

*A Washoe County Law Library Community Service Program*

## **FREE LEGAL SEMINAR**

**ON**

# **Starting and Running a Small Business and Top 10 Legal Mistakes Entrepreneurs Make**

**Speakers:** Jeanne H. Yamamura, CPA, MIM, PHD  
Mark Smallhouse, Esq.

**Date:** Thursday, March 25, 2010

**Location:** Washoe County Law Library  
75 Court St., Old Courthouse

**Time:** 5:00 – 7:00 PM

***Due to limited space please sign up ahead of time by  
contacting the Law Library at 328-3250***

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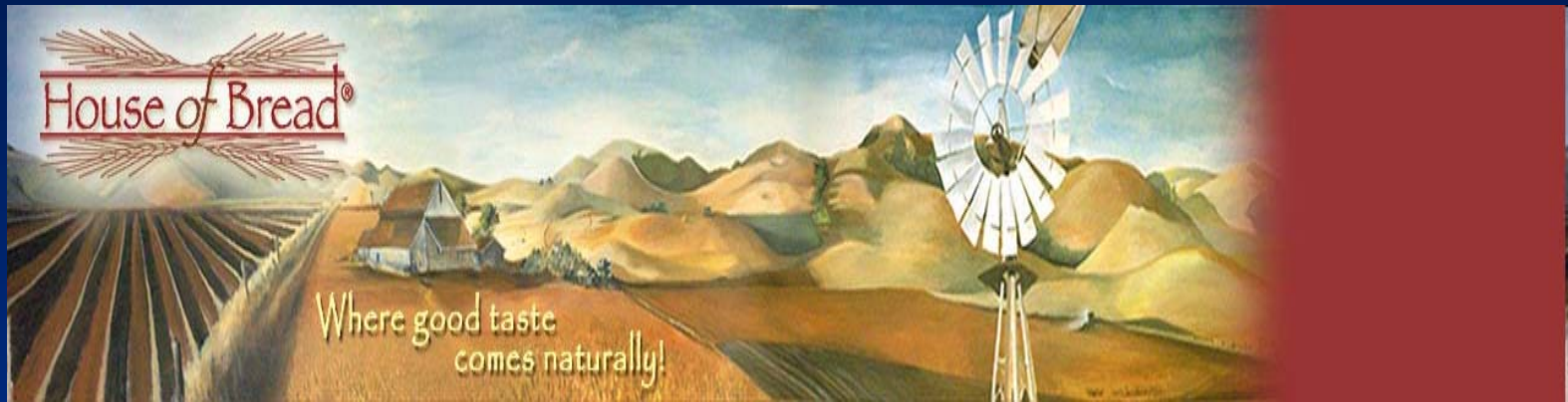


# STARTING AND RUNNING A SMALL BUSINESS

Jeanne H. Yamamura, CPA, MIM, PhD  
Chairman, Financial Literacy Committee  
Nevada Society of CPAs

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# HOUSE OF BREAD



- Eric & Chris Breeze
- Franchise
- Opened 2001

# SILVER PEAK RESTAURANT & BREWERY



The banner features two logos for Silver Peak. The top logo is for 'Silver Peak Grill & Taproom' with the text 'Enter' and 'ON THE RIVER GRILL & TAPROOM RENO NEVADA'. The bottom logo is for 'Silver Peak Restaurant & Brewery' with the text 'Enter' and 'RESTAURANT BREWERY RENO NEVADA'. The banner includes several images: a restaurant interior, an outdoor patio, a salad, a glass of beer with condensation, and a man smiling with a beer. At the bottom, there is a navigation menu with links: 'About Us', 'Silver Peak Restaurant & Brewery', 'Silver Peak Grill & Tap Room', 'Calendar', and 'Have a Party'.

Silver Peak Grill & Taproom

Enter

Silver Peak Restaurant & Brewery

Enter

About Us Silver Peak Restaurant & Brewery Silver Peak Grill & Tap Room Calendar Have a Party

David Silverman and Trent Schmidt

- Opened 1999
- Met working at Adele's
- Expanded to second location downtown

# KRISPY KREME

- Krispy Kreme in Reno closes due to economic struggles
- May 15, 2008
- 25 employees
- Fuel prices + 30% increase in corporate prices



# BUTCHER BOY

- Started 1974
- Opened 2<sup>nd</sup> location 2007
- 11/26/09 - **Butcher Boy stores to close next week**
- Bankruptcy filing 2008
- 37 employees



# SMALL BUSINESS IMPACT ON THE ECONOMY

Estimated 29.6 million small businesses in the US

- Employ just over half of the country's private sector workforce
- Hire 40 percent of high tech workers, such as scientists, engineers and computer workers
- Include 52 percent home-based businesses and two percent franchises
- Represent 97.3 percent of all the exporters of goods
- Represent 99.7 percent of all employer firms
- Generate a majority of the innovations that come from United States companies

# SMALL BUSINESS SURVIVAL RATES

## Small Business Openings & Closings in 2008:

- There were 627,200 new businesses, 595,600 business closures and 43,546 bankruptcies
- Seven out of 10 new employer firms survive at least two years, and about half survive five years.
- Findings do not differ greatly across industry sectors.



# TOP FIVE THINGS YOU NEED TO KNOW

1. Start with a business plan
2. Obtain funding to start the business
3. Set up the business
4. Understand the finances
5. Control your operations

# 1. START WITH A BUSINESS PLAN

You need a business plan – no matter what!

- It shows with how you plan to make a profit
- For small businesses, key components are
  - Break-even analysis
  - Profit-and-loss forecast
  - Cash flow projection
- Enables determination of projected start-up costs
- Identifies marketing strategies (how you will reach your customers)

# 1. START WITH A BUSINESS PLAN

If the numbers don't work on paper, they won't work in real life!!



# 1. START WITH A BUSINESS PLAN

## Start on a shoestring

- Don't rent an office if you don't really need it
- Use temps or independent contractors until you can keep employees busy full-time
- This will enable you to make mistakes without permanently sinking your business



# 1. START WITH A BUSINESS PLAN

Why are employees so expensive?

- They are paid whether or not you have work for them
- Social security, Medicare, federal and state unemployment, and workers compensation taxes must be paid
- Other benefits? Paid holidays, vacation, sick leave?
- Space and equipment
- Employee cost = 1.25 to 1.4 times base salary/wages

## 2. OBTAIN FUNDING TO START THE BUSINESS

- Important to know – how much capital (start up costs) do you need to start your business?
  - Making a product – raw materials, beg. inventory
  - Business premises – rent, buy
  - Employees – LOTS of costs related to employees
  - Business organization and registration - licenses
  - Insurance – liability
  - Advertising

## 2. OBTAIN FUNDING TO START THE BUSINESS

- Sources of capital – Debt vs. Equity
  - Loans (debt)
    - Usually payments required
    - Lender can call loan
    - Credit cards
    - Small Business Administration
  - Savings (equity)
  - Investments (equity)
    - Angel investors
    - Venture capital
    - Loss of control? May need to show profits quickly

## 2. OBTAIN FUNDING TO START THE BUSINESS

- Credit - FICO score
- Ranges from 300 to 850
- Based on five factors, including payment history, the amounts you owe and the types of credit you've obtained.
- Personal information like income, occupation, age and marital status not considered



## 2. OBTAIN FUNDING TO START THE BUSINESS

Freecreditreport.com



- Free credit report annually from
  - Equifax, TransUnion, Experian
- [www.AnnualCreditReport.com](http://www.AnnualCreditReport.com)
- Can access via phone, online, or written request
- You do NOT need to sign up for monitoring!

## 2. OBTAIN FUNDING TO START THE BUSINESS

Save up as much money as possible before starting

- It can take months or years for business to show profit
- Any cash may have to be invested back into the business
- What will you live on? Include living expenses for 1-2 years

# 3. SET UP THE BUSINESS



Partnership



Sole Proprietorship

# Corporation or LLC

# 3. SET UP THE BUSINESS

Why does it matter?

- Protection for your personal assets
  - Personal liability for all judgments and debts incurred by the business
  - Even if incurred by partners!!
- “Forgotten founder” can come back with BIG demands for ownership

# 4. UNDERSTAND THE FINANCES

Understand how – and if – you will make a profit and what it takes to run your business

- Requires knowledge of
  - Accounting
  - Cash flow
  - Analytical techniques
- Professional assistance (e.g., CPA)

# 4. UNDERSTAND THE FINANCES

## Accounting (Principles of Accounting)

- Accrual versus Cash
- Generally accepted accounting principles (GAAP)
- Financial statements
  - Balance sheet
  - Income statement
  - Statement of changes in retained earnings
  - Statement of cash flows

# BALANCE SHEET

## 12/31/09

### Assets:

Cash	\$1,000	
Accounts Receivable	5,000	
Fixed Assets	<u>10,000</u>	
Total Assets		<u>\$16,000</u>

### Liabilities:

Accounts Payable	\$2,000	
Loan Payable	<u>8,000</u>	
Total Liabilities		\$10,000

### Stockholders' Equity:

Capital Stock	\$3,000	
Retained Earnings	<u>3,000</u>	
Total Stockholders' Equity		\$ <u>6,000</u>
Total Liabilities & Stockholders' Equity		<u>\$16,000</u>

# INCOME STATEMENT

## Year ended 12/31/09

Sales Revenues	\$25,000
Cost of Goods Sold	<u>15,000</u>
Gross Profit	\$10,000
Operating Expenses:	
Sales and marketing	\$3,000
General and administrative	<u>2,000</u>
Total operating expenses	\$ <u>5,000</u>
Operating Income	\$ 5,000
Income Tax	<u>2,000</u>
Net Income	\$ <u><u>3,000</u></u>



# STATEMENT OF CHANGES IN RETAINED EARNINGS

Year ended 12/31/09

Retained earnings, 1/1/09	\$ -0-
Net income	3,000
Dividends	<u>-0-</u>
Retained earnings, 12/31/09	<u>\$3,000</u>

# STATEMENT OF CASH FLOWS

## Year ended 12/31/09

### Cash flows from operations:

Cash received from customers	\$20,000	
Cash paid for CGS and expenses	<u>(20,000)</u>	
Net cash flow from operations		\$ -0-

### Cash flows used for investing activities:

Purchased of fixed assets	<u>(\$10,000)</u>	
Net cash used for investing activities		(\$10,000)

### Cash flows from financing activities:

Capital stock issued	\$ 3,000	
Loan proceeds	<u>8,000</u>	
Net cash received from financing activities		<u>\$11,000</u>

Net change in cash		\$1,000
Beg. Cash balance		\$ <u>-0-</u>
End. Cash balance		<u>\$1,000</u>

# 4. UNDERSTAND THE FINANCES

## Cash Flow

- Profit  $\neq$  Cash
- You can never afford to run out of cash!
- Know your cash balance now
  - Enter activity daily and reconcile balance
  - Bank balance is NOT your cash balance

# 4. UNDERSTAND THE FINANCES

## Cash Flow

### Prepare cash flow projections

- Monthly, quarterly, yearly
- How quickly will customers pay?
- When will vendors require payment?
- When are loan and tax payments due?

# 4. UNDERSTAND THE FINANCES

## Analytical techniques (Managerial Accounting)

- Product costing
  - Direct materials, direct labor, overhead
- Fixed versus variable expenses
  - Fixed – stay the same
  - Variable – change in accordance with a factor, e.g., usage
  - Mixed – combination of fixed and variable

# 4. UNDERSTAND THE FINANCES

## Analytical techniques

- Break even analysis
  - How much do you have to sell to cover your fixed expenses?
- Contribution margin analysis
  - Can you afford a “special price” for an extra large order?
- Variance analysis
  - Why was actual different from budget?



# 5. CONTROL YOUR OPERATIONS

Internal controls are critical!

- In small businesses, guard against losses due to employee errors and fraud
- In beginning, owner does everything
- As employees added, need for procedures and oversight
  - Procedures ensure things are done the right way each time
  - Oversight ensures that errors or fraud are prevented or detected

# 5. CONTROL YOUR OPERATIONS



Internal controls – NOT JUST FOR BIG BUSINESS

- Checks and balances within a company
  - Prevent fraud
  - Limit financial losses
  - Reduce errors and omissions



# 5. CONTROL YOUR OPERATIONS

## Fraud in Reno, Nevada

- August 2008 – 61 year old Reno woman sentenced to 4 to 10 years in prison and ordered to pay \$485,461 in restitution for embezzlement from doctor's office where she worked for 7 years
  - Losses >\$800,000
  - Gambling addiction
  - Depositing insurance checks into personal account

# 5. CONTROL YOUR OPERATIONS

## Fraud in Carson City, Nevada

- September 2004 – Former head of Carson City's cable access television must serve 180 days in jail for embezzling \$77,500
  - Executive director
  - Wrote 400 checks to himself and to petty cash
  - Gambling problem
  - Repaid most of stolen money by tapping his wife's retirement fund

# 5. CONTROL YOUR OPERATIONS

- 2008 Report to the Nation – Association of Certified Fraud Examiners
- Small businesses — defined as those with less than 100 employees — suffered
  - A greater percentage of frauds (38%) AND
  - A higher median loss (\$200,000) than their larger counterparts.

# 5. CONTROL YOUR OPERATIONS

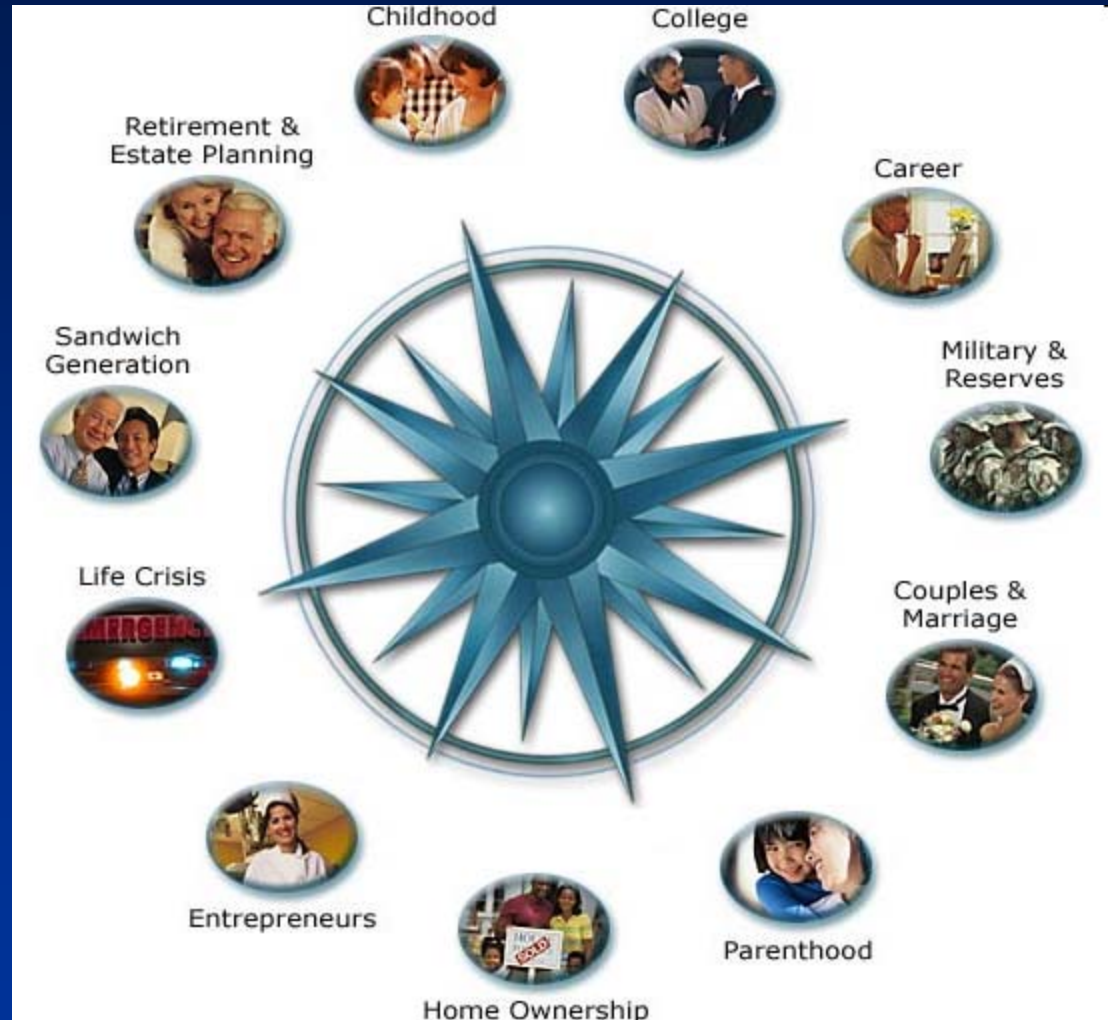
## Internal Controls

- Segregation of duties
  - Separate custody, authorization, recording
  - BAD IDEA: Letting one person “even trusted employee” write and record checks, make and record deposits, and reconcile bank account
  - BETTER IDEA: If you can’t stand the bookkeeping, at a minimum, have bank statement come directly to you unopened and review all contents; then review bank reconciliation when completed

# RESOURCES

AICPA – 360  
Degrees of  
Financial  
Literacy

- <http://www.360financialliteracy.org/>
- Life Stages -  
Entrepreneurs



# RESOURCES

## Articles

- Business Planning Basics
  - [A Small Business Plan for Uncertain Times](#)
  - [Qualifying for the home office deduction](#)
  - [Record keeping for your own business](#)
  - [Tax planning for the self-employed](#)

# RESOURCES

## Articles

- Insuring a business
  - [Properly insuring your business](#)
- Starting a business
  - [Advantages and disadvantages of self-employment](#)
  - [\*\*Choosing an entity for your business\*\*](#)
  - [Funding a business](#)
  - [\*\*Hiring your first employee\*\*](#)
  - [\*\*Starting or buying a business\*\*](#)

# RESOURCES

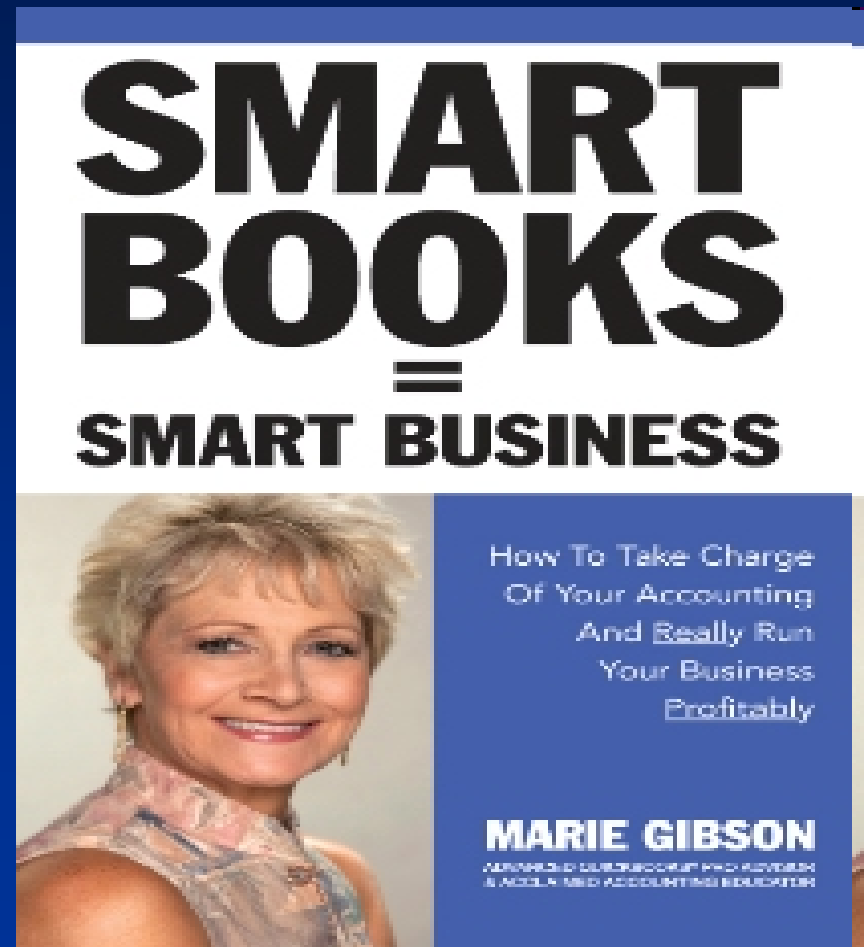
## Tools

- Business Planning Basics
  - [Breakeven Analysis](#)
  - [Business Valuation](#)
  - [Cash Flow Calculator](#)
  - [Choosing a business entity](#)
  - [Commercial Loan Calculator](#)
  - [Comparison of LLCs LLPs and professional corporations](#)
  - [Debt Consolidation Calculator](#)
  - [Equipment Buy vs. Lease](#)
  - [Financial Ratios](#)
  - [How C Corporations Limited Liability Companies and Limited Liability Partnerships Protect Personal Assets](#)
  - [Inventory Analysis](#)
  - [Net worth calculator](#)
  - [Profit Margin Calculator](#)
  - [Working Capital Needs](#)



# RESOURCES

Smart Books  
=  
Smart Business  
by Marie Gibson



# QUESTIONS?



# Top 10 Legal Mistakes Entrepreneurs Make

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# 1. Starting a Business While Working at Potential Competitor

- ▶ The law is clear—if you are currently working for a competitor; especially, if key employee—you cannot operate a competing business.
- ▶ Either quit before starting—or disclose to employer
- ▶ Avoid using previous employer's trade secrets
- ▶ Make sure co-founders or employees are not subject to non-competes/non-disclosure agreements

## 2. Failing to “Incorporate” soon enough

- ▶ The problem of the “forgotten founder”
- ▶ Avoid by setting up your entity at the inception
- ▶ Require that all founders assign all inventions, source code, and work related to the start-up to the entity as partial consideration for shares
- ▶ Issue founders shares that vest over time and only to those who take the venture forward
- ▶ Make sure that any Section 83(b) elections are timely filed

# 3. Failing to Protect Intellectual Property

- ▶ Determine if your novel idea is patentable
  - any person who “invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof, may obtain a patent”
  - Types of Patents
  - Term of Patents
  - Budget for and retain competent patent counsel
- ▶ Trade Secrets
- ▶ Trade names/Trademarks and Servicemarks
- ▶ Copyrights
- ▶ Make sure you obtain all rights from employees and independent contractors

# 4. Safeguard Confidential Business Information

- ▶ Prepare and use non-disclosure and confidentiality agreements
- ▶ Adopt a trade secret policy
- ▶ Require that all employees sign non-competition and/or non-disclosure and confidentiality agreements
- ▶ Designate and classify trade secret information
- ▶ Implement physical security measures—locked storage devices; passwords, TV cameras

# 5. Select the Right Type of Business Entity

- ▶ C–Corporation/S–Corporation/LLC/P.C.
  - Work with a Team of Advisors
  - Avoid sole proprietorships
  - Avoid general partnership
  - Evaluate tax ramifications
  - Evaluate Accounting Issues
  - Evaluate tax year considerations
  - Evaluate capital needs



# 6. Prepare a Detailed Business Plan

- ▶ Cover at least 2–3 years of projected revenue and expenses to determine capital needs and sources
- ▶ Determine capitalization and sources
- ▶ Comply with State and Federal Securities laws
- ▶ Make sure that Business Plan remains confidential
- ▶ Do not promise more than you can deliver

# 7. Respect Organizational Formalities

- ▶ Protection against personal liability for business debts requires:
  - Adequate capitalization—issuance of stock for capital
  - Carrying of adequate liability insurance
  - No commingling of funds
  - Keep minutes
  - Signed documents should reflect capacity
  - File required quarterly and annual reports
  - Pay employment taxes

# 8. Enter into Buy–Sell Agreements with Co–Owners

- ▶ Avoid having ex–founders as minority shareholders
- ▶ Cover the 4 D’s–
  - Death
  - Disability
  - Divorce
  - Dissolution
- ▶ Provide means for valuation, payment and capitalization
- ▶ Provide for succession planning

# 9. Draft Contracts to Prevent Legal Problems

- ▶ Habitually send written confirmations of agreements
- ▶ Create Standard Documents for Venders
- ▶ Use Venue and Choice of Law Provisions
- ▶ Limitations of Liability
  - Limitation to actual damages; waiver of other damages
  - Refund of money policies
  - Waivers of Express and Implied Warranties
  - Use Alternative Dispute Resolution Techniques

# 10. Failure to Adopt Appropriate Employee Policies

- ▶ Include At-Will Wording in all Job Applications and offer letters; prepare standard agreements for employees and independent contractors
- ▶ Prepare an employee handbook/Injury Prevention Plan
- ▶ Plan for and have performance reviews
- ▶ Establish a set procedure for employee discipline
- ▶ Know the do's and don'ts of sexual harassment

# 10. Failure to Adopt Appropriate Employee Policies (Continued)

- ▶ Negligent hiring and retention is a big problem as is employee theft and embezzlement
- ▶ 1 / 3 to 1 / 2 of all job applicants provide employers with information containing material inaccuracies
- ▶ Carefully Review All Applications
- ▶ Contact Previous Employers and References
- ▶ Verify Educational Information
- ▶ Conduct a Public Records Search

# Conclusion: Deal with Legal Problems at the Inception

- ▶ Avoid thinking that you will solve–patch up any legal problems once you are up and running and capitalized
- ▶ Excellent legal talent can usually be retained for relatively little money at the inception
- ▶ It will cost a lot less money to get it right at the inception–rather than trying to sort it out later