

Small Business TodaySM

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How Healthy Is Your Small Business?

Your Existing Business May Need a Check-up

March 9, 2007

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Most small business owners start their enterprises with the best intentions. Some seek professional advice right away, while others procrastinate, operating day-to-day with the full intention of “getting legal advice when we grow a little bigger.”

In my opinion, this approach to running your business is like getting a new car and never bothering to learn the first thing about car maintenance. I once heard a story about a woman who bought a car and drove it around for a very short time before it suddenly stopped running. She called the dealership irate about this lemon that only went a couple of hundred miles before breaking down. Apparently, she was unaware that the car required gas to go.

“Well,” I hear you say, “that’s ridiculous. I would never make a mistake like that.” But all too often that’s how we run our businesses—without the slightest clue of how it works or what it takes to keep it going. How will you know it’s time to get your business some professional help? Will you wait until you hear the sounds of sputtering and your company stops working?

Simply learning about your car’s fuel requirements doesn’t help, however, if you aren’t willing to fill it up. Or perhaps a more extreme example of maintaining your transmission is closer to the point. Most people know the consequences of refusing to learn about quick, cheap transmission maintenance are dire—costly replacement of the transmission.

With transmissions you understand the seriousness of caring for your investment, but you would be amazed at how many business owners avoid learning the first thing about how their company works. Too many wait until trouble arrives before finding out how to properly operate their business. By then, the cost of curing the problem is far higher than it would have been to just do regular maintenance, if it is possible to fix the problem at all.

The point is: if your business has been up and running for a few years without benefit of professional assistance, it’s probably time for a tune-up. After a while, it’s no longer a question of “if something will go wrong” but rather “when something will go wrong.”

What are some actions that can lead to trouble?

One issue that I frequently see in my practice is the failure to properly form the company to begin with. The process of organizing a company or incorporating is easy but not simple. Further, organizing your business is just the first step, after which you must actually run the darn thing. By “running your company,” I’m not talking about doing business in it but maintaining the company structure itself.

Small business owners who use accountants, “friends” or internet form companies to organize their business are short-cutting their liability protection from the outset. Rarely can a company be properly organized without the participation of a competent business lawyer.

Companies who skip this important step are typically missing out on key agreements and important education. Your lawyer should not only “get you a company,” but teach you what all of the forms mean and what your obligations are to maintain your company going forward. If you don’t understand how to run your company, you will not get many of the benefits you originally sought when forming it.

The next most frequent error by new business owners, after improper formation, is bringing in partners without properly documenting the relationship. This is an especially troublesome situation where one owner brings the money and the other puts in sweat equity. Without an explicit, written agreement there are almost never good answers when issues arise or if one partner dies or becomes disabled. That is because the issues were not considered when the company was formed. An experienced advisor will help you consider issues you have never thought about before they become a problem.

The next big issue, and one that can make you pay more taxes than you owe, is failing to properly document money that is put into or taken out of the firm. Is it a loan? Does it bear interest? Are you paying taxes on money twice? Can you get your money out if the company fails or is terminated? Who knows?

There are thousands of other decisions that go into making your business grow. Some key times for your business are when you add employees, when you start buying assets, when the business starts creating or inventing things, etc. The questions can be complex, but the resolution may be simple. Failure to address the questions as they arise is a recipe for disaster.

Did you know?

According to *Fortune Small Business*, 672,000 new companies were formed in 2005—30,000 more than 2004 and 12% more than 1996. 66% of respondents to a recent poll said they wanted to start a company someday and 37% said they hoped to do it in the next five years.

Attributing some of the boom in entrepreneurship to a loss of job security and decreased benefits of working in large firms, the article notes that in 2004 the number of firms with no employees (because the owners kept their day job) grew by 26% compared to 1997.

— Phaedra Hise, *Everybody Wants In*, FORTUNE SMALL BUS., February 2007, at 20-24.

Hey, what's the worst that can happen?

Some degree of professional involvement in your growing business is not optional if you plan to succeed. If you've managed to avoid such involvement in the past, there is no time to waste in seeking a review of your business structure and procedures. What you learn will undoubtedly surprise you and help improve the operation of your company.

Not all of the businesses I work with are disasters waiting to happen, however. Some owners use a business check-up to put their minds at ease about the state of their enterprise and pick-up pointers to improve how they handle issues that routinely arise. These are the ones who know the value of "nipping a problem in the bud."

Proactive owners know that waiting too long before checking on the state of their company can result in a host of problems including, but not limited to:

- inability to pass the value of business assets to heirs;
- inability to sell the business to an outside buyer;
- lawsuits between minority owners, vendors or customers;
- penalties for regulatory violations;
- challenges to the liability protection afforded by your corporation;
- tax audits, unexpected back-taxes and fines;
- undetected embezzlement by employees or co-owners;
- entry of unwanted owners into a small business; or
- the death penalty—involuntary dissolution of your business by the state.

Maybe you'll get lucky and never have to deal with any of these issues. But what if one of these problems is brewing in your company right now? Would you know it?

What should you look for?

In short: you need the name of a competent business lawyer and a CPA. Business check-ups are not a "do-it-yourself" project. Why?

First, because human nature is to handle things the way you always have. This kind of management by momentum can be especially dangerous because small problems, left unchecked, can compound, growing bigger and bigger. Boaters know when they are at sea to periodically check a point of reference and redirect their heading to stay on course. The same is true of your company. You need occasional professional consultations to ensure that your company stays on course and is headed for the destination you want to reach.

Second, because each business, industry and owner is different from every other, there is no one-size-fits-all "checklist" of what to look for. Each small business is truly unique, and with every bit of information gathered, the picture of their operation changes leading to an individualized set of special concerns and customized solutions.

For the sake of discussion, here are a few of the initial issues I typically explore with my new clients:

- 1) How well was your company organized (originally formed)?
- 2) Do you have company books?
- 3) Does your business have an accountant that you meet with to review your books at least annually?
- 4) Do you have adequate commercial liability, property and workers'

- compensation insurance?
- 5) Do you have owner meetings and keep minutes reflecting every power granted and all important decisions?
 - 6) Does your business have its own tax i.d. number?
 - 7) Do you and your company have separate bank accounts and credit cards, etc.?
 - 8) Are all money flows back and forth between you and your company properly documented?
 - 9) And, so on.

These questions are fairly rudimentary, but many business owners are stumped even at this level. The complete list of issues we address is far more

For more information on this subject, see these websites:

- ◆ Entrepreneurship rate, state-by-state:
http://money.cnn.com/magazines/fsb/fsb_beststates/2007/
- ◆ How small businesses are using technology to play big:
http://money.cnn.com/popups/2006/fsb/playbig_smallcos/index.html
- ◆ Tips on how you can play big:
http://money.cnn.com/popups/2006/fsb/playbig_howto/index.html

comprehensive and includes a review of all documentation touching on the questions. Through this process, we discover what your company needs to get back on track (if it has strayed) and stay there.

Will a business check-up prevent bad things from happening?

Not absolutely. But as with any check-up, diagnosing and addressing your business issues early can save your company thousands of dollars in legal expenses that it would need to cure a full-blown problem. It is a far better thing for your attorney to discover and solve your issues

confidentially than to find out you have a problem from a government regulator or in a lawsuit!

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