

## **STARTING YOUR NEW BUSINESS**

*Our Guide For You*

### **InVision Chartered Professional Accountants**

Box 6688, 9811 - 98 Ave.  
Peace River, Alberta T8S 1S5  
(780) 624-3830  
Fax (780) 624-4645  
Toll Free 1-800-268-2549  
Visit: [www.invisioncpa.com](http://www.invisioncpa.com)

# **INVISION CHARTERED PROFESSIONAL ACCOUNTANTS**

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## OUR FIRM

We are an exciting firm. In operation since 1970, we have earned a reputation as a progressive firm offering high quality service and advice.

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Our firm works hard to stay current. This means we are much more than people who just work with numbers. Our skill at providing financial services, tax planning and preparation, and business problem solving for all types of corporations, small businesses, farming operations and individuals extends far beyond to create a special relationship, geared to provide the special service you deserve.

Please visit our website at [www.invisioncpa.com](http://www.invisioncpa.com) to become more familiar with the many services our firm offers, as well as the partners, associates and staff that provide them.

## **INTRODUCTION**

The purpose of this package is to provide information and answer some of the questions asked by people going into business for the first time.

Many new businesses and a large percentage of existing businesses acquired by new owners will fail within the first five years of operation. There are several mistakes made in acquiring or starting a new business that are common to many business failures.

The most common causes for these failures are:

1. Making poor business decisions because of inadequate financial information.
2. Starting a new business for which there is not an adequate market.
3. A bad location for your business within the community.
4. Starting a new business with too little capital.
5. Paying too much money for an existing business.

Don't be too eager to get into business. Take time to investigate the shortcomings of a particular business. Many people starting a business, especially first timers, have stars in their eyes and fail to heed the danger signals. Use your accountant, your lawyer and your banker to avoid some of the problems encountered by many new businesses.

## **FORM OF OWNERSHIP**

There are three basic forms of legal entity under which a business can operate. They are proprietorship, partnership or corporation. You should seek the advice of your accountant and/or solicitor to determine the legal entity which is most appropriate to your particular circumstance.

### **Proprietorship**

A proprietorship is a business owned and operated by one individual. It is the simplest form, with little need for complicated legal and business agreements. The business name does not have to be registered, and simple accounting and financial reporting is normally all that is necessary. Many businesses start out in this form. This form also carries the most risk. Should your business be unsuccessful or should you be sued, your personal assets are at risk and may be seized by your creditors. If your business is really successful, this form also leads to the highest tax cost and least amount of tax deferral.

### **Partnership**

This form of business is used when two or more persons start a business. A partnership agreement is needed to cover allocation of profits and to cover the possibility of the death or disability of one of the partners, or disagreement amongst the partners. With the above exception, partnerships and proprietorships are very similar.

### **Corporation**

A corporation is a separate legal entity which exists under the authority granted by law. A corporation has substantially all of the legal rights of an individual and is responsible for its own debts. It must also file income tax returns and pay taxes on income derived from its operations. Typically, the shareholders of a corporation are protected from the liabilities of the business. However, when a corporation is small, creditors often

require personal guarantees of the principal owners before extending credit. The legal protection afforded the owners of a corporation can far outweigh the additional expense of starting and administering a corporation.

This form of business offers the most protection for personal assets and the most flexibility for tax planning purposes if your business is successful. The legal and financial reporting costs are the highest of the three forms and therefore many businesses ensure they are profitable before incorporating. Many banks, lending institutions, insurance companies and even other businesses prefer dealing with a corporation. Corporations are usually a sign of being more permanent and successful than the other forms of business.

### **Tax Implications**

The tax implications of using these three forms of ownership are as follows:

The proprietorship and partnership are treated very similarly from a tax perspective. A proprietor determines his profit from the business and it is included in his personal income for the year. The income of the business is considered the same as the income of the proprietor. Similarly, with a partnership the partners allocate the profit between the partners as specified in the partnership agreement and each partner includes his share of the profit or loss in his personal income for the year. Partnership taxation is one of the most complex sections of the Income Tax Act, so professional assistance may be of value. The complexity does not arise in the calculation of each partner's share of the income, but rather as the result of a change in value of the partnership interests. There are tax considerations if a new partner is admitted, a partner retires or dies, or the profit allocation is adjusted.

A corporation on the other hand, being a separate legal entity, is subject to tax on its income. When this income is paid to the shareholder, it is subject to tax in his hands. As a result of this double taxation, proper tax planning requires that you consider the total tax burden of both the corporation and the shareholder.

## **OWNER / MANAGER REMUNERATION**

There are two methods of transferring monies from the corporation to the owners - salary or dividends. Salaries are a deductible expense to the corporation and taxable to the recipient as employment income. Dividends are not deductible to the company, and are taxable to the individual. Perhaps the most important tax planning decision to be made by the owner of a corporation is whether to use dividend or salary to withdraw funds from his corporation. The following comparison outlines the advantages and disadvantages of paying a salary vs. dividends.

### **Salary Advantages:**

- a) deductible to the corporation and thereby reduces the corporation's taxes payable;
- b) qualifies as "earned income" for purposes of contributing to an RRSP;
- c) considered as earnings for Canada Pension Plan purposes.

### **Disadvantages:**

- a) deductions at source are required and the company must pay the employer's share of Canada Pension Plan.

### **Dividend Advantages:**

- a) qualifies for the dividend tax credit on the personal tax return.

### **Disadvantages:**

- a) does not qualify as "earned income" on which RRSP contributions are based;
- b) dividends are not deductible to the corporation, but are taxable to the recipient;
- c) does not qualify as earnings for purposes of Canada Pension Plan.

In determining the most appropriate mix of dividends and salaries, the basic objective is to minimize the tax liability of the shareholder and the corporation. As a result, the following factors should be considered:

**Disadvantages (cont'd):**

- a) corporate tax rate;
- b) individuals tax bracket;
- c) whether the individual requires a salary base for purposes of Canada Pension Plan or to make contributions to his Registered Retirement Savings Plan.

It should also be stressed that a salary can be paid to any employee, including relatives. However, dividends can only be paid to shareholders.

Paying a salary to family members with a low tax bracket is a common tax planning tool, but care should be taken to ensure that the payment approximates the value of the service performed by the individual. It is easier to justify a higher salary if the relative performs an executive function, rather than clerical duties.

There are complicated rules that can affect how dividends are taxed personally, so it is important to talk to your accountant before paying dividends, especially to shareholders that are not active in the business.

## **BUSINESS OR HOBBY**

Canada Revenue Agency makes a very important distinction between a business and a hobby. If the activity is a business, then the profit is included in income and any losses that may have been generated are deductible against income from other sources, such as employment income. If the activity is determined to be a hobby, then the profit is not taxable, but any losses are not deductible against other sources of income. This may appear to be reasonable, but in reality is biased against the taxpayer. If there is a loss from the activity, Canada Revenue Agency may rule that the activity is a hobby and losses will not be deductible against income from other sources. If there is profit from the activity Canada Revenue Agency will probably decide that the activity is a business. If you are carrying on a business that may generate losses, it is important that Canada Revenue Agency recognize your activities as a business, rather than a hobby. The difference between a business and a hobby is the expectation of profit. The only test is not whether you generate a profit, but rather your activities must be such that it is reasonable to expect that a profit may be generated after considering all of your expenses. Should you attempt to determine if your activity has a reasonable expectation of profit, be sure to distinguish between profit and revenue. Profit is after expenses, while revenue is your gross receipts. Profit is the key, not revenue.

## **PERSONAL SERVICE BUSINESS**

A Personal Service Business (PSB) essentially means a corporation hired under the same terms as an employee. It generally involves individuals working through their corporations who are controlled and directed like employees, work exclusively for the employer for a long time, and have little independence in an entrepreneurial sense.

Should a corporation be viewed as a PSB the laws significantly restrict the deductible expenses, making them similar to those of an employee; the tax rate applicable on any income earned is increased by almost 30%; and double taxation can result if the shareholder is taking dividends as remuneration instead of wages.

Please seek the assistance of your accountant to help determine whether these rules would apply to your circumstance and what can be done to mitigate your risk exposure.

## **COMMENCEMENT OF BUSINESS ACTIVITIES**

For an amount to be deductible on the grounds that it was an expense incurred for the purpose of gaining or producing income from a business, the taxpayer must have been carrying on business in the period in which the expense was incurred. Therefore, where an individual proposes to undertake a business and make some initial expenditures with that purpose in mind, it is necessary to establish whether they preceded the commencement of the business or whether the business had in fact commenced and they were expenses incurred during preliminary steps leading to the start of normal operations. Consequently, the date when the business can be said to have commenced must be known. It is not possible to be specific about the point in time when a contemplated business becomes an actual business. Generally speaking, it is the tax department's view that a business commences whenever some significant activity is undertaken that is an integral part of the income-earning process in that type of business or is an essential preliminary to normal operations. In order to determine if a business has commenced, it is necessary that there be a fairly specific concept of the type of activity to be carried on and a sufficient organizational structure assembled to undertake at least the essential preliminaries. This requirement is applicable whether the projected business is intended to be a continuing one or is to be a single transaction in the form of an adventure in the nature of trade. Where an activity consists merely of a review of various business possibilities in the expectation or hope that information will be obtained to justify going into a business of some kind, that activity does not represent the commencement of a business. A business would be viewed as being merely contemplated for the future if no serious or reasonably continuous efforts are being made to begin normal business operations. It must be stressed that it is imperative that the business be operating prior to incurring any expenses. If this is not the case, the expense will not be deductible for income tax purposes.

## **TRANSACTIONS PRIOR TO INCORPORATION**

When a business is commenced or purchased by persons with the intention that it will be carried on by a corporation, it often happens that transactions occur before the actual date of incorporation. Because the corporation does not exist in law before the date of incorporation, transactions occurring before the incorporation date cannot legally be accounted for by the corporation. The Alberta Business Corporations Act provides that a corporation may, within a reasonable time after it comes into existence, adopt any written contract made in its name or on its behalf before it came into existence. Upon such adoption, the corporation is bound by the contract and is entitled to the benefits thereof as if it had been in existence at the date of the contract and had been a party to the contract. The tax department will normally accept the accounting for pre-incorporation transactions of a newly formed corporation if the following conditions are met:

- a) The facts clearly indicate that it was the intention that the business was to be carried on by a corporation. This will usually be so where application for incorporation is made before or at the time the business is commenced or purchased.
- b) The period of time between the commencement or purchase date and the incorporation date is relatively short.
- c) There is no dispute between the persons authorizing the transactions and the newly formed corporation as to who will account for the transactions.
- d) The effect on the combined tax liabilities of the parties involved is negligible.

### **Transactions Prior to Incorporation (cont'd)**

- e) The corporation adopts any written contract made in its name or on its behalf before it came into existence in respect of the pre-incorporation transactions it is accounting for.

Notwithstanding the comments above, the Tax Department will not accept the accounting for pre-incorporation transactions in the corporation where the proprietor or the partners of an existing business incorporate, except where they incorporate a newly acquired business.

Taxpayers should not assume that the Department will automatically accept pre-incorporation transactions carried out in the circumstances described above as being transactions of the newly formed corporation. That determination can only be made after all the facts are known and after all of the relevant returns have been filed and examined. With minimal effort, transactions prior to incorporation can be minimized, thereby preserving the deductibility of most expenditures.

## **ACCOUNTING & BOOKKEEPING**

Most operators of a new and growing business have a flair for working in the environment in which the business operates. They may be a great salesperson, an outstanding mechanic, carpenter, lawyer, or inventor. Unfortunately most people don't like to keep books. As the owner of a business you must remember that your company's books and financial statements represent a score sheet which tells how you are progressing, as well as an early warning system which lets you know when and why the business may be going amiss. Financial statements and the underlying records will provide the basis for many decisions made by outsiders such as banks, landlords, potential investors, and trade creditors as well as taxing authorities and other governing bodies. The necessity for good, well organized financial records cannot be over emphasized.

### **Financial Records and Bookkeeping**

One of the greatest mistakes made by owners of small businesses is not keeping good financial records and making improper or poor business decisions based on inadequate information.

Quality financial information does not necessarily translate into complicated bookkeeping or accounting systems. Far too often owners of businesses become overwhelmed by their accounting system to the point where it is of no use to them. An accounting or bookkeeping system is like any tool used in your business; it needs to be sophisticated enough to provide the information you need to run your business and simple enough for you to operate it (or supervise the bookkeeper). As your business grows, you should work closely with your accountant to ensure that your accounting system is providing you with appropriate information.

## **Accounting Records and Record Keeping**

Another question which the owner of a business must answer is - who will keep the books of the business? Will you do it yourself, will the receptionist or a secretary double as a part-time bookkeeper, will you have a bookkeeper that comes in periodically, or will the volume of activity be such that a full-time bookkeeper will be required?

Very often the owners of a business decide to keep the books and underestimate the commitment they have made to other phases of the operation and the time required to maintain a good set of financial records and books of account. As a consequence, the record keeping is often low priority and must be caught up later. This approach, though rarely planned, can require a substantial expenditure of time and money to correct at a future date. While it is important for the owners of a business to maintain control and stay involved in the financial operations of the enterprise, this can be achieved by maintaining a close control over the check signing function and scrutinizing certain records. Your accountant can develop a good program of record keeping duties for you, your employees and any outside bookkeepers.

## **Bookkeeping Programs**

There are a number of well designed, easy to use accounting software systems that are commercially available. The most commonly used are Sage 50, QuickBooks and AgExpert. Reputable online programs include Sage Business Cloud and QuickBooks Online. The desktop versions of the software work best on the Windows platforms and may not work as well on other platforms.

While these programs are designed to simplify bookkeeping and are relatively user-friendly, they must be used correctly as once poor quality financial information is input, they will generate poor quality information. To maintain the smooth operation of a computer based accounting package, either in your own business, with a service bureau or through your accountant, it is imperative that you generate accurate information to be

### **Bookkeeping Programs (continued)**

entered into the system. The real value of the bookkeeping program becomes apparent once it is running smoothly in your business. Your accountant can then function in the capacity for which he was trained, not as a "number cruncher", but as your business advisor, consultant, and strategist. Both of you can focus not on producing reports for various regulatory agencies, but on analyzing your business to make it more profitable.

### **Internal Control**

What is internal control? It is the system of checks and balances within a business enterprise which helps to ensure that the company's assets are properly safeguarded and that the financial information produced by the company is accurate and reliable. When you're operating as a "one man shop", or at least handling all of the company's financial transactions, maintaining good internal accounting control is relatively straight forward. However, when your company grows to the size where you must delegate some of the functions it becomes more difficult to ensure that all the transactions are being accounted for properly. No matter what the size of your business, you should always be able to answer "yes" to the following questions:

- a) When my company provides goods or services to customers, am I sure that the sale is recorded and the revenue is recorded in accounts receivable or the cash is collected?
- b) When cash is expended by my company, am I sure we received goods or services?

No matter what the size of your enterprise, you should consider controlling your business and safeguarding hard earned assets as a priority from the outset.

## **BUSINESS REGISTRATION**

Newly incorporated Canadian corporations must obtain a business number. Recall that transactions occurring before the incorporation date cannot legally be accounted for by the corporation. Similarly, the tax department requires every incorporated business to have a business number before reporting any tax, G.S.T. or payroll information. For unincorporated businesses (such as partnerships and sole proprietorships), they are required to have a business number for G.S.T. and payroll only.

The smoothest method of registration is online using the Business Registration Online (BRO) tool, designed to assign business numbers as well as registering for G.S.T. and payroll. This can be done by searching the words “Business Registration Online” in a search engine or at [www.canada.ca](http://www.canada.ca). Ensure to have all personal and business information available, including physical land location, mailing address, social insurance numbers of all owners, description of the major business activity and incorporation detail. Once completed, you will be able to print the business number for your reference.

Another method is to call the tax department at 1-800-959-5525. All of the same information will be necessary to register under this method.

Finally, if you need additional assistance, your accountant can help in obtaining this number.

## **G.S.T. (GOODS AND SERVICES TAX)**

If your business will have annual revenue of \$30,000 or more, you will be required to register for G.S.T. This means you will have to collect G.S.T. on sales of your goods and/or services. You will also be able to claim the G.S.T. which you have paid on purchases. If your business has revenue of less than \$30,000, you may still wish to register.

Registration for G.S.T. is done online at the Business Registration Online website or over the phone to the Canada Revenue Agency's business line at 1-800-959-5525. You will be asked to provide the following:

- a) Business Number (if the business has already been registered)
- b) amount of your annual taxable purchases
- c) fiscal year-end
- d) effective date of registration

Once you have registered, Canada Revenue Agency will ask you to choose your filing frequency. This may be monthly, quarterly or annually, depending on your annual sales volume and to some degree on your desires.

It is very important to have accurate accounting records to ensure that you are claiming all the input tax credits (i.e. G.S.T. paid) that you are entitled to. It is equally important to ensure all documentation is in the name of the business reporting the G.S.T. and claiming the input tax credits. If a purchase (such as a vehicle) is in the name of the shareholder instead of the corporation, for example, the input tax credit will be disallowed by the tax department.

## **PAYROLL**

The hiring of employees is common to most new businesses. Once an employee is hired you must consider the following:

### **Tax Withholdings**

As an employer in a small business you are required to deduct tax, Canada Pension and Employment Insurance from wages earned by your employees. These amounts must then be remitted to Canada Revenue Agency by the 15th of the following month. This registration is similarly done online at the Business Registration Online website or over the phone to the Canada Revenue Agency's business line at 1-800-959-5525. You will be asked to provide the following:

- a) Business Number (if the business has already been registered)
- b) date employees received their first wages
- c) months covered for payroll of employees' wages
- d) type of pay period (for example, weekly, quarterly)
- e) number of employees

It should be noted that in most cases, any amounts not sent in by the 15th of the following month are subject to a non-deductible 10% late payment penalty.

### **Workers' Compensation**

Workers' Compensation applies to the majority of employers and workers in Alberta. The purpose of workers' compensation is to protect employees against the loss of earnings due to an injury that arose in the course of their employment. In return for paying assessments, the employer is protected against legal action by an employee who is injured or contracts an industrial disease during the course of his employment. The assessment paid by the employer is based on the employer's total payroll, the industry classification and its experience rating. The employer is required to notify the Workers' Compensation

### **Workers' Compensation (continued)**

Board within fifteen days of the commencement of employment and to provide specific information about his operations together with an estimate of the assessable earnings of his workers for the year. An account is then established in the name of the employer, and an assessment statement issued.

Self-employed individuals, partners in a partnership and directors of corporations are not covered by Workers' Compensation unless they make applications for personal coverage. Personal coverage may be applied for in any amount between Workers' Compensation Board's minimum and maximum coverage per person, but the requested amount should reflect actual or estimated actual earnings. To find out additional information or to establish an account you can access the Worker's Compensation Board at: Phone: 1-866-922-9221 (Toll Free)      Out of AB: 1-800-661-9608 (Toll Free)

Online: <https://www.wcb.ab.ca/>

### **Other employment standards**

Depending on what industry the business is operating in, there are employment standards related to hours of work, vacation and more. Ensure to visit the Alberta employment website to see what standards apply to your business.

<https://www.alberta.ca/alberta-employment-standards-rules.aspx>

## **SELECTING A YEAR END**

All proprietorships, professional corporations, and partnerships (where at least one member of the partnership is an individual, professional corporations, or another affected partnership) must report their business income on a calendar year basis.

Professional corporations, for these purposes, include the professional practice of an accountant, dentist, lawyer, medical doctor, veterinarian or chiropractor. Professional corporations are permitted in British Columbia and Alberta.

Individual corporations are allowed to select any day of the year that they desire as their year end. Normally a month end is selected for convenience of accounting records. Only the first year can be shorter than 12 months. When selecting a year end for a corporation, the following factors should be considered:

- a) There is normally more accounting and financial work to be performed following your year end. As a result, if your business is seasonal, it may be beneficial to pick a year end when business activities are slower.
- b) Most small businesses must pay the balance of their income tax three months following their year end. If the business has seasonal fluctuations in its cash flow, it should not pick a year end that will require the final tax payment in a month when cash flow is normally low.
- c) A profitable corporation must start paying tax installments in the first month of its second year. As a result, the maximum deferral of installments is achieved by having the first year end 12 months after the business started.

### **Selecting A Year End (cont'd)**

Once a year end has been selected it may only be changed with the permission of Canada Revenue Agency. A request must be made prior to the desired new year end outlining the reasons for the change.

## **CASH PLANNING AND FORECASTING**

The life blood of any business is its ability to collect cash, pay bills, pay its employees and its owners. Far too often small businesses are profitable, but they do not have enough operating capital to meet their current needs. Consequently, they may be forced to sell out to a stronger competitor, sell a portion of the company to investors at an undesirable price or close the doors and put the company out of business. None of these alternatives are typically what the owners intended when starting the business.

The ability to forecast cash resources and uses is an art and is by no means a well-defined science. None of us have a crystal ball and any cash forecast which is prepared by the management of a company or an outside consultant can be no more than a guess as to when the customers will pay and when your business will meet its obligations. Hopefully, the more effort that is put into cash forecasting the better the educated guess will be and the more accurate the resulting picture of the future operations of your business.

### **Starting the Analysis**

One of the most significant factors to be considered in your cash flow forecast is the volume of sales which will be generated in the next several months and for the rest of the period for which you intend to forecast. Your sales forecast must be as fine-tuned as possible. It is typically unrealistic to assume that there is a million dollar market for your product in your area and you will be able to capture a specified percent of it. A sales forecast needs to be based upon specific facts. These might include your sales history or the history of similar businesses you have owned or operated, or information on the competition. In your area of industry, what has been the experience of similar operations? In preparing a forecast, you must take into consideration items such as the seasonal effect of your business, the relative state of the economy and the period over which you will forecast.

### **Starting The Analysis (cont'd)**

Obviously you have more ability to forecast what your sales will be for the next month than you will for three to five years from now. The amount of detail which must be included in the cash forecast is really a matter of preference. It can be based on per-unit or an average sales volume per day, week or month of your type of business in its current environment.

### **Cash Collections**

Once you have determined a reasonable level of sales and you are comfortable with the forecast you have made, you must address questions such as: what percentage of my sales are received in cash, and what portion are credit sales for which I will have to carry accounts receivable? For those that are receivable based, how soon is the cash collected? Do I have to wait for customers to pay me or do third parties such as Visa or Mastercard take the customer's account and convert it to cash for me with an appropriate discount? If you are relying on customer payments for collection of receivables you must determine what portion of the receivables will be collected in thirty days, sixty days, ninety days and thereafter, and what portion, if any, may never be collected. Other sources of cash may be available in addition to sales. Do you expect to bring in a partner or other investors, or can you borrow money from a bank? When will you receive the cash and how much will you get? Part of your cash flow analysis may be to determine how much investment money or borrowings will be required to operate your business. Once you are comfortable with the cash receipt side of your business and the timing of the collections of funds from your sales and other sources, it is necessary to consider the expenses and other cash needs of your business operation.

## **Disbursements**

In most businesses you are required to purchase inventory and pay operating expenses and wages prior to earning any revenue. This may require a significant outlay of cash before the first dollar of sales is generated and received. You should consider how often and in what amount your employees must be paid and when their payroll taxes are due. Additionally, you need to know the credit trade terms your suppliers are willing to advance to you. Do you have to pay for items on a C.O.D. basis or can you pay for them thirty or forty-five days after receipt? Once you have determined the cost of operating your business you need to consider what other expenses you must pay to keep the doors of your business open. You typically will have to pay rent for your office or shop. If you are opening a new business, you must consider what your cash requirements are to make your facility ready for your specific needs. Will you have to buy furniture? Will you need to make tenant improvements or pay deposits for utilities and other services? You also need to consider many of the overhead items and costs to open a new business that will hopefully be onetime expenses. This may be lawyer's fees for drafting partnership agreements or incorporating your business, the cost of obtaining business licenses, setting up an accounting system, stationary costs and costs of signs or logos. It is imperative to make the list as detailed as possible to ensure that you have sufficient funds to make your operation ready for business prior to running out of cash. The more detailed the list and the more information you can provide, the less chance there is of unpleasant surprises as you move towards opening your business. In addition to determining the amount and volume of expenses and cash outlays you will have to make, it is critical to determine the timing of such payments. Some of the start-up costs which you incur may be delayed or deferred until you can generate the cash from your operation to help pay them. This needs to be carefully analyzed and factored into your cash flow analysis. A good rule of thumb

### **Disbursements (cont'd)**

is to assume that you are going to have to pay your expenses sooner than you think and that you will collect your cash slower than you anticipate. If you work with this attitude any surprises should be favorable ones.

Cash flow projections can be very slow, time consuming and tedious to undertake. Your accountants can help you prepare the cash flow, but the critical factor is that they only help. You, as the owner and operator of the business, are the only one truly qualified to develop your cash flow projections. You know what it takes to open and operate your business. Your accountant can offer guidance, ask pointed questions to be sure you are considering all the costs of operating a business, and assist with the drafting of the cash flow in an acceptable format. However, the more effort you put into developing the cash flow projections the more accurate they will tend to be. This exercise may also help you to pinpoint areas of potential cash savings which you had not otherwise considered.

## **OBTAINING CREDIT & FINANCING FOR YOUR BUSINESS**

Unless you are independently wealthy and perhaps even if you are, eventually you will probably need to obtain some outside capital for your business. You may need to obtain capital for the initial expenses prior to opening your business or for expansion or for working capital during the off season. Generally business financing can take two forms, debt or equity. Debt, of course, means borrowing money. The loans may come from family, friends, banks or other financial institutions. Equity relates to selling an ownership interest in your business. How do you get the money? Irrespective of the type of financing you need and are able to obtain for your business, the process of obtaining it is similar in each case. There are several questions that must be answered during the course of raising money for your business. Your ability to answer these questions is critical to your success in obtaining financing as well as the overall success of the business. Remember, in raising capital you have to sell the ability of your business to potential investors in much the same way as you sell your product to your customers.

### **Obtaining Credit and Financing for Your Business**

- a) How much cash do you need?
- b) What will you do with the money?
- c) What experience do you have in running your business?
- d) What is the climate for your type of business?
- e) How and when will the capital be returned to them?

Once you have developed concrete answers to these and other pertinent questions, you can begin looking for financing. One of the first steps is to determine whether to raise funds through debt or equity. There are positive and negative aspects to each type of capital. The cost to your company for each type of funding is different, as is the way in which they are treated for income tax purposes.

## **Debt Financing Sources**

### **Banks**

The first source of funds which typically comes to mind when borrowing money is a bank that is why they are in business. Banks typically lend to small businesses on a secured basis using equipment, inventory or accounts receivable. The more liquid and readily saleable the assets you have to offer as security, the more acceptable they are likely to be to a banker. Loans from a bank may take several forms such as:

- a) A line of credit which allows you to borrow up to a predetermined maximum as you need it and pay it back as funds from sales and receivables are collected.
- b) A short term demand note which is payable in full on a specified date.
- c) A term loan for the purchase of a specific asset.

### **Lease Financing**

In today's business environment it is quite common to acquire equipment through lease agreements. Leasing packages come in a variety of types through many sources. Leasing companies typically will accept a somewhat higher degree of credit risk because they are looking to the value of the equipment for collateral if your business cannot make the agreed upon payments. For this reason, leasing companies generally prefer to finance new equipment of a general purpose nature which can be resold if necessary. Leases often run for a period of three to five years and because of the risk that leasing companies are willing to take, they charge a higher interest rate than on commercial bank loans.

### **Trade Credit**

A very important source of financing for your company may be from the vendors and suppliers with whom you do business. Many suppliers will originally ask for cash on delivery or in some instances they want payment before starting on your order, depending on the nature of your purchase. Most suppliers will quickly establish trade credit with you

### **Trade Credit (cont'd)**

once you have gained their confidence by continuing to do business with them and paying as requested. Establishing good relationships with trade creditors is essential because it allows you to use the goods and services in your operations and sell your product to your customers, in some instances, before you pay for them. The trade credit you build today will be relied upon by other vendors as you attempt to establish yourself with other vendors in the future. Trade credit terms will vary depending on the type of purchase you make, the industry you are buying from and the industry you are in.

### **Equity Financing Sources**

Equity financing usually means selling a portion of your business. This can be accomplished in a number of ways including the sales of common or preferred stock. Equity sales are usually carefully tailored to meet the needs of both the company and the investor.

### **Private Individuals**

Individuals, who are successful in their own right and have accumulated wealth, may be looked to for investment in your business venture. Such individuals may believe that the success of your business may enhance theirs as well as help increase their personal wealth. These individuals very often want to participate in the management activities of your firm and help guide your progress through representation on the Board of Directors.

## INSURANCE

Business insurance, like many types of expenditures, is one of those items which business owners typically do not like to pay. You must remember that sufficient insurance can be as critical to the success of your business as a good product or service. Without proper insurance you could lose all of the money, time and effort you put into your company. The types and amounts of coverage you purchase must be evaluated on a cost-benefit basis like any other commodity which you purchase. Your accountant and insurance agent can help you review the types and amount of coverage you may wish to purchase. You will usually want to insure against risks which could have significant detrimental impact on your business. This normally would include such items as fire, storm damage, theft, general and product liability. Depending on the nature and size of your business it may be a good idea to self-insure for all or a portion of certain losses. Self-insurance can be accomplished by not buying coverage for incidental risks or increasing the deductible on policies which you do buy. Often, raising the deductible can have a very favorable impact on policy premiums. The administrative cost to the insurance company to process small claims is quite high, consequently the rates typically go down substantially if they are relieved of this expense. An insurance agent can provide you with comparative costs for various types of coverage with varying degrees of deductible amounts.

Insurance is like any other product which you purchase. Before purchasing it you should consult with more than one agent as to your needs for protection. You should discuss insurance needs with acquaintances in the same or related business as yours. Before buying coverage you should check out the reputation of the company that is underwriting the policy.

## **SELECTING PROFESSIONAL ADVISORS**

Starting your own business obviously entails a multitude of decisions; decisions which can seem overwhelming without the right players on your team. In order to succeed you need to equip yourself with every tool at your disposal.

One of the most cost effective tools you can utilize is the expertise of a specialist. The right accountant and lawyer can eliminate a host of problems and potentially costly errors you might make as you build the financial foundation of your successful business. Their expertise can help save you money which in turn can be used to increase profits.

When enlisting the expertise of an accountant and lawyer you want a specialist suited to meet your specific needs. You want a specialist who will listen to you. More importantly, you need someone you can and will listen to you as they devise strategies to help you succeed.

You want to succeed - and you can. By taking the time to make key decisions and enlisting the right players on your team - you will succeed!

We wish you success and welcome you to the wonderful world of free enterprise.