** How long do you anticipate owning your business? When will you want to sell your business? Success does not always mean thirty years of owning a business. You might build the business and sell in five to ten years. Make sure your idea for your business matches the longevity of your business and your exit strategy.

As accountants we see many businesses come and go. We wish they could all succeed; however, many do not have a chance from the start. We have been surprised at some that make it and also surprised at some that do not.

Many of the businesses that struggle from the beginning are underfunded. You must prepare a budget for the first couple of years of your business. If you underestimate the funding you need, it's likely that you will not be able to obtain more. Banks will usually not lend to a new business that has not accumulated any equity. You might have heard of a successful business that started on a shoe string, but most that start that way don't make it. Plan to succeed by having the right amount of money available.

Choosing the right business for you is a crucial first step in succeeding with your new enterprise. Consider your current field, your past experience, and your current financial resources before making this important decision. The next chapter will help you evaluate yourself.
You’ve made it through the seven criteria and have selected a business that looks like a good opportunity. Congratulations! Now it’s time to evaluate your skills, risk tolerance, and commitment.

Doing a self-evaluation is a critical step in deciding if you should start a business. To really be successful in starting a new business, you must take a close look at what it is going to take and determine if you have the time and resources to make your business successful.

Decision-Making Skills

Let’s start by discussing quick thinking skills and critical thinking skills, two very different types of skills that may be needed to make the right decisions for you and your business.

First, do you have quick thinking skills? Those are skills that show your ability to think on your feet when faced with an immediate decision that might have a dramatic impact on your business. Generally people are faced with making tough decisions when they are put on the spot. As a leader of your business you will be tasked with constant circumstances that require your immediate response, and you will need to be able to make logical decisions under pressure. Often these immediate responses will play critical roles in your businesses success. Some things that might affect your decision-making process are how you were raised, your religion, political views, education, and your core beliefs.

The next type of decision you might be faced with making is that which requires critical thinking, more in-depth thought and deeper analysis. Critical thinking becomes much easier when you utilize training and other available resources to assemble relevant facts. This is one reason to keep building knowledge through reading books and articles, and also seek out knowledgeable people through relationships, organizations, professional contacts, and other business owners who can support you when you need to make a critical decision.

These are just two different situations. Keep in mind that thinking ahead and anticipating problems or questions will help put you in a better position to make the right
decision. In general, try to avoid making a rush decision, but also show leadership and confidence in your decisions while admitting when you make a mistake. Keep in mind that **sometimes you must also trust your gut instinct**.

Risk Tolerance

Owning and operating your own business can have the appearance of either being a stable long-term opportunity or an extremely risky endeavor. Risk tolerance, which is the measure of uncertainty a person is willing to accept in respect to the perceived benefits, is why there is such a wide range of perceived risk in owning a business. The realization of owning your own business does have risks, and those risks can be mitigated by making good decisions and by being prepared.

Many studies indicate that entrepreneurs have a low tolerance for risk, which can appear contradictory to most people’s perceptions. This appears to be so counterintuitive because most entrepreneurs also tend to be overconfident in their ability to be successful. This overconfidence gives the entrepreneur the ability to adapt and commit to tasks that most people would consider crazy, like working eighty hour weeks for weeks on end without any form of compensation. So, if you are risk averse, owning your own business might become very stressful and unmanageable unless you also possess a great deal of confidence in the success of your endeavor.

Your personality and risk can be assessed many different ways to provide a self-evaluation. The assessments generally consist of a series of questions and can be done by using a reputable online source or ordering a package that allows you to take and score the test. One of the most detailed is the DiSC® Assessment, which can be reviewed and purchased online from a number of sources, like www.TheDiSCPersoalityTest.com. Another good tool to consider is a career assessment test. These also can be researched and accessed online. One to consider is the Myers-Briggs® test, which is a career, personality, and leadership test. The last area of test you can consider is a hiring test for yourself. These will also provide good information on your personality and goals and help direct you to your areas of strengths and weaknesses in business.

Commitment and Passion

As accountants, we see many passionate people starting new businesses. Passion must be properly directed to a product or service that can produce a viable business. Many passionate people get caught up in the idea and not the truth of the idea’s ability to sustain a business. If the idea has sustainability, the commitment behind it must be unyielding.

One’s commitment can be tested in many ways when you own a business and often includes the drain on financial resources, the time to make a business successful, one’s
adaptability to unexpected changes, and even trust in the business itself. Proper budgeting will help prepare a business owner for the financial commitment, but it is the unanticipated sacrifices that come with owning your own business that give the true test of one’s commitment. Seven-day workweeks for months are a true possibility for some new businesses. The challenge is to find ways to avoid having your business consume you, your family, and your money. Make good decisions on what can and should be delegated to professionals and employees. If you try to do everything, you might start to fail at the one product or service that is your business.

No doubt entrepreneurship is not for everyone. Our website, www.6stepstobusiness.com, has tools and resources that you can use for further information and deeper analysis. Be sure to do a self-evaluation so that you feel confident in your decision-making skills, assess what you are willing to risk to make your business successful, and are able to move forward with passion and commitment.

In addition to your self-evaluation you can get advice from a variety of skilled professionals, as you will see in the next chapter.
Chapter 4

Advisers for Your Business

Most often, even before a business opens its doors, the business owners have consulted and worked with professional advisers to draft agreements, such as buy/sell agreements, partnership agreements, and the like. Advisers will play many roles as you prepare to open the business’s doors.

One common trait many successful business owners have is that they maintain a close business relationship with their trusted advisers. These advisers include accountants, attorneys, bankers, financial, information technology (IT), and other professionals. Advisers should be selected based on the business owner’s skills and available resources. Obviously we all have different skills, and business owners must recognize the areas in which they might need professional advice and when it is appropriate to seek that advice. Far too often the decision not to hire and retain advisers is based on economics or the assumption that an adviser isn’t affordable. In many circumstances the lack of proper advice can cost business owners thousands of dollars or even the loss of their business. For example, many business owners fail to consult with an attorney regarding employee relations or contractual documents for customers. That can lead to costly litigation when a question or problem arises that was not properly documented in the beginning. The stress and challenges around these problems can certainly become overwhelming to the business owner, causing distractions and challenges that can reduce the opportunity for the business to be successful.

Let’s look at some advisers and the role they can play in supporting your business.

Accountant or CPA

Accountants can assist a business owner in a number of ways. They are usually familiar with the government agency requirements of setting up a new business. This might include filing for business and sales tax licensing along with initial recommendations relating to a multitude of questions a new business owner regularly has.

After the business is established, an accountant can assist with many of the accounting-related functions of the business. This includes properly prepared financial statements, bank reconciliation, sales tax preparation, payroll tax preparation, and
other regulatory reporting requirements. Accountants can assist annually with the federal
tax preparation and state reporting requirements. As the business matures, the business
owner should discuss the business’ needs with his accountant on a regular basis. Also,
budgeting and even exit strategy planning will become key discussion items that the
accountant will need to coach the business owner through. The accountant also is often a
key player in the communication with the other advisers.

Attorney

Attorneys are often looked to when a problem arises and legal advice is needed to help
resolve the concern. They can also play an important role in the formation of the
business and preparing documents that will help the business avoid future problems. If
you as the business owner have elected to form a legal entity, such as a limited liability
compny (LLC), corporation, or partnership, there are many legal documents that might
be required to properly establish and protect your business and its other owners. Many
businesses require special regulation and unique legal considerations, so an initial
consultation with an attorney for any new business is recommended. Additionally the
attorney should be considered whenever the business is challenged legally. There are many
specialties in law, and if a unique situation arises that requires specific legal assistance,
the business owner would be wise to consult with the proper attorney to resolve the legal
challenge.

Banker

During the life cycle of a business, there are usually numerous occasions that require
additional capital. Financing may be required to start the business and support the business
in the early years until a revenue stream can become large and consistent enough to maintain
the business. As the business matures, a reliable banker can also support the business needs
to acquire equipment, finance growth or develop new products. Well- managed financing
can be the cornerstone of a successful business. Banks often go through lending changes, so
regular correspondence with your banker is advised. The need for financing for the next five
to ten years should always be evaluated to properly communicate the needs to your banker.
This will help provide opportunistic planning that will lead to a simpler approval process
and better conditions for financing. Also always discuss your bank’s available services with
your banker; many banks can provide you and your business with added services.
Financial Adviser

Financial advisers can play an important role during all phases of the business cycle. If a new business owner is funding the start-up of the business, his current financial portfolio will need to be managed to meet the short-term needs of the business. As the business matures, a focus on retirement and investment savings becomes a more important goal of the business owner. Therefore, the financial adviser should consider the various risks and needs of the business owner on a regular basis. Although it is important that all the business advisers stay connected, the financial adviser and the accountant should consider communicating with the business owner at least annually. Tax law changes and investment planning strategies often provide various planning opportunities throughout the business life cycle, which keep these two advisers connected. One final measure of a business’s success can be the sale of the business, often providing substantial cash for the owner to invest.

Insurance Adviser

A wide range of insurance needs are common for a new business owner. Although more details are provided later in the book as to the different types of insurance, we want to remind the new business owner here to consider building strong relationships with the various insurance providers.

Information Technology (IT) Expert(s)

Not only do the traditional IT needs of a business, like hardware and software need to be considered and managed, but other important aspects—like information security, system backups, power supplies, internet providers, along with a host of similar technology-driven items—need to be evaluated. Most businesses collect a wide range of information for customers, employees, and other businesses. That information must be kept secure, and the risk of loss of such information must be mitigated. Consider partnering with an IT professional who not only can meet your immediate perceived needs but also provides direction in areas with which you might be unfamiliar.

Other Advisers

There are a number of other business-related advisers that can assist a business owner during the business’ various phases and changing needs. They might include consultants, coaches, and marketing experts.

As with all your advisers, please evaluate not only your own needs and expectations but also the qualifications and experience of your advisers. Although most advisers have
an interest in your success, some are also out there to take advantage of unsuspecting business owners. Ask for referrals, do your research, and find ways to measure your success in relation to your advisers. Your good decisions and strong, trusted adviser relationships generally spawn greater opportunity for success and help avoid costly mistakes.

Most qualified advisers have experience with franchises. The next chapter discusses the pros and cons of buying a franchised business.
Chapter 5

Buying a Franchise or Starting from the Ground Up

Most business owners start or join an independent business, others decide they stand a better chance for success by buying a franchise. If after reading this chapter you crave additional information consider more in-depth research on websites like www.franchising.com that help educate prospective business owners about the franchise industry including the Pros and Cons. Books like Franchising in Canada: Pros and Cons by Michael M. Coltman even provide additional statistical information about independent and franchise businesses.

Whether you have been consulting with trusted advisers or have just started your research, many prospective business owners will need to closely evaluate the decision to buy a franchise or take the more independent approach and start a business your own way.

Franchise: A business contract in which an independent business (the franchisee) sells or markets the products and/or services of a larger firm (the franchisor). The franchisee often receives training and marketing support from the franchisor and pays a fee for the ongoing support. Some franchises that you’re probably familiar with are McDonald’s®, Subway®, CITGO, Stanley Steemer, The UPS Store®, and Fantastic Sams®.

When prospective business owners work with a franchisor, they will typically go through more research and be exposed to greater planning that can lead to greater understanding of the business and a better opportunity for success. Also, the franchise can expose you to other business franchise owners who can share problems and solutions allowing you to be less prone to make the same mistakes they made. Owning a franchise can be like working with a good advisory team or mentorship team that can provide you a greater opportunity for your own business success.

A franchise provides prospective business owners with a systematic approach to business ownership that has been proven successful and is then basically packaged up for reproduction. The franchisor gives the franchisee a detailed list of procedures to follow that helps the franchisee start and manage the business. The franchisor also has strict guidelines that control the operations, products, and services of the franchisee. If
the franchise is well managed, the franchisor can offer added value to the franchisee. The franchisor may be able to invest in marketing techniques that, for the franchisee, would be unattainable due to the pooling of resources. Some franchisors can also develop buying power and pass savings on to the franchisee.

Generally the start-up cost of a franchise is more than a similar type of non-franchise business due to the cost involved with paying the franchise fee and specific requirements the franchisor may have. Some non-franchise business owners may elect to postpone costs that most franchisors require prior to opening. The requirements of the franchisor are designed to take the risk out of starting a new business (which does not always happen—we can all recognize failed franchisees that have closed where we live and work). There is no sure thing when it comes to opening a business, even a franchise. Business owners themselves often play a key role in the success of the business.

Advantages of Buying a Franchise

Franchise businesses often eliminate some of the guesswork in starting and running a business. The franchisor will provide the framework for the new business, and other franchisees often become a primary source of information that is shared among the various franchisees.

Disadvantages of Buying a Franchise

The ongoing royalty fees that are paid to the franchisor are one area of franchise ownership that you should understand and be comfortable with. Some franchise owners perceive great value in the franchise fees and the ability to help their business. Others look at the franchise fees as an anchor. Be sure you understand what the royalty fees are and be sure you are comfortable with the payments, as they will generally be there for as long as you own the business.

Summary

Owning a business is a dream of many people, and a franchise provides that opportunity to thousands, if not millions, of business owners. To help determine if franchise ownership is right for you, do your research. Talk to franchisees and franchisors. Research what type of business you would like to own, and look at the risk involved.

Start your research by performing an online search of “most successful franchises” and “least successful franchises.” The results change every year, so it will be important to do the research when you are considering franchise ownership. As you start to narrow your selection, dig deeper into your list of franchise considerations. Search online for
ownership satisfaction statistics, customer satisfaction statistics, and industry statistics to help solidify your choice of franchise.

Your personality may help point you in the right direction. If you like a systematic, disciplined approach to owning and operating a business, a franchise might be a good option. If you resist conformity and thrive on creativity, you might be better off not committing to a franchise. Keep an open mind and evaluate all your options. Arm yourself with knowledge. When looking at business ownership opportunities, people tend to lean in one direction or the other, franchise or independent business. Both have advantages and disadvantages, and we hope this chapter helps lay the groundwork for helping you make the right decision.

The U.S. Census Bureau reported on Tuesday, September 14, 2010, that franchise businesses accounted for 10.5 percent of businesses, from data collected in 2007. Of the 4.3 million total establishments surveyed, 453,326 were either franchisee- or franchisor-owned businesses,\(^\text{ii}\)

Now that you have decided what kind of business you want to own, it is time to start doing some more in-depth planning and business analysis. Whether you buy a franchise or start your own business from the ground up, your business will be more successful with a business plan.
Chapter 6

The Business Plan: Creating the Map to Your Success

Previously, in the chapter on franchises, we talked about the systems and fundamentals that are required by the franchisor to be a franchisee. These systematic approaches to starting a business are required because they help lead a new business to success. So why don’t all business owners do thorough business planning? The answer is that they should. Whether they have chosen to buy a franchise or decided to create their own unique business, the next item on their to-do list should be extensive business planning.

**Business Plan:** A business plan is a formal document which describes the business, details the goals of the business, and describes how those goals will be attained as well as the risk factors that may present problems.

There are a number of resources available to help assist you in preparing a business plan. Too many business owners think they have a good idea and decide that a good idea warrants starting a new business. If business owners take the time to prepare a business plan, they might find that risk factors, originally undetected, become evident in the business plan and decide against starting a new business. It is far better to invest the time in writing a business plan than to invest more time and money in a failed idea. After the business plan is prepared and the business started, keep the business plan available and revisit it every couple years. Make updates to the plan and use it as a working document to help aid your success.

**The Business Plan Overview**

A business plan will typically be made up of the following elements. Use a step-by-step process similar to this when outlining key points:
1. **Start with a description or story about the business.** The description should go into some details and talk about your vision, the market, and the people involved with the business.

2. **Include market analysis.** This should be considered to fully understand the market opportunities and the competition that is currently present, along with potential future competition.

3. **Prepare a SWOT report.** A SWOT report is a short discussion on the Strengths, Weaknesses, Opportunities, and Threats of your business.

4. **Include financial projections.** Do this initially, to get the company started, and then prepare an annual budget for the first few years.

5. **Include a marketing plan.** This should discuss in more detail how you plan to market the business.

6. **Detail key employees, daily operations, and staffing requirements.** Again, discuss the business at start-up and for the first few years.

Books that may be helpful are:
- *Successful Business Plan: Secrets & Strategies* by Rhonda Abrams
- *Writing a Convincing Business Plan* by Arthur DeThomas Ph.D. and Stephanie Derammelaere, MBA.

See the Further Reading section for additional information.

**Business Plan Information**

**Industry Profitability and Industry Potential**

Later in the book we will discuss key operating statistics to understand how your business is doing against other businesses in the same industry. Before you start a business, it is also recommended that you study the industry to determine the profitability levels and the potential revenue in that particular industry. This type of research can be done on all types of industries and should provide valuable information.

Research on a particular industry can be challenging and takes time. Be creative, use not only online resources but also consider interviewing other business owners, search out industry associations, and speak to their members or look for organizations that publish industry data.

If you have developed a new or unique product or service, you might want to consider doing an analysis of a similar product or service in a different industry. By doing the industry analysis you will begin to understand what makes a particular
business successful in its respective industry. That understanding might also give you a competitive edge that can lead to greater success.

Market Share Availability
Market share availability is important because you need to determine what kind of demand for your product or service exists in the market. Some market share analysis can be local—for instance a restaurant or small retail store. Other types of market analysis might be considered at the regional, national, or even global levels. A market analysis can be summed up as a report that discusses the who, what, why, where, when, and how of the product or service that you will sell or deliver to the customer or consumer. The more detail you can provide in the report, the better you will understand your market and the opportunities for success.

Analysis of Competition
Now that you studied the market share, you should have a good idea of who your competition is. You should study your competition to gain a competitive edge. When you have a competitive edge in business you create a greater opportunity for success. When you study the competition, think of yourself as a consumer, act like a consumer, and talk to your competitors’ consumers. Try to learn about specific people in your industry and what their current strengths and weakness might be. This knowledge will not only help you gain a competitive edge now but will also prepare you to be competitive in a world that is changing more rapidly than ever.

Cash Flow
A cash flow is different from a budget because a cash flow takes into account all sources of income. Most often business owners focus on the cash inflow from sales. In addition, cash can come from investors or lending sources. When you combine all sources of cash, you develop an understanding of the necessary funds needed to run and maintain a successful business. The reason you analyze sources of cash is that most businesses are faced with struggles or opportunities that will require cash. Being prepared and understanding what sources are available will help you position your business to be proactive rather than reactive when cash is needed.

Planning for your business can be a time-consuming task. Consider the benefits a well-thought-out plan will provide as you develop documents to not only support your business but also give you the opportunity to gather information and knowledge before you make the final decision to start your new business. This information might be what ultimately determines your success.

In addition to your business plan, a strategic marketing plan will help both you and any investors make decisions about where to focus your marketing efforts and spend
marketing dollars. The next chapter reviews the components of this important document.

Chapter 7

Strategic Marketing Planning

Strategic marketing planning is the most important component to achieving business success; however, it is also one of the most overlooked areas contributing to business failure. This chapter covers strategic marketing planning and tactical planning. A sample strategic marketing plan is included, which can be used as a quick guide to help you develop your own plan.

Businesses today operate in a complex, fast-paced, quick-changing environment. Marketing planning is a process for coping with these changes. Marketing is everything a company does to get in front of a customer whether it’s face to face or via e-mail, website or the telephone. Most successful companies that I have seen are market driven and follow a long-term strategic plan.

The three-year strategic marketing plan is preceded by the annual tactical plan. The three-year strategic marketing plan is a written document outlining how the business is perceived in the market relative to its competitors, what the objectives are that will be achieved, what resources are required, and what results are expected. In my opinion, three years is the perfect window for planning. In today’s fast-paced, quick-changing world, any plan longer than three years could make the plan only a guess.

The strategic marketing plan will be used by management to run the company and to stay focused on the goals. It will also help management communicate the strategy to investors and creditors. Not only must management write up the plan, but all key stakeholders must buy into the goals. This is usually done starting with a one- or two-day retreat followed by a number of follow-up meetings. The following are the major components included in the strategic marketing plan:
• **Mission Statement:** defines the company’s core values, business definition, core competence, and future indicators.

• **Financial Summary:** summarizes the financial implications over the three-year planning period.

• **Market Overview:** provides a brief picture of the market including; structure, threats, and segments.

• **SWOT Analysis:** Strengths, Weaknesses, Opportunities, and Threats—the strengths and weaknesses of the business, the opportunities presented by its customers, products or services and the threats against it.

• **Assumptions:** must be tested as they relate to the marketing objectives and strategies.

• **Marketing Objectives:** defined by the profits, sales, value, and market share that the business wishes to achieve.

• **Marketing Strategies:** State how the objectives are to be achieved, which include product or service (the benefit to the customer), price (how it is priced to attract the right customers), place (who their customers are), and promotions (how they can be reached).

• **Budget Requirements:** broken down by year, by product, or service and are to include detailed revenue and costs associated.

• **Pricing:** High pricing can work against free referral marketing, and low pricing can erode profits. Value creation should drive your pricing model as well as competition.

Tactical Marketing Planning

After your strategic marketing plan is completed, you’ll want to have an annual tactical marketing plan, which is similar to a to-do list. This will cover what detailed programs will be implemented and include detailed scheduling and costing of tactics by year.

Successful marketing planning is the cornerstone of a solid, progressive, innovative, and profitable business. Given the rapidly changing business environment and high number of variables that influence profits, proper ongoing strategic marketing planning will enable a company’s vision to become a reality. A detailed list of elements in a tactical marketing plan is included in Chapter 26. The timing of implementation, the budget for each element, and management responsibility should also be included.

Sample Strategic Marketing Plan

**ABC123 Computers Inc.**
1. Mission
ABC123 Computers Inc. will focus on serving the small-business market located in Rhode Island and nearby Massachusetts. The company will provide hardware, software, and network support using a proactive service plan. This plan will preserve data integrity, minimize downtime, and maximize system usage and efficiency. The company will work with clients who want a strong service relationship and who value integrity of support.

2. Financial Summary (projected)

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<th></th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
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<tbody>
<tr>
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<td>Hardware and Software Cost</td>
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<tr>
<td>Net Income</td>
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</table>

3. Market Overview
The current marketplace is represented by large, institutional companies who overcharge and have continuous technician turnover and weak relationship building. The smaller companies lack customer service and are limited in technical knowledge.

4. SWOT Analysis

**Strengths**
- Twenty-five years of experience
- Strong knowledge of hardware and networks

**Weaknesses**
- Needs more education on social network sites and search engine optimization

**Recommendations:** seminars, articles, and education

**Opportunities**
- Growing usage
- More consistency
- More processes
- More dependent on computers

**Threats**
- Disposable hardware
Online software
Remote support

Disposable hardware will reduce the need for an outside consultant. Online software will reduce the need for network consultants. Remote support will drive down the repair profits.

Recommendations: change with the times by serving what customers need.

5. Marketing Strategies
The following will be performed on an ongoing basis:

• Develop a quarterly newsletter program that directly asks for referrals and additional work.
• Build a strong relationship database.
• Send handwritten thank-you cards to all referral sources.
• Show up on time (ten minutes early).
• Do what you say you are going to do.
• Always say please and thank you.
• Be proactive.
• Develop a simple website.
• Develop a thirty-second commercial, a way to ask for referrals, and a way to ask for more work.
• Consider a letter-writing campaign.
• Turn your business card into a mini brochure, and include it with all mailers.
• Develop a referral postcard.
• Consider joining a BNI® networking group.
• Join local chambers, and make it a goal to give everyone your business card.
• Consider telemarketing for appointment setting.
• Consider hiring a part-time sales representative.

6. Pricing
Material pricing—gross profit will be 30 percent on items greater than $50 and 50 percent on items less than $50.
Labor pricing—will be $120 per hour with write-downs for rework and inefficient projects and write-ups for special knowledge learned from other clients or from continuing education. Develop proactive retainer pricing. Labor will
make up 60 percent of the gross profit, and product sales will make up 40 percent.

In summary, a strategic marketing plan clearly outlines what steps you will take to market your business and promote sales. It is an invaluable document.

Marketing Books

The following marketing, relationship, sales, and strategy books have been hand selected after reading over two hundred books. These are the best ones for small businesses. Be careful when reading other books on the subject, because books written for medium and large businesses may lead you in the wrong direction.

- The Referral of a Lifetime: The Networking System That Produces Bottom-Line Results... Every Day! (The Ken Blanchard Series) by Tim Templeton with Lynda Rutledge Stephenson
- Guerrilla Marketing for Free: Dozens of No-Cost Tactics to Promote Your Business and Energize Your Profits by Jay Conrad Levinson
- Raving Fans: A Revolutionary Approach to Customer Service. by Ken Blanchard and Sheldon Bowles
- Book Yourself Solid: The Fastest, Easiest, and Most Reliable System for Getting More Clients Than You Can Handle Even if You Hate Marketing and Selling by Michael Port
- Purple Cow: Transform Your Business by Being Remarkable. by Seth Godin
- Never Eat Alone: And Other Secrets to Success, One Relationship at a Time by Keith Ferrazzi & Tahl Raz
- You Can't Teach a Kid to Ride a Bike at a Seminar: The Sandler Sales Institute’s 7-Step System for Successful Selling by David H. Sandler and John Hayes
- Close the Deal: 120 Checklists for Sales Success by Sam Deep and Lyle Sussman
- Mr. Shmooze: The Art and Science of Selling Through Relationships by Richard Abraham
- How to Win Friends & Influence People by Dale Carnegie
• *The Likeability Factor: How to Boost Your L-Factor and Achieve Your Life’s Dreams* by Tim Sanders
• *Endless Referrals, 3rd Ed.* by Bob Burg
• *How to Become a Rainmaker: The Rules for Getting and Keeping Customers and Clients* by Jeffrey J. Fox
• *Secrets of Great Rainmakers: The Keys to Success and Wealth* by Jeffrey J. Fox
Chapter 8

Partnerships and Agreements for Multiple Owners

The dedication of each owner to a shared vision is the first step in starting a successful partnership. Each owner might have a different personal goal, but the company goals and direction should be consistent to take the best advantage of opportunities. As a team, owners are combining forces to react more quickly and efficiently to business opportunities. The partners must be very cautious of others and avoid creating unnecessary tension that can begin to erode the advantages of the partnership.

Based on our experience, it is often this tension between partners that can create additional challenges that can eventually result in the failure of the partnership and can even result in the failure of the business. Long and prosperous partnerships are not always necessarily fair ones; the partners, however, have a strong understanding that as a group they are more successful than they can be individually. The partners often take on very different roles within the business, which creates diversity and the opportunity for each partner to be personally successful.

Because partnerships are faced with the risk of losing partners or disagreements among partners, it is highly recommended that the parties involved do some additional planning to try to avoid challenges that can not only tear apart strong personal relationships but also tear apart the business itself.

Communication

Although we can see the value of open communication between owners, there also needs to be a leader and decision maker for specific judgments or specific tasks. It might be related to divisions, such as operations or sales, or it might be assigned as an overall responsibility to a specific partner. Other decisions may require the collaboration of partners’ opinions to come to an agreeable solution. It is often recommended that one partner or group of partners have a majority, at least 51 percent ownership, to avoid a deadlock on a decision. A deadlock can drain the energy from the partners and the business, causing obvious concern for the success of the business. If decisions cannot be
made efficiently and with the trust of the partners, the business will have a difficult time maintaining a competitive edge.

Flexibility

Change is inevitable when it comes to business. All the planning in the world will not prepare you for the challenges that are created within a partnership. The understanding, commitment, and flexibility of the partners are what will determine the long-term success of the partnership. Sales could fall short or exceed expectations, staff might change, or key operational components might change. When these dramatic events occur, the flexibility of the partners and the business might be the most important aspect of the partnership to lead the business in a new direction for success.

Important Partnership Documents

Creating the proper documents is a required step for a partnership to be successful and deal with changes that occur during the life of the partnership. Nearly all partnerships will go through some kind of ownership change, and it is better to be prepared for the change rather than be reactive because your documents are not in order. Every year we consult with clients relating to changes to their partnership. These changes often involve family or close friends, and if the proper documents don’t exist, these partnership changes can create so much tension that they ruin the fabric of the family relationship or friendship. Take the steps needed to create the following documents.

**Partnership Agreement:**

All partnerships should start with a partnership agreement. The partnership agreement can be made up of a number of separately described agreements. For example, the partnership agreement might include how the company will be funded and what each partner will be investing. It most often includes a general statement about the type of business the partnership will be conducting and may even provide details around the individual partners’ job descriptions. Based on each partner’s particular job, it will also talk about how partners are compensated and how profits and losses are split among owners. In addition to the general operations, the agreement should contain provisions as to how and when a partner’s interest in the partnership is sold or purchased and when dissolution of the partnership would occur (Like a buy-sell agreement). A qualified attorney should be considered when drafting and reviewing the partnership documents. These documents help avoid litigation that can be very costly to the partners and the business.

The Center for Disease Control (CDC) provides studies and reports with detailed statistics on the success and failure rate of marriages in the United States. It would be
interesting to see what type of information would be available if they were also able to study and report on the success of business partnerships.

It can be said a partnership is a bit like a marriage. You must trust, respect, and have the commitment to work together for a common goal. It is also common to hear that a partnership will never last, which is true because we will either outlive the business or the business will outlive us. Here are some pointers on making a business partnership last:

**Ten Ways to Make a Partnership Last**

1. Never insist on being right.
2. Work with your partner; teamwork is the key.
3. Start with rules and review documents when necessary.
4. Don’t embarrass or criticize your partner in front of others.
5. Be communicative, not confrontational.
6. Recognize mistakes, but forgive and move on to new business.
7. Embrace challenges and work together to resolve them.
8. Share in the successes of the partnership.
9. Don’t let outside distractions affect the goals of the partnership.
10. Be positive, have fun, and applaud your partner’s efforts.

Especially for partnership-based businesses, advisers are typically very helpful in uncovering areas that need to be researched, discussed and, if necessary, documented with agreements among the partners. Although partnerships are unique and very popular, there are also other business forms and structures that are discussed in the next chapter.
Chapter 9

Business Format and Tax Structure

Every business owner needs to make a decision about the business format and the tax structure within which they will operate. Make this decision before your business begins. The options include sole proprietorship, partnership, limited liability company (LLC), or corporation. Each of these is taxed differently. You will need to consult with your attorney and accountant to confirm that your business format provides you with the best liability protection appropriate for your business. Changing this format is possible in later years, but you will spend more money in professional fees and possibly taxes than making the best long-term decision at the beginning.

The business format choice is made first for legal reasons and second for tax reasons. Forming a separate entity to operate your business helps to keep legal problems restricted to the assets of your business and prevents them from affecting the owner’s personal assets. In today’s business environment, the two most popular choices are an LLC or a corporation. Due to the flexibility of organizing an LLC and less stringent annual record-keeping requirements, many new businesses are formed as LLCs. Other entity choices are a general or limited partnership or a sole proprietorship. Neither of those options will provide the legal liability protection that the corporation or LLC provide.

The simplest business format for a business owner is the sole proprietorship. Similar to the partnership, it does not offer any legal liability protection. Many businesses that start as a hobby or second job may use the sole proprietor entity but should always be considering the change to either an LLC or a corporation. The ability to separate the owner’s personal net worth from the business’ is a major advantage in forming an LLC or corporation. Once a business is using either employees or independent contractors, the owner should consider the change to a separate legal entity for the business. The potential of someone misrepresenting the business fraudulently, or ethically, significantly increases as the business grows. Insurance coverage is very important and will be covered in Chapter 18, but keeping the business as a separate entity is the first line of defense.

We recommend that a business selects a business format before the business starts. Unfortunately we have worked with many businesses that never form the separate entity
and get too busy to make the decision later. Spending the time and investing the money in the beginning will be easier than doing it after the business is running.

Business Forms and Taxes

Making the business format choice should be done with both your attorney and accountant so that both the legal liability and tax consequences are considered. Everyone starting a business anticipates having profits quickly. Of course, you will have to pay taxes on those profits, but good planning will help minimize how much you pay. Each of these business formats are taxed differently. There is not one answer for every business, so working with your team of advisers will help you sort through the options.

There are two major tax characteristics of any business format. Either the tax on the profits will be paid by the business or the profit will flow through to the owners who pay the tax personally. The major advantage of a flow through tax entity is that the profit will be taxed once on the owners’ individual tax return. Businesses that pay the tax themselves may create another tax that the owners will pay from their salaries.

One advantage an LLC has over a corporation is that it can choose the method of taxation. There is not an LLC tax return form. A single-member LLC can choose to be taxed as a sole proprietor, a C corporation, or an S corporation. A multimember LLC could choose from a partnership, a C corporation, or an S corporation. It is important to keep the business format separate from the tax form that is filed. The flexibility of the LLC can create some confusion, but overall it is a good business format choice.

Tax Returns and Filing

Here are details about tax forms and how each of the business forms are taxed.

**Sole proprietors** will file a Schedule C on their personal income tax return, which is a simple income statement for their business. In addition to paying the 15.3 percent self employment tax that is comprised of Social Security and Medicare, the taxable profits will also be subject to federal, state and any related local income taxes for the owner. The owner will be taxed on the profits of the business, not based upon how much money the owner draws from the business. Often the amount the owner draws and the taxable profits are not the same number, so an accurate accounting throughout the year is important to prepare for the tax that will be due.

**Partnerships** file a Form 1065 federal income tax return. Most states and some city or county jurisdictions also have partnership tax returns. The taxation of the partnership is very similar to the S corporation. The differences are that a partner does not take a salary but withdraws the profits as they are available. All profits allocated to a non-
passive owner may be subject to the self-employment tax. There is not an easy way to separate the income that is subject to employment taxes verses the business profits, like there is in an S corporation. One advantage partnerships have over corporations is that they are able to allocate the profit or losses to the owners with a different percentage than the ownership percentage. Generally a business with passive investments, such as real estate investments, would choose to be taxed as a partnership. Non-passive businesses that have owners working in the business would normally elect to be taxed as an S corporation.

**S corporations** file a Form 1120-S federal income tax return. Most states and some city or county jurisdictions also have corporate tax returns. This return reports the profits of the business and how much profit each owner needs to report on their individual income tax returns. The profit is reported on the owners’ Schedule E and is not subject to the self-employment tax. The owners will include this income with all other taxable income and pay tax based upon their individual tax rate. If there is a loss it will flow through to the owner’s individual income tax returns and, depending on the owner’s basis, may be allowed to offset other income.

A simple definition of “basis” is the total of the money originally invested plus the taxable profits and less the tax losses each year and less the profits distributed to the owners. The basis calculation is one of the more complex issues in S corporation taxation. A schedule of the owners’ basis needs to be maintained from year to year.

The owners that work in the S corporation business (not just investors) are required to take a reasonable salary. These wages are subject to all the taxes any other employee is required to pay. One of the biggest issues for an S corporation is how much the owner’s salary should be compared to the profit distributions. Because the profit distributions are not subject to employment taxes, there is an advantage in paying out the profits rather than paying a salary. However, the tax law requires that a reasonable salary be paid to all working owners. You will want to discuss with your accountant the appropriate allocation of salary and profit distributions for your business.

To elect to become an S corporation, you must file a Form 2553 within seventy-five days of the start of the tax year. If the election needs to be made after that deadline, there are many exceptions where the IRS may allow a late filing. There are some rules that would not allow a C corporation or LLC owner to elect to be an S corporation. For example, all owners must be either U.S. citizens or U.S. residents. There are other requirements to qualify as a small business corporation that must be met before you can make the S corporation election. But with some planning with your advisers, most small businesses would easily qualify.
C corporations pay tax on the businesses profits by filing a Form 1120 federal income tax return. Most states and some city or county jurisdictions also have corporate tax returns. The C corporation will pay the tax on the profits based upon the federal corporate income tax rates that start at 15 percent for the first $50,000 of profit and go as high as 35 percent for profits over $100,000. If the owners of a C corporation decide to distribute profits to the owners as a dividend, an additional tax will be paid on the owners’ personal income tax return. Because the same profits can be taxed twice, most small businesses will not want to be taxed as C corporations but rather as S corporations or partnerships. Most small-business C corporations will pay bonuses to the owners before year-end to eliminate or greatly reduce the profits. You must have an up-to-date accounting system in place to be able to make this decision before the end of the year. If the business has a loss, no tax will be paid and it will be used to offset either past or future years’ profits. Estimated tax payments must be made by the corporation each quarter to all the taxing agencies.

If your business is in a separate business form, make sure that personal expenses are not comingled with business expenses. If an LLC or corporation is not run separate from the owners’ personal and household expenses, you will lose the liability protection. If your home mortgage, utilities, or credit card bills are paid from the business checking account, you run the risk of “piercing the corporate veil.” If you hear that term in court, it means the judge does not consider that you have formed a separate entity, so your personal assets may be at risk. This is very easy to avoid by making sure all personal expenses are paid from your personal checking account and business expenses from the business checking account.

Owners of flow-through entities must pay their taxes each quarter with estimated tax payments. An S corporation owner will also have income tax withheld from their paycheck. It is very important that the estimates are paid to meet the safe-harbor rules so that penalties are not paid. You must meet one of two rules to avoid paying a penalty for underpaying your income taxes. Either you pay in 100 percent (or 110 percent if your adjusted gross income is over $150,000 on a joint tax return) of your prior year’s tax paid evenly throughout the next year or pay at least 90 percent of the tax that you will owe for the year. For example, if in the last tax year your total tax was $8,000, then you will make four quarterly payments of $2,000 on the fifteenth of April, June, September, and January. Or if you estimate that your taxes will be $10,000 for the year, you need to pay at least $9,000 throughout the year and pay the balance when you file your tax return. Keep in mind that if you pay what you paid last year but the current year is more profitable, then on April 15 when you file your tax return, you will owe more tax. Not only that, but you will also owe the first quarterly payment for the new year, which will be higher than the last year's payments.
## Figure 9.1 Business Formats and Taxes

<table>
<thead>
<tr>
<th></th>
<th>Sole Proprietorship</th>
<th>Partnership</th>
<th>S Corporation</th>
<th>C Corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net Income</strong></td>
<td>Included on owner's form 1040</td>
<td>Included on partners’ form 1040</td>
<td>Included on shareholders’ form 1040</td>
<td>Tax paid by corporation</td>
</tr>
<tr>
<td><strong>Tax form</strong></td>
<td>Schedule C on 1040</td>
<td>1065</td>
<td>1120-S</td>
<td>1120</td>
</tr>
<tr>
<td><strong>Capital Gains</strong></td>
<td>Owner pays at capital gain rates</td>
<td>Passes to partners and pays at capital gain rates</td>
<td>Passes to shareholders and pays at capital gain rates</td>
<td>Corporation pays at ordinary tax rates</td>
</tr>
<tr>
<td><strong>Capital Losses</strong></td>
<td>Owner offsets other capital gains plus deducts $3,000</td>
<td>Passes to partners; treated the same as sole proprietor</td>
<td>Passes to shareholders; treated same as sole proprietor</td>
<td>Only deductible against other corporate capital gains</td>
</tr>
<tr>
<td><strong>Owner's Wages</strong></td>
<td>N/A</td>
<td>N/A</td>
<td>Treated as other employees</td>
<td>Treated as other employees</td>
</tr>
<tr>
<td><strong>Profit Distributions</strong></td>
<td>All income taxed as ordinary and is subject to self-employment tax whether distributed or not</td>
<td>All income taxed as ordinary and may be subject to self-employment tax whether distributed or not</td>
<td>Profits taxed as ordinary income whether distributed or not</td>
<td>Taxed as dividends on the shareholders' 1040</td>
</tr>
</tbody>
</table>
Business forms and their tax consequences warrant special attention and advice from professionals. This is not the time to do it yourself!

Do not let taxes put you out of business. Too many businesses fail because they do not consider how much tax they will owe. Tax planning should be done throughout the year so that there are no surprises when you file your income tax return.

Chapter 10


In this first section of the book, we talked about things you need to consider prior to going into business. In addition to the business, however, you’ll want to consider your family and personal life, and keeping them working too.

When you have a business you enjoy, it is so easy for the business to consume your life. So before you address the systems you need to run your business, you first need to coordinate life and business. This chapter is about how to make sure you run your business and don’t let the business run your life. In the scheme of everything it takes to succeed in business, the advice in this chapter may be some of the most difficult to enact.

As you climb the ladder of success, you will find the climb speeds up if you work on your job and not in it and if you work smarter and not harder. By working on your job you need to rethink how you do things to make sure you are always taking the most efficient and best route. Whereas when you simply work in your job, you tend to be like a robot, going through the same motions you went through in the past. Those who work in their jobs will often use the argument, “That is the way we’ve always done it.”
Don’t be afraid to rethink the old rules to improve on anything. There are two key concepts to consider here. First is how to make smart decisions about running the business. Second is coordinating personal and business life.

Make Smart Decisions in Running the Business

Most people go into business because they are technically very good at what they do. However, it is important to know what you don’t know. Henry Domke, a very successful photographer in a very specialized field of photography, put it best. Henry said, “People think I spend all my time in photography. Actually, I only spend 25 percent of my time on anything to do with photography. The other 75 percent is running the business, marketing, communications, and all the daily administrative work of business.” Thinking through what Henry said, I realized he put in very simple terms the reason most businesses fail. Most entrepreneurs are good at what they do, but they have no clue what else it takes to run a successful business. Thus, they only master 25 percent of what it takes to have a successful business. Anyone with their own business needs to step back and make sure they work on their business and not in their business.

Spend Time with Your Unique Ability®

Strategic Coach® is an entrepreneurial coaching organization that works with successful individuals to help them increase their income while also increasing their free time. One of the concepts taught by Strategic Coach is “Unique Ability,” which is the essence of what you love to do and do best, in all areas of your life. It is a tool that identifies your unique talent and passion, and allows you to create value with maximum satisfaction and success. It’s important for you to focus solely on your Unique Ability® Activities™ and to delegate any tasks that do not fall into your area of Unique Ability to others who do have a Unique Ability in those areas. This frees you up to focus only on what you do best, leading to higher productivity, greater results, and a more enjoyable way of life. For more information on the Strategic Coach® program and the Unique Ability® concept, please visit their website www.strategiccoach.com.

Take Your Family and Friends with You

Family and friends are number one. As the author who had to put this section to words, I had to look back at my personal life. The person from whom I learned the most about life is my wife and best friend. I must admit I was a slow learner and I probably failed more courses than she cares to admit, but she taught me that family is truly the most important part of life. I always wanted my kids to be perfect because, of course, I was, and rather than let them experience things for themselves, I always wanted to do things for them or correct things when they got done. Over time I finally learned that the best
way to learn is through our own failures. I also realized that if we didn’t have time for our kids when they were young, why should we expect them to want to make time for us later in life? If you only take one piece of advice from this book, take this one I learned from my wife: There is nothing more precious in life than family, and no one ever said on their deathbed that they wished they had worked more.

Understand It Is Not about You

On a recent business trip we were with a very successful business owner, and during our conversations he spoke of the time he held a gun to his head but at the last second could not pull the trigger. He had been an extremely successful salesman, and the company he worked for assigned him a private jet in which he would fly around the country to give motivational talks. One day his wife told him he either needed to give it up or he would have no family, so he decided to retire to farming his one thousand-acre farm. Six months later, when there were no longer any crowds and no one looked up to him at every turn, he decided to commit suicide because there was no longer any value to life. As he sat with the gun to his head, he heard the Lord tell him, “If you stop taking all the credit and start giving the credit, I will give you all the riches you could ever want.”

After that he started his own very successful business, which today he has handed over to his children, and he now spends a lot of his time doing charitable work and helping others. We all like to feel indispensable, but in reality we are not the most important people in other people’s lives. It is not about you!

In summary, you need to understand that a successful business involves so much more than being a very good technician. You need to learn the other 75 percent of what it takes to run the business and regularly set uninterrupted time to work on your business and not in your business. Then, once you go home, make family the same priority you made your business when you were at work, and understand the world does not revolve around you. As a business owner, if you implement the items discussed in this chapter you will experience what others have found. You will have a substantial increase in profitability of your business and a substantial increase in time off for personal life.

Now that you have a basic understanding of the lifestyle adjustments that come with successful business, let’s get to the daily details of running the business. No business operates without a good understanding of financing, so let’s start there.