



A ROADMAP TO STARTING A SUCCESSFUL BUSINESS

NATIONAL INSTITUTES OF HEALTH

Office of Strategic Management Planning

<http://osmp.od.nih.gov>

and

Small Business Office

<http://sbo.od.nih.gov>

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FOREWORD

What is entrepreneurship? What does it mean to start a business and why do people attempt it? This guide was developed to teach you the basics of starting and maintaining a successful business, but first, let's look at the big picture-what is starting a new business all about?

An entrepreneur is someone who organizes, operates, and assumes the risk for starting a business. Many people take this risk because they want to work for themselves. For these people, the thought of working for someone else is not appealing. They would rather put their time and effort into something they can build themselves. One of the most compelling reasons for starting a business is the ability to control the direction it takes and fulfill a personal vision. Regardless of the reason, if you are planning to start a business, be ready for a great adventure-although there will be many challenges along the way, too.

The rewards of successful entrepreneurship are obvious, such as personal and financial fulfillment. However, to realize these rewards, you must first commit substantial personal and financial investments of your own over a long period of time. And there is no guarantee you will succeed. As a business owner, you must watch over every aspect of the business and pay close attention to the details. Be willing to learn from your mistakes and know when to make changes to meet the needs of your customers. Ultimately, you alone will be responsible for the quality of the products and services you offer. This means your reputation, as well as your livelihood, will be on the line.

Yes, entrepreneurship brings constant challenges, but many before you have faced the risks and come out on top. You can take this step if you truly want to, but you must be willing to learn many new skills. To assist you in your journey, this guide describes the foundational skills common to most small business startup efforts and provides references to additional resources. If you have the determination and vision to follow through, you may be on the road to success.

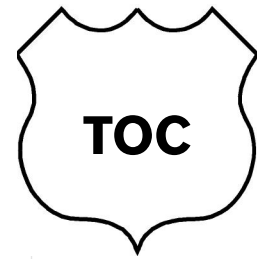


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INTRODUCTION

This guide is designed as a reference tool for individuals who are considering the path to small business ownership—and for those who have started the journey, but would like additional guidance. Remember that the information presented here is intended only as a starting point. The success of a business venture will require additional information and, most likely, professional advice beyond the scope of this guide.

A ROAD MAP FOR SMALL BUSINESS OWNERSHIP

Our goal is to provide a “road map” for navigating the major issues faced by small businesses as they move forward. Within these pages, you’ll find descriptions of the major requirements of small business ownership, sample documents, and references to many additional resources. This guide answers the following questions:

- ✓ What are the advantages and disadvantages of owning a business? Is business ownership right for me?
- ✓ How can the Small Business Administration help me get started?
- ✓ How can I protect myself from personal liability and find out about all required taxes?
- ✓ How can I find out which State and local laws apply to my business?
- ✓ Why is a business plan important and what should be in it?
- ✓ How can I raise the money I need to start my business?
- ✓ What is involved in marketing my products or services?
- ✓ How do I learn about the licensing, bonding, and zoning issues that affect me?
- ✓ What types of insurance will I need?
- ✓ How do I keep track of my finances?
- ✓ What are the basics of recruiting and hiring employees? How can I motivate my employees so they’ll want to make the business successful?
- ✓ How can I get a Web site up and running?

HOW TO USE THIS GUIDE

Each chapter of this guide begins with several “Learning Objectives” for the reader. The chapter then focuses on describing one topic related to small business ownership, providing general information on the topic, and directing the reader to additional resources. These resources include Web sites, books, addresses and phone numbers of helpful organizations, and sample tools and documents (some of which are provided at the end of the chapter).

We also use symbols, or “icons” throughout this guide to help the reader find key points. The information flagged by the icons falls into one of the following categories:

“Buzzwords” are key terms relating to the chapter topic. You should become familiar with these definitions, as they’ll assist you in making critical business decisions. The icon that indicates a Buzzword is shown below:



A “Caution” warns the reader about challenges or precautions that relate to the chapter topic. Failure to pay attention to these Cautions could lead to delays, legal problems, fines, or even the end of your business. The icon that indicates a Caution is shown below:



Additional resources and information that may be helpful to the reader are indicated by the following icon:

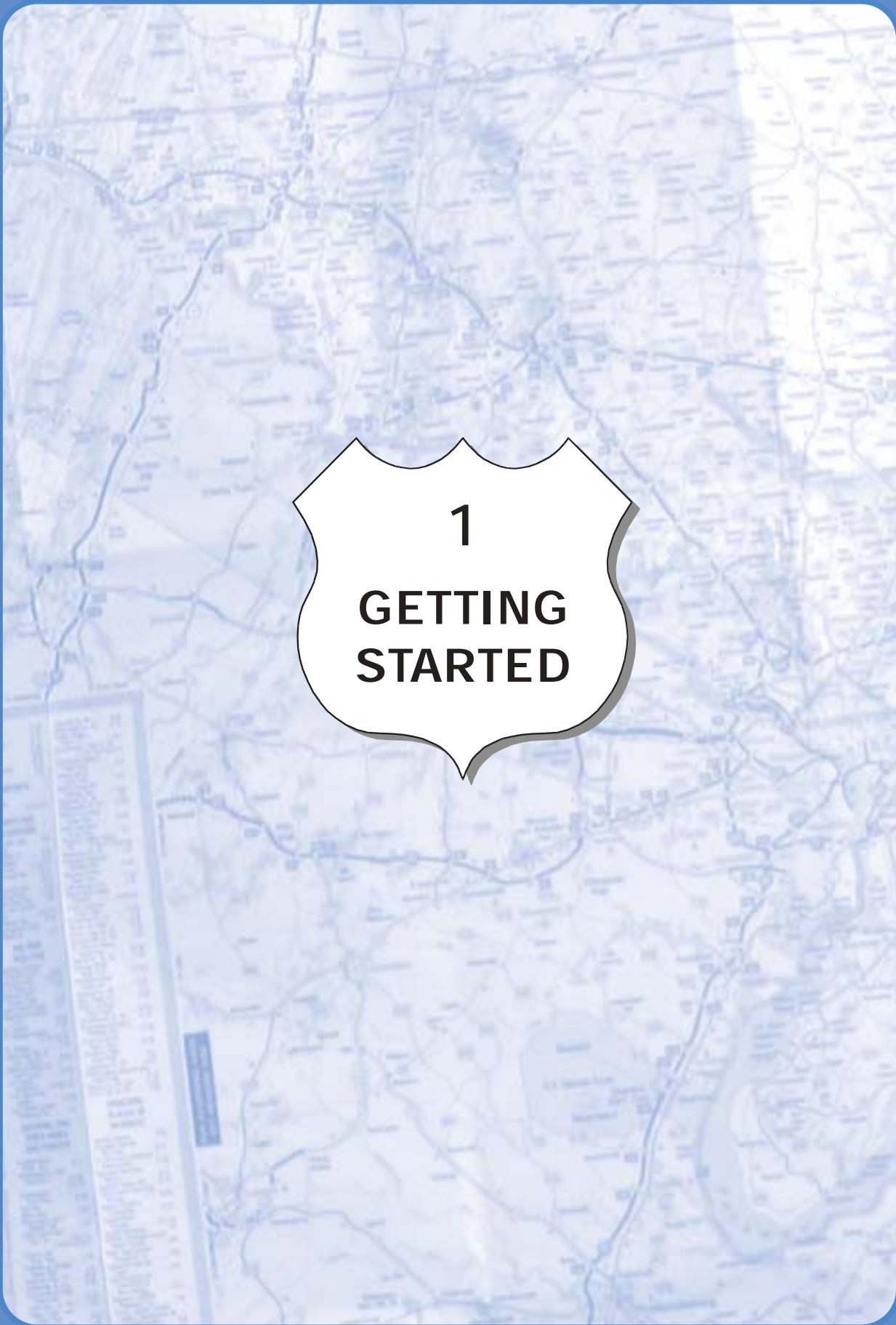


At the end of each chapter, the most “Important Points” for the reader to take away are indicated by the following icon:



It’s easy to get overwhelmed when starting your own business. There’s a lot to learn, money to raise, legal and financial structures to set up, and customers to attract. However, if you’re determined to make your business work, you can succeed. Every journey begins with a single step.

Step One: Turn the page.



1

**GETTING
STARTED**

GETTING STARTED

At one point or another, everyone has had thoughts and dreams of being their own boss. Many of you have already taken the plunge into entrepreneurship, while others have researched and planned to start a business, but have not yet gotten it off the ground. Others have started multiple small businesses, but have not yet found the one that has met their career goals and expectations, or the ventures were just too difficult to sustain with the resources available.

LEARNING OBJECTIVES

- 👉 How to determine whether entrepreneurship is right for you
- 👉 How to get started in your business
- 👉 How to choose the right idea for your business

WHY START YOUR OWN BUSINESS?

There are many reasons not to start your own business, but for the right person, the advantages of business ownership far outweigh the risks. Listed below are some of the advantages of entrepreneurship:

- ✓ You get to be your own boss.
- ✓ Hard work and long hours directly benefit you, rather than increasing profits for someone else.
- ✓ Earning and growth potential are far less limited.
- ✓ A new venture is exciting.
- ✓ Running a business will provide endless variety, challenges, and opportunities to learn.

ENTREPRENEUR:
A person that starts his or her own business enterprise.



IS ENTREPRENEURSHIP FOR YOU? A SELF-ASSESSMENT



Not everyone is cut out to own a business. There is no sure way to eliminate all the risks associated with starting a small business; however, you can improve your chances of success with good planning. Evaluate your strengths and weaknesses as the owner and manager of a small business (see the section on Resources for additional self-assessments).

Carefully consider each of the following questions:

- ✓ **Are you a self-starter?** It will be up to you—not someone else—to develop projects, organize your time, and follow through on details.
- ✓ **How well do you get along with different personalities?** Business owners need to develop working relationships with a variety of people, including customers, vendors, staff, bankers, and professionals; such as lawyers, accountants, and consultants. Can you consistently deal with a demanding client, an unreliable vendor, or a cranky staff person in the best interest of your business?
- ✓ **How good are you at making decisions?** Small business owners are required to make decisions constantly; often quickly, under pressure, and independently.
- ✓ **Do you have the physical and emotional stamina to run a business?** Business ownership can be challenging, fun, and exciting. But it's also a lot of work. Can you face 12-hour workdays 6 or 7 days a week?
- ✓ **How well do you plan and organize?** Research indicates that many business failures could have been avoided through better planning. Good organization of financial matters, inventory, schedules, and production can help you to avoid many pitfalls.
- ✓ **Is your drive strong enough to maintain your motivation?** Running a business can wear you down. Some business owners feel burned out by having to carry all the responsibility on their shoulders. Strong motivation can make the business succeed and will help you survive slowdowns, as well as periods of burnout.
- ✓ **How will the business affect your family?** The first few years of business start-up can be hard on family life. The strain of an unsupportive spouse may be hard to balance against the demands of starting a business. There also may be financial difficulties until the business becomes profitable, which could take months or years. You may have to adjust to a lower standard of living or put family assets at risk.

Points to Remember When Getting Started

Starting a business is not an easy task, and extensive preparation must take place. Here are some of the things you need to consider:

- ✓ **Plan, plan, plan:** Examine every angle you can think of to make sure your business is feasible.
- ✓ **Take your time:** Take as much time as you need to research your business and make your plans—before you give up your day job.
- ✓ **Be flexible:** Prepare for the unexpected.

- ✓ **Be professional:** Never shortchange your current employer. Work hard through the end of your very last day.
- ✓ **Separate your business life while still employed:** Don't hold "your" meetings on your employer's time or use the company copy machine. And don't burn bridges—your former employer could become one of your clients.
- ✓ **Prepare for the ups and downs:** Starting a business involves a series of disappointments and triumphs. Be prepared for the long run.
- ✓ **If you expect a task to take 2 months, budget for 4 months:** Your cash flow isn't your client's problem—at least not to them. Plan accordingly.
- ✓ **Step back and look at the long-term plan:** It's easy to get frustrated because one project is hung up. Remember that every detail you're sweating is just one piece of the puzzle.
- ✓ **Be "cheap":** Most businesses fail in their first year because cash runs out. The more you save, the more time you have.
- ✓ **Stay true to your vision:** "Vision" is an overused word, but every person who starts a company has one. Whether your goal is to offer the best microbrewed beer in the East or sell the most advanced cellular phone on the market, there's an overriding goal to your efforts beyond simply making a pile of money.
- ✓ **Look forward, not back:** It's easy to beat yourself up about decisions gone wrong, strategies that didn't work, or employees who cost more than they made. Since you're going to make mistakes, you need to learn from every one of them—and then move on.
- ✓ **Have fun!**

GETTING IDEAS FOR YOUR BUSINESS

Once you've decided you want to start your own business, what are you going to do? You may have had an idea for a business for some time now. Or maybe you have no idea what you would like to pursue.

BRAINSTORMING

If you don't have an idea about what type of business to start, brainstorming (see the section on Resources) is an excellent way to come up with ideas. If you have partners or just helpful friends, you can brainstorm in a group, which will help generate a range of ideas and allow you to bounce ideas off one another. If you don't have anyone that can participate in a brainstorming session with you, brainstorm by yourself. Take notes in any case, then review your notes to see if you have any ideas you can run with.



USING PROVEN IDEAS

Using an existing idea for a business is a common business practice that can provide many advantages. If entrepreneurs didn't take inspiration from fellow business owners, there would be no Burger King or Wendy's, just McDonald's, and perhaps not even that, because White Castle and other burger joints had already been on the scene

before McDonald's. Starbucks wasn't the first coffeehouse, and Barnes & Noble wasn't the first bookstore.

There are distinct advantages in emulating a successful business. For example, if you want to open a restaurant, there are books that can tell you how to start and run one. Another advantage to following a successful business model is that other resources are at your disposal, such as trade magazines and/or associations. You could also go to the organization SCORE (Service Corps of Retired Executives) and find a retired restaurant owner who is willing to give you some tips (more information about SCORE is found in Chapter 2). None of these resources will be available to you if you invest your efforts in an obscure business.

When using an existing business idea, focus not just on duplicating what has been done, but on improving on that idea and reaching an untapped market segment. The TV show "American Idol" was adapted from a European version of the show; the creators brought this existing idea to a different market.

BUYING A BUSINESS

There are distinct advantages to buying an existing business, as opposed to starting one from scratch. Much risk and uncertainty has been removed, because the initial startup risk has been taken by someone else. You would have existing customers and a track record of the business's past performance. And since the basic business structure is already in place, you can focus on improving and growing it. However, since the business is already in place, you might have difficulty changing existing bad practices—and you generally have to come up with substantially more money up front to purchase a business that has already achieved some level of success.

FRANCHISING

FRANCHISING:
Buying the name and formula of an existing brand and running your own business under that brand.

Many entrepreneurs choose to invest their money and efforts in buying a franchise, which offers its own advantages. First of all, the brand recognition and proven business formulas automatically attract customers, which drastically reduces marketing costs. Also, many franchisors have existing training programs that will save you time and money when training employees. Some disadvantages are that as a franchisee, you are required to pay an up-front fee to use the franchisor's name, and most likely ongoing licensing fees. Most franchises have uniformity rules to abide by that might hinder your creativity in some areas.

A BUSINESS THAT SUITS YOU

It is important to choose a business that fits your personality and can be successfully implemented using whatever resources are available to you. If that means scaling your idea back a bit in the beginning, that's fine. Once you get your idea off the ground, you can grow it as much as you're able. Take inspiration from the many businesses that started in someone's basement and are now multimillion-dollar corporations.

Here are a few things to keep in mind when choosing a business venture:

- ✓ Keep an open mind about possible businesses.



- ✓ Constantly look at the financial bottom line to see if the business would be viable (“do the math”).
- ✓ Even when a business seems potentially profitable, do a reality check and ask yourself if it could live up to the expectations you have for yourself and your future company.
- ✓ Do you own the idea?
- ✓ Is it realistic?
- ✓ Is there a need for it in the marketplace?

HAVE YOU REALLY FOUND THE RIGHT IDEA?

Before committing yourself to a new venture, it is best to have a formal business plan in place (see Chapter 4). However, at the very least, you need to do some basic calculations to see if the business can make a profit. Do a budget. List monthly expenses, such as rent, salaries, utilities, insurance, taxes, supplies, advertising, services, and other overhead expenses. Then figure out how much profit you will make from each sale or service and how many sales you will need to cover your expenses. Can you reasonably expect that many sales? If not, your idea is not going to work. You need to rethink your strategy or go back to the drawing board and come up with another idea altogether.

Survey your potential market and competition. If you want to start a retail shop, figure out how many customers are in close proximity. See how many stores you will be competing with you for customers. Visit existing stores in the area, and without giving your plans away, ask some general questions to see how busy they are and what challenges they face.

CHOOSING THE BEST NAME FOR YOUR BUSINESS

Choosing a name for your business is normally a little tougher than most people anticipate. Many choose to use their own name to brand their business. There are two types of name to consider in your search:

- ✓ **Fictitious** – A name other than your own. For example, if Jane Doe owns a beauty supply store, a fictitious name would be “House of Beauty” rather than “Jane Doe’s Beauty Supply Store.” Fictitious names are also known as “assumed names” or DBAs (Doing Business As).
- ✓ **Nonfictitious** – Using your own name. For example, “Magic Johnson Theaters” is named for the owner, Magic Johnson.

If you are well known and well respected in your community, you may want to use your own name, as it could serve as a good marketing tool. However, if the business fails, you could taint that good name.

If you select a fictitious name, you will have to do a little more legwork, as you may have to register it with the city, county, or State. Some States require that you file the name in the office of the county recorder of deeds, fill out a fictitious name statement, and pay a modest fee. Some areas may require that you advertise your business’s name in the local newspaper to inform the public that you are the carrier of the name.

It may not be a good idea to use your own name if it is long or difficult to pronounce. You should choose a name that is short and easy to remember. Select a name that

describes the type of business you own. Avoid using names that are misleading. If you are not a licensed electrician, your business name should not suggest or state that you are.



IMPORTANT POINTS

- ✎ Evaluate your strengths and weaknesses as the owner and manager of a small business.
- ✎ Run your ideas by family members, friends, and potential customers to see how people react to your idea. Use that information to help determine whether there is actually a need for the product or service you would like to provide.
- ✎ Choose a business that fits your personality and can be successfully implemented using the resources that are available to you.

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- Feffer, Mark. "A Small-Business Boss Shares His Insights." *Start Up Journal*. 2003. <http://www.startupjournal.com/howto/soundadvice/20021014-trampsteamer.html>
- Strauss, Steve. "Choosing the Best Business Idea." *Entrepreneur Magazine*. January 2001. <http://www.entrepreneur.com>
- Williams, Geoff "Looks Like Rain." *Entrepreneur Magazine*. September 2002. <http://www.entrepreneur.com>.

BRAINSTORMING

- For Brainstorming Techniques: <http://www.jpb.com/creative/brainstorming.php> (JPB Creative Co., Ltd.)
- Service Corps of Retired Executives (SCORE). <http://www.score.org>
- Small Business Administration (SBA). <http://www.sba.gov>



2

**ABOUT THE
SMALL BUSINESS
ADMINISTRATION**

ABOUT THE SMALL BUSINESS ADMINISTRATION



LEARNING OBJECTIVES

- ☞ To gain familiarity with the programs offered by the Small Business Administration
- ☞ How to find local help centers in your area
- ☞ How the SBA can help get your business Government contracts

The mission of the Small Business Administration (SBA) is to “maintain and strengthen the Nation’s economy by aiding, counseling, assisting, and protecting the interests of small businesses.” This means it is the SBA’s job to help people like you start and maintain your business. Every American’s tax dollars pay for the services available through the SBA, and it is a valuable source of free assistance. The SBA has many programs to assist individuals as they develop business ideas and turn them into profitable operations. The SBA is always available to answer questions about starting your own business. Regional SBA centers are available throughout the country and can be located through the SBA Web site.

For more information on the SBA and the location nearest you, please visit the Web site at <http://www.sba.gov> which has a map of all the SBA centers.





Within the SBA, there are individualized support centers called Small Business Development Center Programs (SBDCs). They provide management assistance to current and prospective small business owners. It might be more helpful to visit the local SBDC rather than the SBA office, because you will receive more individualized attention. SBDCs offer one-stop assistance to individuals and small businesses, providing a wide variety of information and guidance in centralized, easily accessible branch locations. The SBDCs are especially helpful if you are still in the early stages of the planning process. Local Washington DC, Maryland, and Virginia offices are listed below. However, for a full listing of SBDCs across the country, visit the Web site: <http://www.sba.gov/sbdc>. A map showing all the SBDC locations in the United States is available at <http://www.sba.gov/sbdc/sbdcnear.html>.

Washington, D.C. Small Business Development Center
Howard University School of Business
2600 6th Street, NW
Room 128
(at Georgia Avenue and Fairmont Street, NW)
Washington, DC 20059
Phone: 202-806-1550

DC SBDC at the Center for Urban Progress
Office of Latino Affairs
2000 14th Street, NW Suite 330 North
Washington, DC 20002
Phone: 202-671-2828

Maryland SBDC - Capital Region (Montgomery and Prince Georges Counties)
7100 Baltimore Avenue
Suite 402
College Park, MD 20740
Phone: 301-403-0501

Maryland SBDC – Central Region (Baltimore, Baltimore City, Howard, and Anne Arundel Counties)
Towson University
8000 York Road
Towson, MD 21252
Phone: 1-877-421-0830

Maryland SBDC - Western Region (Garrett, Allegany, Washington, and Frederick Counties)
957 National Highway
Suite 3
La Vale, MD 21502
Phone: 1-800-457-7232

Maryland SBDC - Northern Region (Carroll, Harford, and Cecil Counties)
Maryland Small Business Development Center - Harford Community College
205 Edgewood Hall
401 Thomas Run Road
Bel Air, MD 21015-1698
Phone: 410-836-4237



Many of the topics the SBA can help with are listed below. Topics fall within the areas of Startup, Planning, Finance, Marketing, Employment, Tax, Legal, and Special Interest.

- | | | |
|-------------------------|--|--|
| STARTUP TOPICS | <ul style="list-style-type: none">○ Are You Ready?○ Buying a Business○ Checklist for Starting a Business○ Product Business | <ul style="list-style-type: none">○ Finding a Niche○ Buying a Franchise○ Protecting Your Ideas○ Startup Guide |
| PLANNING TOPICS | <ul style="list-style-type: none">○ Business Plan Basics○ Writing the Plan○ Using the Plan | |
| FINANCE TOPICS | <ul style="list-style-type: none">○ Financing Basics○ Estimating Costs○ Finding Capital○ Applying for a Loan○ Small Business Lenders | <ul style="list-style-type: none">○ Understanding Financial Statements○ Personal Financing vs. Business Financing |
| MARKETING TOPICS | <ul style="list-style-type: none">○ Marketing Basics○ Competitive Analysis○ Ads and PR○ E-Marketing | <ul style="list-style-type: none">○ Marketing Research○ Marketing Plan○ Trade and Shows○ Signage |
| EMPLOYMENT TOPICS | <ul style="list-style-type: none">○ Finding Employees○ Employee Benefits○ Employee Contractor | <ul style="list-style-type: none">○ Employee Taxes○ Employee Law |
| TAX TOPICS | <ul style="list-style-type: none">○ Payroll Taxes○ Federal Income Tax○ Sales and Use Tax○ EIN | <ul style="list-style-type: none">○ Self Employment Tax○ State Tax○ Local Tax |
| LEGAL TOPICS | <ul style="list-style-type: none">○ Forms of Ownership○ Licenses and Permits○ Business Laws | |
| SPECIAL INTEREST TOPICS | <ul style="list-style-type: none">○ Minorities○ Veterans○ Woman Entrepreneurs | <ul style="list-style-type: none">○ Native Americans○ Young Entrepreneurs○ International Trade |

SBA'S SERVICE CORE OF RETIRED EXECUTIVES

The members of the Service Corps of Retired Executives (SCORE) are "Counselors to America's Small Businesses." SCORE is a national nonprofit association dedicated to providing entrepreneurs with free, confidential, face-to-face, and email business counseling. Services, including workshops, are offered at 389 chapter offices across the country.

SCORE is composed of retired corporate executives who have offered to volunteer their time to work with small business entrepreneurs. Many of these individuals have worked for Fortune 500 companies and have a great deal of experience in the business world. This free program is affiliated with the SBA and is available simply by signing up. Local SCORE offices are referenced below.

For offices closer to your region, visit <http://www.score.org>.



Washington, DC SCORE

1110 Vermont Ave. NW
9th Floor
Washington DC 20043
Phone: 202-606-4000 x287

Prince William County SCORE

Prince William County-Manassas
8963 Center Street
Manassas, VA 20110
Phone: 703-368-6600

Greater Baltimore SCORE

The City Crescent Bldg.
6th Floor
10 South Howard Street
Baltimore, MD 21201
Phone: 410-962-2233

SMALL BUSINESS TRAINING NETWORK

The SBA also offers a virtual campus that houses free training courses, workshops, and knowledge resources designed to assist entrepreneurs and other students of enterprise. This program, part of the Small Business Training Network, is sponsored by the Office of Entrepreneurial Development. It makes the SBA's business management resources available online. This dynamic learning center is designed to help small businesses compete in a constantly changing global environment. See <http://www.sba.gov/training/>.



In addition to online courses, the SBA offers several classroom-based training sessions several times a month at various sites. Session topics range from creating a winning business plan to repairing poor credit. The link below provides a November class schedule:

<http://app1.sba.gov/calendar/states/Calendar.cfm?&OP=MAIN&GRP=0&YR=2003&MN=11&T=160832&CFID=5442398&CFTOKEN=4314079>

The library of the Small Business Training Network houses hundreds of SBA publications, business magazines, current business news sources, and links to thousands of outside small business resources. The virtual library contains e-books and over 200 free SBA business publications. These resources are available free of charge.

SPECIAL INTERESTS

The SBA can help special interest businesses prosper and take advantage of opportunities put in place to help them. Programs include the SBA's 8(a) Business Development Program, created to help small disadvantaged businesses compete in the American economy and access the Federal procurement market. In addition to the 8(a) and the HubZone status requirements, there are additional programs of assistance for other individuals. These individuals include Small Disadvantage Business Owners, Women Business Owners, and Veteran and Service Disabled Veteran Owners.

8(a): This program allows disadvantaged companies an advantage when competing for Federal Government contracts.

B

To qualify for 8(a) Status, an individual must (1) be a small business, (2) be unconditionally owned and controlled by one or more socially and economically disadvantaged individuals who are of good character and citizens of the United States, and (3) demonstrate potential for success.

Additional opportunities for special interest firms are available through the Historically Underutilized Business Zone (HUBZone) Empowerment Contracting Program. This program provides Federal contracting opportunities for qualified small businesses located in distressed areas.

DISTRESSED AREAS: *Areas where the average income is below a certain level and/or there are not many large companies.*

B

The HUBZone Empowerment Contracting Program stimulates economic development and creates jobs in urban and rural communities by providing Federal contracting preferences to small businesses. These preferences go to small businesses that obtain HUBZone certification, in part by employing staff who live in a HUBZone.

SBA BUSINESS LOAN PROGRAMS

One of the most important aspects of business that SBA can assist with is financial help. The SBA administers three separate, but equally important, loan programs and sets guidelines for the loans. The SBA's partners (lenders, community development organizations, and micro-lending institutions) make the loans to small businesses. The SBA backs the loans with a guaranty that will eliminate some of the risk to the lending partners. The agency's loan guaranty requirements and practices can change, however, as the Government alters fiscal policies and priorities. Therefore, past policy can't always be relied upon when seeking assistance in today's market.

Federal monies are given to the SBA to provide guarantees on loans structured under the agency's requirements. With a loan guaranty, the actual funds are provided by independent lenders who receive the full faith and credit backing of the Federal Government on a portion of the loans they make to small businesses.

SBA LOAN GUARANTY

The loan guaranty that the SBA provides transfers the risk of borrower non-payment, up to the amount of the guaranty, from the lender to the SBA. Therefore, when a business applies for an SBA loan, they are actually applying for a commercial loan, structured according to SBA requirements, which receives an SBA guaranty.

LOAN GUARANTY: *Refers to the policy of the SBA not to fund small business loans, but instead, to guarantee that the loan will be paid back to the bank by the borrower (you).*

B

SBA'S INVESTMENT PROGRAMS

In 1958, Congress created the Small Business Investment Company (SBIC) program. SBICs, licensed by the SBA, are privately owned and managed investment firms.

INVESTMENT FIRMS:

Companies whose goals are to invest in other companies and take part in the success, and profit, realized by the other companies.

They are participants in a vital partnership between Government and the private sector economy. With their own capital, and funds borrowed at favorable rates through the Federal Government, SBICs provide venture capital to small independent businesses, both new and already established. All SBICs are profit-motivated businesses. A major incentive for SBICs to invest in small businesses is the chance to share in the company's success if they grow and prosper.

SBA'S BONDING PROGRAMS

The Surety Bond Guarantee (SBG) Program was developed to provide small and minority contractors with opportunities for which they would not otherwise bid.

The SBA can guarantee bonds for contracts up to \$2 million, covering bid, performance, and payment bonds for small and emerging contractors who can't obtain surety

SURETY BOND: *A three-party agreement in which the surety company assures the obligee (owner) that the principal (contractor) will perform a contract.*

bonds through regular commercial channels. The SBA's guarantee gives sureties an incentive to provide bonding for eligible contractors and strengthens a contractor's ability to obtain bonding and greater access to contracting opportunities. A surety guarantee, an agreement between a surety and the SBA, provides that the SBA will assume a predetermined percentage of loss in the event the contractor should breach the terms of the contract.

In addition to these SBA programs, there are many other ways to gain financing for your business. See Chapter 6, Funding Issues for Small Business.

GOVERNMENT CONTRACTING

The Office of Government Contracting (GC) works to create an environment for maximum participation by small, disadvantaged, women-owned, HubZone, Veteran and Service Disabled Veteran owned businesses in Federal Government contract awards and large prime subcontract awards. GC and the Small Business Offices of the various Federal Departments and Agencies advocate on behalf of small businesses in the Federal procurement world.

Under the Small Business Act, Federal agencies conduct a variety of procurements that are reserved exclusively for small business participation.

PROCUREMENTS:

Government purchases of goods or services from private companies.

These transactions are called "small business set-asides" and include the Small Business Reserve, the Small Business Competitiveness Demonstration Program, the Very Small Business Set-Aside Pilot Program, and the HUBZone Empowerment Contracting Program (described previously).

For more information on these programs, visit the Web site at: <http://www.sba.gov/GC/indexprograms.html>.



IMPORTANT POINTS

- ✎ The SBA, SBDC, and SCORE have excellent counselors for you to speak with one-on-one when starting your business. Plus, they're free!
- ✎ While the SBA does not give loans, they can help you get a loan by guaranteeing the bank that they will pay back the loan if you default.
- ✎ The SBA has many programs in place for special interest companies. These programs set aside Federal contracts for certain types of small businesses. Contact the SBA to see if you qualify.

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3

**LEGAL
CONSIDERATIONS
FOR SMALL
BUSINESSES**

LEGAL CONSIDERATIONS FOR SMALL BUSINESSES

LEARNING OBJECTIVES

- 👉 When to hire a legal professional to help you
- 👉 How the different types of business structures can benefit you

Once you've decided to start your own business, one of the first decisions you face is whether to set up a legal entity through which the business will be owned and operated and, if so, the type of entity that will work best for you. The two most important factors to be considered are the amount of protection from liability you seek and the tax implications of your selection.¹

As discussed below, you should consult the services of a qualified attorney and accountant to assist you in making decisions about entity structure and other key matters.

LEGAL CONSULTATION

A number of problems and missteps can be avoided by consulting a qualified attorney at the outset of this complex decision process.

Setting up a legal entity involves a number of factors specific to the type of business you're starting, and any missteps may have long-term and costly consequences. An attorney can ensure that you consider and address all the factors relevant to your situation. Additionally, your attorney can see that all organizational documents are properly prepared and filed and can advise you about the types of licenses or registrations needed in your jurisdiction. Your attorney can also ensure that you maintain your busi-

¹ The factors discussed here are general, and do not cover all variables that should be considered. A qualified attorney and accountant can analyze your specific situation and explain the benefits and disadvantages of the various types of entities available in your jurisdiction. For example, other factors to consider may include: the effects a certain type of entity will have on your ability to procure funds; whether there will be surplus or retained funds in the entity; the expense and time commitments required for establishing and maintaining a certain type of entity; whether a certain type of entity will fit with your management style; and the manner by which a certain entity is to be dissolved or terminated.

ness entity in accordance with the statutes and regulations of the jurisdiction in which your business entity was formed and operates.

A word of caution: The Internet has numerous legal sites that advertise corporate or other organizational documents for a small fee. Documents obtained from such sites may not satisfy all the requirements of the jurisdiction in which you're operating. Additionally, these documents tend to be generic, and most likely will not address the issues particular to your type of business.

The use of these Internet documents should be avoided.

Although the cost of an attorney may seem too great an expense, the money will be well spent, even if one major problem can be avoided. The cost of preventing a major problem will greatly offset the cost of properly preparing the necessary documentation.



PROTECTION FROM PERSONAL LIABILITY

A legal entity will afford you some protection from personal liability. Thus, the debts or contractual obligations incurred or entered into will be the obligation of the entity and not yours personally—provided that you did not personally guarantee the debt or enter into the contract personally. Furthermore, any negligent or tortious actions by your employees will result in the liability of the entity, and not you personally. If the business fails, as long as the owners have not personally obligated themselves, the business can file bankruptcy or follow the insolvency procedures of the appropriate jurisdiction without the bankruptcy or insolvency affecting the personal credit of the owners. Establishment of an entity to own and operate your new business venture will protect you against the loss of your personal assets, such as your house, car, and other belongings.

A TORTIOUS act *interferes with the business affairs of another.*



TYPES OF LEGAL STRUCTURES

There are a number of structures you can choose from. The legal structures discussed here include: sole proprietorship, general partnerships, joint venture, corporations, limited liability companies (LLCs), and limited partnerships. Your jurisdiction may offer alternative or additional types of entities.

A "sole proprietorship" is the establishment of a business by an individual, without the benefit of a legal entity that will be responsible for owning and operating the business. If an individual starts to operate a business and does not take any action to establish a legal entity, by default, the person will be operating under a sole proprietorship. No specific documents must be executed.

SOLE PROPRIETORSHIP:
The establishment of a business by an individual, without the benefit of a legal entity that will be responsible for owning and operating the business.



A sole proprietorship does not afford the owner any protection from liability.

The owner is personally responsible for all liabilities of the business, including debts, contracts, and the negligence and tortious actions of the employees. There are, however, numerous tax advantages with this type of structure. Among other things, a sole proprietor will be able, in most situations, to deduct his or her business losses and use the cash accounting method. The owner of a sole proprietorship discloses the profits



realized from the business in his or her personal income tax return. The business will not be taxed separately; the owner will be taxed at his or her respective tax rate. However, such benefits can usually be gained through other types of entities that provide greater liability protection.

A “general partnership” is an agreement by two or more persons or entities to establish and operate a business or venture. The parties to a general partnership do not need to execute or file any documents to form a general partnership. However, a written agreement between the partners should be prepared and signed before the business is started. The agreement should address the management of the general partnership, allocation of profits and losses, and the manner by which the general partnership is to be dissolved if a partner should die, become incapacitated, or wish to withdraw. Each partner can bind the other partners and the partnership for any and all obligations associated with the business.

GENERAL PARTNERSHIP: *An agreement by two or more persons or entities to establish and operate a business or venture.*



Each partner is personally liable for all of the debts, contractual obligations, and liabilities of the business, including the negligence or tortious actions of the employees or other partners.



A partner to a general partnership has as much personal liability as the owner of a sole proprietorship. A general partnership does not protect the personal assets of the partners. As with a sole proprietorship, there are numerous tax advantages to this type of structure. Partners to a general partnership will be able, in most situations, to deduct their proportionate losses and use the cash accounting method. Each partner to the partnership discloses the profits realized from the partnership in his or her personal income tax return. The general partnership will not be taxed, and each partner will be taxed at his or her respective tax rate. As is true of a sole proprietorship, however, those advantages can usually be enjoyed through other types of entities.

JOINT VENTURE: *A general partnership whose purpose is to make a profit on a one-time basis. When the purpose is accomplished or abandoned, the joint venture automatically terminates.*



A “joint venture” is a general partnership whose purpose is to make a profit on a one-time basis. When the purpose is accomplished or abandoned, the joint venture automatically terminates. The liability and tax considerations for a joint venture are identical to that of a general partnership.

A “limited liability company” (often called “LLC”) is a business structure that combines the limited liability protections of a traditional association with corporations and the tax status of a general partnership. The holder of an interest in an LLC is called a member. A member does not have personal liability for the debts, obligations, or liabilities of the LLC, including negligent and tortious actions of its employees.² As long as the statutory requirements for establishing and maintaining a limited liability company in your jurisdiction are met, the maximum personal exposure for each of the members is the amount of their investment. To create an LLC, articles of organization that comply with the statutes and reg-

² A member can personally guarantee or enter into a contract related to the business. In these instances, the member will be personally liable for those debts or contracts that he or she has guaranteed or contracted. Furthermore, if a member commits negligence or a tortious act while acting on behalf of the business, that member will be personally liable for the negligence or tortious act.



LIMITED LIABILITY COMPANY (LLC): *A business structure that combines the limited liability protections of a traditional association with corporations and the tax status of a general partnership.*

ulations of the jurisdiction in which the LLC is to be formed must be filed. In addition, an operating agreement must be prepared and signed by each person or entity that will be a member. The operating agreement should address certain requirements of the Internal Revenue Service code for limited liability companies and general partnerships, as well as management of the LLC, length of the life of the LLC, manner and method of dissolution, and any other con-

siderations specific to the parties and required by the jurisdiction in which the LLC is formed.

There are considerable tax advantages to a limited liability company. A member will be able, in most situations, to deduct his or her losses (subject to certain restrictions) and use the cash accounting method. The profits will not be taxed at the level of the LLC. Instead, each member will be required to disclose their proportion of the profits when filing his or her income tax return and will be taxed at that member's respective tax rate. Therefore, the LLC will not pay taxes on profits earned. Due to the liability protection and tax advantages afforded from a limited liability company, this structure has become a favored vehicle for establishing and maintaining businesses.



CORPORATION: *An entity created by filing articles of incorporation with the appropriate agency in the State in which the corporation is being formed. The corporation is separate and distinct from the owners of the corporation.*

A "corporation" is an entity created by filing articles of incorporation with the appropriate agency in the State in which the corporation is being formed. The corporation is separate and distinct from the owners of the corporation. The owners of an interest in the corporation are called shareholders or stockholders. Articles of incorporation that comply with the statutes and regulations of the jurisdiction in which the corporation is to be formed must be filed.³ In addition, by-laws must be prepared and approved by the shareholders.⁴ Shareholders in a corporation that is not publicly traded are well advised to have a buy/sell agreement prepared

when the corporation is established. Such an agreement will state the mechanism for a shareholder to sell or transfer his or her interest in the corporation. This precaution helps avoid (or at least minimize) lengthy and expensive disputes if a shareholder dies, becomes disabled, decides to sell or transfer their interest in the corporation, or wants to withdraw from the corporation.

Each corporation must select a board of directors and officers, which typically consists of a president, vice president, treasurer, and secretary. Each jurisdiction has explicit statutes and regulations about the requirements for maintaining a corporation in good standing. At a minimum, each corporation must hold an annual meeting of its shareholders and directors. The minutes of those meetings must be kept in the permanent record of the corporation, typically called a corporate minute book. Many jurisdictions have periodic filing requirements.

Failure of the corporation to adhere to the statutory requirements of the jurisdiction in which the corporation is formed or operating may result in the corporation being deemed invalid and can expose the directors, officers, and shareholders to personal liability for the debts, obligations, and liabilities of the corporation.



³ In addition to the filing requirements for a business, the corporation may be required to register with the United States Securities and Exchange Commission or the State, unless a corporation falls within one of the Federal or State exemptions available within the jurisdiction in which the corporation is being formed.

⁴ Articles of incorporation may be thought of as the "constitution" of the business and the by-laws as the laws of the corporation.

Provided a corporation adheres to the requirements of the jurisdiction in which the corporation is formed or operating, a corporation affords its shareholders protection from liability for its debts, obligations, and liabilities, including the negligence and tortious actions of the employees. Thus, the shareholders' maximum personal exposure is their investment in the corporation.

The tax benefits and disadvantages from a corporate structure are complicated. A corporation will be taxed on any profits realized by the corporation at the applicable corporate tax rate. Additionally, each shareholder in the company will be personally taxed on any distributions made to that shareholder at the applicable rate. However, in certain closely regulated situations, a corporation may submit an election under Subchapter S of the Internal Revenue Service code, so that the profits of the corporation will be passed through to the shareholders of the corporation without being taxed at the corporate level.⁵ Additionally, subject to certain limitations, the shareholders in an S corporation are entitled to deduct certain losses of the corporation.

A "limited partnership" is a type of partnership in which there is at least one general partner and at least one limited partner. The advent of the limited liability company has made the use of the limited partnership structure obsolete. However, the basic structure is described here for informational purposes.

The personal liability of the owners in a limited partnership varies depending on the type of partnership held by the owner. A general partner has liability equal to that of the limited partnership. Thus, a general partner has personal liability for all of the debts, obligations, and liabilities of the limited partnership. A limited partner is not liable for the debts, obligations, or liabilities. Thus, the personal liability of the limited partner is their investment in the limited partnership. Articles of organization that comply with the statutes and regulations of the jurisdiction in which the limited partnership is being formed are required to be filed.

A partnership agreement should be prepared and executed by each of the general and limited partners.

As with other types of entities, the partnership agreement should address management of the general partnership, allocation of profits and losses, and the manner by which the general partnership is to be dissolved if a partner should die, become incapacitated, or wish to withdraw. A limited partnership is taxed in a similar manner to a partnership.

The following chart compares different types of entities. It is provided for informational purposes only, and may vary by jurisdiction.

LIMITED PARTNERSHIP: *A type of partnership in which there is at least one general partner and at least one limited partner.*



⁵ A corporation that has filed a Subchapter S election is commonly called an S corporation. A company that has not filed a Subchapter S election is commonly called a C corporation.

	Sole Proprietor	General Partnership	Corporation	S Corporation	Limited Liability Company	Limited Partnership
Management	By owner	By all partners, unless otherwise agreed	By the board of directors, with day-to-day operation by officers	By the board of directors, with day-to-day operation by officers	By all members, unless otherwise determined	By the general partner; limited partners may not be involved in management
Number of Owners	By definition, one	No maximum, but at least two	No maximum	A maximum of 75	No maximum	No maximum, but at least one general partner and one limited partner
Type of Owners	No restriction	No restriction	No restriction	Except in certain situations, no corporations, pension plans, partnerships, LLCs, or non-resident aliens	No restriction	No restriction
Different Classes of Interest	N/A	Permitted	Permitted	Only one class of ownership permitted, except for differences in voting rights	Permitted	Permitted
Continuity of Life of Entity	Permitted	Permitted	Permitted	Permitted	Permitted	Permitted
Free Transferability of Interest	Permitted	Permitted	Permitted	Permitted	Permitted	Permitted
Flexibility in Structuring Retirement Buyouts	Yes	Yes	No	No	Possibly in the context of LLCs engaged in professional services	No

	Sole Proprietor	General Partnership	Corporation	S Corporation	Limited Liability Company	Limited Partnership
Taxation Upon Distribution of Appreciated Property	Depending on method of treatment prior to distribution	Depending on method of treatment prior to distribution	Yes	Yes	No, except for special rules regarding marketable securities	No, except for special rules regarding marketable securities
Insolvency Exception to Discharge of Indebtedness Provisions	Determined at the individual level	Determined at the partnership level	Determined at the corporate level	Determined at the corporate level	Determined at the investor level	Determined at the investor level
Deductibility of Losses by Owners	Yes, subject to certain limitations	Yes, subject to certain limitations	No	Yes, subject to certain limitations	Yes, pro rata, subject to certain limitations	Yes, pro rata, subject to certain limitations
Availability of Cash Method of Accounting	Yes	Yes	Not available unless the corporation is primarily providing a service	Not available unless the corporation is primarily providing a service	Possibly not available if there are members who are not active in the business	Not available unless the limited partnership is primarily providing a service
Flexibility of Income Allocations	Very flexible	Very flexible	Flexible, but potentially subject to double taxation	Inflexible	Very flexible	Very flexible
Limitation of Liability	Sole proprietor has unlimited liability	Each partner has unlimited liability	Limited liability for shareholders, even if they participate in management	Limited liability for shareholders, even if they participate in management	Limited liability for members, even if they participate in management	Limited liability only for limited partners who do not engage in management; general partners have unlimited liability



IMPORTANT POINTS

- ✎ The two most important factors to be considered when starting a business are the amount of protection from liability you seek and the tax implications of your selection.
- ✎ A number of problems and missteps can be avoided by consulting a qualified attorney at the outset of this complex decision process.
- ✎ The structure of a sole proprietorship does not afford the owner any protection from liability. There are, however, numerous tax advantages.
- ✎ In a general partnership, each partner is personally liable for all of the debts, contractual obligations, and liabilities of the business.
- ✎ There are considerable tax advantages to a limited liability company. Due to the liability protection and tax advantages, this structure has become a favored structure for establishing businesses.
- ✎ The tax benefits and disadvantages from a corporate structure are very complex.
- ✎ A partnership agreement should address management of the general partnership, allocation of profits and losses, and the manner by which the general partnership will be dissolved if a partner should die, become incapacitated, or wish to withdraw.



4

**DEVELOPING A
BUSINESS PLAN**

DEVELOPING A BUSINESS PLAN

LEARNING OBJECTIVES

- ☞ Why a business plan is important for your business
- ☞ How a great business plan can help you and who needs to see it
- ☞ How to write a great business plan

A business plan is much like a roadmap that describes where you're going and how you'll get there. Your business plan will map out your journey toward small business success. Others can look at your map and decide whether there is room for them to join you. Investors can examine your business plan and determine whether they want to come along for the ride (hopefully, most of them will want to!). For these reasons, a business plan is the foundation of your new business.

The business plan document is generally about 25-50 pages long. It is detailed enough to outline your plans and intentions for running your business. Key reasons why you should write a business plan are:

- ✓ To obtain financing to start your company;
- ✓ To organize your thinking by putting your goals and ideas down on paper;
- ✓ To demonstrate your commitment to the business, which will impress potential investors, suppliers, and employees;
- ✓ To create a guide to achieving your goals that you can refer to regularly;
- ✓ To ensure that your employees understand where you plan to take the business; and
- ✓ To focus your organization on its mission, reducing the chance that the business will become sidetracked by lower-priority activities.



JOINT VENTURE PARTICIPANTS:

Individuals who are willing to invest money in your company in exchange for certain pieces of ownership in your business

Others will need to see what you intend to do before they believe in your ideas. There will probably be many different people who will want to see the business plan, each for different reasons, including:

- ✓ Banks and other funding sources, who will use your plan to determine whether you are capable of starting and running a business;
- ✓ The Small Business Administration (SBA), which will review your plan for profitability, giving them confidence that their guaranteed loan will be paid;
- ✓ Employees, who will want to see sections of the business plan to understand whether the company holds long-term career opportunities for them; and
- ✓ Strategic partners or joint venture participants, who will determine whether your overall direction is in alignment with their plans and mission.

Before beginning your business plan, you must first learn more about your business area: the market you're working in, the type of products or services you'll be offering, and the needs of your customers. Although you may have years of experience working in the type of business you want to start (perhaps you've been working in your family's printing shop for decades), investors want to feel confident that your instincts are correct. To demonstrate that your ideas are on target, you need to show them reliable, published articles, reports, and statistics. This information is available from the library and the Internet. Merely stating that you know that the market for printing is growing exponentially each year may be convincing to some, but backing that statement up with a report from the Department of Commerce gives you more credibility.

The work you put into your business plan is equal to the reward you will receive. Do enough research about your area of business so that people who read your business plan will be convinced that you will be successful.

Although the preliminary research for your business plan may seem challenging, there is help out there for you. The SBA sponsors a business support group to assist businesses just like yours as they are created and attempt to get funding. The group is run by retired executives who call themselves the Service Corps of Retired Executives (SCORE). They have already been where you hope to go, and they can guide you through the process. Better yet, their services are free! These individuals are volunteers and you already pay for SBA coordination with your tax dollars. For more information on the SBA, see Chapter 2.

ORGANIZATION OF THE BUSINESS PLAN

A business plan is divided into specific subsections. Each subsection addresses an aspect of the way you will manage the business. The business plan should include:

- | | |
|--|---|
| ✓ Table of Contents | ✓ Operations Plan |
| ✓ Executive Summary | ✓ Marketing Strategy |
| ✓ Description of Your Product or Service | ✓ Financial Analysis |
| ✓ Market and Industry Analysis | ✓ Conclusion |
| ✓ The Competition | ✓ Appendices or Supplementary Materials |
| ✓ The Management Team | |



Let's take a look at each of these sections in detail. (The Resources section at the end of this chapter contains SCORE's suggestions for developing a sample business plan.)

TABLE OF CONTENTS

A Table of Contents is generally found in well-organized documents and will alert the reader to the information they will find in the coming pages.

THE EXECUTIVE SUMMARY

Although this section appears first in the business plan, it will be much easier to write after the other sections are complete. The Executive Summary should include a short overview of each section of the business plan. End the Executive Summary by listing the amount of money required, the projected return on investment, and the major advantages your company will have over the competition.

Although the Executive Summary is generally only one to two pages long, it is often the only section a potential investor will read. Based on those few paragraphs, he or she will decide whether to continue to read the plan. If he or she doesn't proceed, you've just lost an investor. For this reason, your summary needs to catch and hold the reader's attention.

DESCRIPTION OF YOUR PRODUCT OR SERVICE

This part of the plan explains your product or service idea and how it meets the needs of your market. Describe exactly what it is you will be selling and why individuals or businesses will buy it. How is it different from similar items already on the market? If it is a revolutionary concept, explain why the world needs this new product or service.

Describe your product or service in detail. For instance, is it a new kind of car, a new type of cookie, or a better housecleaning service? Explain what the product or service will do for the user, what the benefits are, and why people would buy it. If there are similar products or services on the market, briefly compare them to what you offer and explain how yours is better. If your new product or service is unlike anything currently available, convince the reader why it is needed.

MARKET AND INDUSTRY ANALYSIS

The Market and Industry Analysis section of the business plan describes the market need for your product or service. In this section, detail the information gathered at the library about the size of your market, the number of potential customers for your product or service, and the growth rate for your market or for the industry as a whole (which usually means worldwide). This section will be effective based on the results of your research and on your ability to convey this information in a simple, concise, easy-to-read format.

You must make a number of assumptions when completing your market analysis. For example, the percentage of available customers you expect to pay for your product or

RETURN ON INVESTMENT:

The amount of money an investor will receive back in addition to their initial investment. It is usually given in a percentage format (for example, 20% return on an investment of \$5,000 = \$1,000.)



service, called market penetration, is a key estimate used in determining your potential sales revenue. You can find this information based on analysis of other companies that are in the same business, or from “guesstimates” obtained from people experienced in the field. No one expects you to know exactly how many sales you will make during your first year, or even the first 2 years, but you can provide fairly accurate estimates using educated assumptions.

THE COMPETITION

What are the established companies already selling products and services similar to yours? How will they react to your company? Depending on your idea and how long your product or service has been available, your competition may consist of other new and aggressive companies just like yours, or established companies from whom you intend to take business.

Anyone who believes that they have no competition is in for a rude awakening, even with a revolutionary product. Always be prepared to react to your competition.

There is no reason to be afraid of competition. Take every opportunity to learn from these companies. What are they doing right? What can you do better? It is wise to learn from others' mistakes and imitate the strategies that work for them.

It's a good idea to provide a list of other major players in the marketplace to show that you know your competition. You should also indicate your impression of their strengths, weaknesses, and overall success in the market. By learning about your competition, the reader can better understand how you will succeed: either by going after a market opportunity that no existing competitor is addressing, or by improving on what others are doing.

A good business plan clearly states what each competitor offers the customer, the price of their service, and additional information about each business. Such information gives investors an honest picture of how a new idea stands up to the profitable businesses already out there.

MARKETING STRATEGY

If nobody buys your product or service, you're out of business. Period! Nothing ends a business faster than no customers. In the *Marketing Strategy* section, you need to explain to the reader what you intend to do to get customers.

As part of your marketing strategy, describe how you intend to let the public know you're in business and explain the sales approach (e.g., direct sales representatives, a mail-order catalog, a retail storefront). Chapter 7 provides a detailed discussion of the ways you can market your business.

THE MANAGEMENT TEAM

One of the most important elements of your business plan is the section that tells the reader why you and your partners are uniquely qualified to start and run this business. Investors want to feel confident that you have experience in the type of business you're starting and that other members of your management team complement your skills. This means that if you hate numbers and love marketing, it would be smart to hire someone who loves numbers, so they can handle the financial and accounting aspects



of the business. Assuming that you intend to grow, you'll also want to describe the types of people you'll need to hire in the first year. You don't have to have specific people in mind for each position, but you must demonstrate that you understand the skills that will be needed to perform required tasks.

Briefly describe the background and experience of your management team. Define each of the major jobs that will be held by the people who will be working with you, including job titles, responsibilities, and qualifications. Resumes should be included in an Appendix at the back of the plan, but in the Management Team section, include a paragraph or two about each person.

If advisors or consultants have been giving you advice, mention them in this section if they are fairly well known or if they have extensive experience. If you've set up a Board of Directors, mention the members of the board. This demonstrates to the reader that you're not trying to do everything yourself. You recognize that you don't know everything and will rely on professionals when necessary.

Many business owners think they don't need advice from other people. These individuals usually don't last very long in the business world.



OPERATIONS PLAN

This section describes operational procedures, manufacturing equipment, level of production required, locations, international arrangements, licensing arrangements, and any other factors related to the product or service.

For those starting service businesses, this section may be very short, because service providers, such as management consultants, accountants, and attorneys, sell their time and experience. They don't use machinery or factories, so production capacity is less of an issue. However, assumptions should be outlined that explain how many hours per month you expect to spend on client-related work that you'll receive payment for.

OPERATIONAL PROCEDURES:

The processes used by a business to produce its product or service. For example, the operational process for making soccer balls would include purchasing the material, sewing the ball, blowing air into the ball, and packaging the ball for purchase.



FINANCIAL ANALYSIS

For those who are not financial experts, this section of the business plan may be the most difficult to complete. If that's the case, call upon your local SBDC or SCORE counselors for help.

Every other section presented up to this point forms the foundation for the financial analysis section.

Financial Analysis is one of the most important sections of the business plan. It spells out the actual investment required and when and how the business will make enough money to pay investors back. You should get help from your local SBA, SBDC, or SCORE counselors, if necessary.



Define the amount of initial investment required and how much money will be needed in the future, based on sales and operations projections. The investor primarily wants to know how much money will be invested, how much they can expect to make, and within what time frame they can expect a return. You should also include a break-even

analysis that covers the volume required to push the company from a deficit to a profitable operation.

PRO FORMA: *Estimates of future sales and expenses. If you have not been in business long enough to have actual numbers, take your best guess at what these numbers would look like.*

This section should include an income statement, balance sheet, and cash flow analysis that projects the first 12 months of operation, as well as a balance sheet for the next 3 years. These projections are sometimes called pro/forma income statements.

If you don't have actual numbers to include, use the best estimate possible. It's important to include these figures as a way of justifying why your business is worthy of an investor's attention.

An income statement summarizes how much money was made and spent during a specified period of time, typically 1 year. It allows you to look at the "big picture"—how much money you expect to make. Again, if you are not in business yet, use your best guess.

Use a balance sheet to determine the value of what you own (your assets) and what you owe (your liabilities) at a particular point in time, usually the last day of last year. Bankers are interested in this statement because it gives them an idea of your business's worth and whether you can pay off your loan by selling assets. Use the most accurate figures possible.

Estimate your actual cash needs for the first 12 months, month by month, and then for years 2 and 3 on an annual basis. The key is figuring out exactly when you will receive payment for your sales. Keep in mind that if you do not receive payment immediately when you sell your product, you will always be waiting for some customers to pay their bills. Generating a cash flow statement will ensure that you are always ahead of your expenses so that you won't run out of cash.

It's also wise to tell investors when they can expect to get their money back and how that will happen. Spell this information out, including your assumptions, in great detail.

CONCLUSION

This section of the business plan is optional. It summarizes all the information presented in the plan and provides recommended actions on the part of the reader's investor. This section must directly correspond to the recommendations made in the Executive Summary, but can include more detail.

APPENDICES

Most of the work that goes into building a house doesn't show, such as the foundation and the walls. However, without these "invisible" elements, the house wouldn't stand up on its own. The appendices and supplementary materials of the business plan are similar in importance. Appendices may include charts, graphs, and resumes to convince the investor that you have done your homework.

SUMMARY

Try to keep the business plan within the 25-50 page range. A small plan that clearly and concisely addresses all the major points of interest will be better received than a lengthy one that provides pages and pages of irrelevant information. Lead your readers

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through your plan step-by-step, explaining your idea and how you intend to make money doing it.

If you plan to show your business plan to potential investors, include the assumptions you made when writing the plan, potential risks and rewards, and important milestones, to ensure that the investor understands the big picture. Trying to make your situation appear too “rosy” will make investors skeptical, while making it appear too risky may scare them off. By simply being honest about what you see as the strengths and weaknesses of your situation, you will allow investors to make up their own minds, based on the information available.

Once you have completed your business plan, you should use it as a working document that outlines your “best guesses” on creating a successful business. The plan should remind you of what was important to you when you were starting out and it can be a barometer for determining performance compared to estimates.

If you don't feel comfortable creating your own business plan from scratch, there are business planning software programs available. These packages ask you questions about your business and you simply fill in the blanks. Your responses are then entered into the appropriate plan sections and the contents are automatically created. When you are done, you have a finished business plan. However, proceed with caution: these packages don't work for everyone. Some find that the software is too general and doesn't allow room to tailor and add “personality” to the plan. Others find these tools useful.

These software packages cost between \$100 and \$150. Two of the more popular business planning packages are the Biz Plan Builder (1-800-346-5426) and the MultiMedia MBA (1-800-228-5609).



IMPORTANT POINTS

- ✎ There are many reasons why you need an excellent business plan. However, one of most important is that eventually you will need to obtain more money for your business. You will need a business plan to do so.
- ✎ Writing a business plan is hard work, but it is in your best interest to take your time and do it right.
- ✎ You should talk to your local SBA, SBDC, and/or SCORE counselors when writing your plan.

REFERENCES

Adams, Bob. *Small Business Start-Up: Your Comprehensive Guide to Starting and Managing a Business*. Holbrook, MA. Adams Media Corporation. 1996.

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5

TAX BASICS

TAX BASICS

LEARNING OBJECTIVES

- ☞ All the basic types of taxes that you will have to pay (but not all of them)
- ☞ What the local and state tax regulations are for your region
- ☞ How to pay federal taxes

Not many people are excited about taxes. Who enjoys worrying about—or paying—taxes? However, all small business owners must be aware of tax basics and the various filings they are required to make. Keep in mind that this task is not an easy one. You face Federal tax filings and forms, State tax filings, local filings, sales taxes, use taxes, and unemployment taxes. At a certain point, you may want to consider hiring a professional accountant or tax lawyer to help you. Regardless, it is important that you understand the tax information necessary to run a small business.

THE FEDERAL TAX YOU PAY DEPENDS ON YOUR BUSINESS TYPE

One of the most important tax decisions you will make will take place before your first day of business. When deciding which type of business to form, tax liability should be one of your most important considerations. The different types of businesses (e.g., corporation, partnership, LLC) are discussed in Chapter 3, *Legal Structures for Small Businesses*. Different business entities offer different types of tax structures. For example, if you choose to have a corporation, you will have to pay a double tax. This is because corporations must pay corporate taxes on income and the shareholders (owners) have to pay taxes on their profits. You (as the business) and you (as the owner) must pay taxes twice.

On the other hand, partnerships and LLCs generally have pass-through taxation, so that shareholders, but not the business entity, are required to pay taxes on the business's income. Tax issues are an important component (but not the sole factor) in choosing one type of business entity over another.



Make sure that you take your time when deciding which type of business to form. This decision has a great impact on the amount of taxes you pay. You may need to seek assistance when making this decision. More information on legal structures is available in Chapter 3.

APPLICATION FOR A TAXPAYER IDENTIFICATION NUMBER

You must have a taxpayer identification number for your business so that the IRS can process your tax returns. The two most common kinds of taxpayer identification numbers are the Social Security Number (SSN) for individuals and the employer identification number (EIN) for businesses.



KEOGH PLAN: *A retirement plan whereby a self-employed person may set aside a certain portion of income (tax deferred) into a retirement account. The money is taxable upon withdrawal at retirement, when the person's tax bracket is often lower.*

numbers are the Social Security Number (SSN) for individuals and the employer identification number (EIN) for businesses.

You must include your taxpayer identification number (SSN or EIN) on all returns or other documents you send to the IRS. EINs are used to identify the tax accounts of employers, sole proprietors, corporations, partnerships, estates, trusts, and other entities.

You need an EIN if you:

- ✓ Have employees;
- ✓ Have a Keogh plan;
- ✓ Operate your business as a corporation or partnership; or
- ✓ File any of these tax returns:
 - ✗ Employment
 - ✗ Excise
 - ✗ Alcohol, tobacco, or firearms.

If you need an EIN, apply for it as soon as you form a business.

HOW TO PAY FEDERAL TAXES

Five to six weeks after you receive your EIN, the IRS will send you a coupon book. This book is for use before you file your IRS tax return; when you deposit employment taxes, withhold income taxes, certain excise taxes, corporate income tax, and S corporation taxes. Deposits with completed deposit coupons can be marked or delivered to an authorized financial institution or a Federal Reserve Bank for your area, or you can make the deposits electronically.

If your total deposits for Social Security, Medicare taxes, and withheld income tax during previous years exceeded \$50,000, you will likely be required to deposit your taxes electronically through the Electronic Federal Tax Payment System (EFTPS). Taxpayers who are not required to make deposits using EFTPS may still enroll in the system, which allows tax deposits without coupons, paper checks, or visits to an authorized depository.

Be sure to deposit taxes on time—sizable penalties can apply if you don't. And small businesses owners who also act as managers can be held personally liable for withheld taxes that are not deposited with the IRS.



LOCAL TAXES

Local authorities may tax personal property, such as machinery, equipment, furniture supplies, leased equipment, and even movable machinery used in a business. Some cities and municipalities also levy income taxes on any business operating within their borders. Your accountant or attorney can provide information about the specific taxes that apply in your area and instructions for registering your business.

A helpful site for more information on local taxes is: <http://www.taxsites.com/state.html>.



STATE TAXES

Every State levies some form of tax on small businesses, but in some States some business structures (especially sole proprietorships) have little or no tax imposed. To learn more about tax structures in any given State, visit the Business Owner's Toolkit Site at: http://www.toolkit.cch.com/text/P07_4500.asp.

A list of local taxing authorities in each State can be found at: <http://www.sba.gov/hotlist/statetaxhomepages.html>.



INCOME TAX

All businesses, except partnerships, must file an annual income tax return with the IRS and in certain States where business is conducted. Partnerships must file an information return. An information return is a tax filing that notifies the IRS of the partnership's activities for the year. The form you use depends on how you've organized your business.

Generally, sole proprietors, partners, and shareholders of an S corporation pay income taxes by making regular estimated tax payments during the year. If you expect to owe taxes, including self-employment tax of \$500 or more when you file your return, you generally have to make estimated tax payments.

SELF-EMPLOYMENT TAX

Self-employment tax is the combination of Social Security and Medicare taxes for individuals who work for themselves. Your self-employment tax payments contribute to your coverage under the Social Security System. Social Security coverage provides you with various retirement benefits, disability benefits, survivor benefits, and medical insurance (Medicare) benefits. You generally must pay self-employment tax if your annual net earning from self-employment is \$400 or more.

EMPLOYMENT TAXES

Employment taxes consist of the following:

- ✓ Federal income tax withholding;
- ✓ Social Security and Medicare taxes; and
- ✓ Federal unemployment (FUTA) tax.

FEDERAL WITHHOLDING

Businesses must withhold Federal income taxes from an employee's wages. To determine how much Federal income tax to withhold from each wage payment, you need the employee's W-4.

SOCIAL SECURITY AND MEDICARE

Social Security and Medicare taxes pay for benefits that workers and their families receive under the Federal Insurance Contributions Act (FICA). Social Security tax pays for benefits under the old age, survivors, and disability insurance part of FICA. Medicare tax pays for benefits under the hospital insurance part. You withhold part of these taxes from your employee's wages and you pay a matching amount yourself.

FEDERAL UNEMPLOYMENT (FUTA) TAX

The Federal Unemployment Tax, required by the Federal Unemployment Tax Act (FUTA), pays unemployment compensation to workers who lose their jobs. You report and pay FUTA tax separately from Social Security and Medicare taxes and withheld income tax. You pay FUTA tax only from your own funds. Employees do not pay this tax or have it withheld from their pay.

EXCISE TAXES

If you manufacture or sell certain products, operate certain types of businesses, or use various types of equipment, facilities, or products, you may owe excise tax. Most small businesses don't fall into these categories, which include such businesses as retail stores for heavy trucks, wagering, guns, and tobacco or alcohol products.

SALES TAX

If your business sells retail products and your State imposes sales tax on those goods, your business is usually responsible for collecting and paying that tax. The tax is computed on the product's sale price—not on your net profits.

As the seller of products, you are responsible for:

- ✓ Ensuring that the tax is properly charged and collected from the customer;
- ✓ Ensuring that the tax amount is reported to the appropriate State or locality in a timely manner; and
- ✓ Obtaining sales permits, as needed.

Some States also impose a use tax for the use of personal property, as a complement to the sales tax. Your business is responsible for paying this tax.

EMPLOYEE TAX FORMS

All employees you hire must fill out Form I-9 and Form W-4 on or before the first day of employment.

- ✓ **Form I-9:** The law requires you to verify that each new employee is legally eligible to work in the United States. Both you and the employee must complete the

Immigration and Naturalization Service (INS) Form I-9 (Employment Eligibility Verification).

- ✓ **Form W-4:** Each employee must fill out IRS Form W-4 (Employee's Withholding Allowance Certificate). You use the filing status and withholding allowances shown on this form to figure the amount of income tax to withhold from the employee's wages.

DEDUCTIONS

Knowing what is and isn't deductible can save tax money and should affect your decisions as you set up your company.

BUSINESS EXPENSES

You can normally deduct business expenses on your income tax return.

BUSINESS EXPENSE:
Any ordinary or necessary expense that you pay while conducting your business.



According to the IRS, a business expense must be both ordinary and necessary to be deductible. An ordinary expense is one that's common and accepted in your field of business, trade, or profession. A necessary expense is one that's helpful and appropriate for your business, trade, or profession. An expense does not have to be indispensable to be considered necessary.

Examples of expenses that are normally deductible include: accounting fees, advertising, attorneys' fees, commissions, employee wages, insurance, interest, mailing and delivery costs, manufacturing costs, office supplies, rent, and travel expenses. The following list includes some expense categories that are of interest to startup businesses, although you may be able to deduct many other expenses as well.

- ✓ Business startup costs: details about how to deduct the costs you absorb before you open your business;
- ✓ Depreciation of your business equipment;
- ✓ Business use of your home;
- ✓ Car and truck expenses; and
- ✓ Meal and entertainment expenses. The IRS generally only allows businesses to deduct 50 percent of business-related meal and entertainment expenses.



IMPORTANT POINTS

- ✎ The choices you make when deciding which type of business entity to form will have a tremendous impact on the ways you are taxed.
- ✎ Pay close attention to tax matters or hire a professional. If you are not careful, you will have large penalties to pay.
- ✎ Remember that the information outlined in this chapter provides basic tax information. There are many additional resources available for you to address your overall tax situation. You should use these resources. Again, hire professional help, if necessary.

REFERENCES

- Adams, Bob. *Small Business Start-Up: Your Comprehensive Guide to Starting and Managing a Business*. Holbrook, MA. Adams Media Corporation. 1996.
- Harroch, Richard D. *Small Business Kit for Dummies*. New York, NY. Hungry Minds, Inc. 1998.
- <http://www.sba.gov>. Web site for the Small Business Administration.
- Paulson, Edward. *The Complete Idiot's Guide to: Starting Your Own Business*. New York, NY. Alpha Books. 1995.

RESOURCES

SMALL BUSINESS TAX EDUCATION PROGRAM:

Small business owners and other self-employed individuals can learn about business taxes through a partnership between the IRS and local organizations. Through workshops or in-depth tax courses, instructors provide training on starting a business, recordkeeping, preparing business tax returns, self-employment tax issues, and employment taxes. Check your telephone book for the local number of the IRS office closest to you or call 1-800-829-8020.

IRS TAX FORMS AND PUBLICATIONS:

You can obtain forms and publications from the World Wide Web at <http://www.irs.ustreas.gov>, by fax at 703-321-8020, or call 1-800-TAX-FORM toll-free.

IRS WEB SITE ON SMALL BUSINESS TAXES:

<http://www.irs.gov/businesses/small/index.html>

In addition to this Web site, the IRS offers the Small Business Resource Guide, CD-ROM 2003, which provides critical tax information to small businesses, including forms, instructions, and publications. The CD also provides valuable business information from a variety of Government agencies, nonprofit organizations, and educational institutions. The CD contains essential startup information needed by new, small businesses to be successful. The design of the CD makes finding information easy and quick, and incorporates file formats and browsers that can be run on virtually any desktop or laptop computer.

Copies can be ordered from the IRS by calling 1-800-829-3676.

TAX QUESTIONS:

You can call the IRS with your tax questions Monday through Friday during regular business hours. Check your telephone book for the local number or call 1-800-829-1040.

SMALL BUSINESS ADMINISTRATION:

The Small Business Administration (SBA) offers training and educational programs, counseling services, financial programs, and contract assistance to small businesses owners. The SBA also has publications and videos on a wide range of business topics. For more information on the SBA, see Chapter 2.



6

**FUNDING
ISSUES**

FUNDING ISSUES FOR SMALL BUSINESSES

LEARNING OBJECTIVES

- 👉 How the Small Business Administration can help you get a loan
- 👉 How to get money for your company if you cannot get a business loan
- 👉 How banks decide whether to give a business a loan

Raising money to start a business can be difficult, time-consuming, and very frustrating. You can generally choose from three routes when financing your company: Use your own money, borrow money, or give investors ownership in your company in exchange for their investment. If you decide to go the first route and use your own money, credit, or equity (such as in your home), the best advice is not to overextend yourself. If your business fails, you could find yourself up to your elbows in debt.

FIRST THINGS FIRST: PERSONAL FINANCES

If you borrow money or give investors ownership in exchange for money, you will still need to use some of your own money to start your business. There are very few investors or lenders who will give you money for your business unless they see that you have invested some of your own money. Most investors feel more comfortable lending money if they see that you have something to lose if the business goes sour. They think you will work harder to make the company profitable.

Therefore, you need to have your personal financial situation in order before you can start your business. Startup costs can place a tremendous strain on your personal finances.

Be careful when deciding how much of your personal income to invest. It can take 6 months or more before your new venture is profitable enough to provide financial support for you and your family.

Write a monthly household budget that accounts for your income and your household expenses. Be as conservative as possible, because it is vital to your success that you

STARTUP COSTS:
The amount of money required to start your company.



have the resources to maintain your household expenses while your business is growing. Any strain on your personal budget will place the financial success of your business at risk.

It is also a good idea to check your personal credit situation. Too often, aspiring business owners think their business credit and personal credit profiles are separate. However, business credit is built on the owner's personal credit. Since you have not established a business credit history, lenders and suppliers will use your personal credit history to determine your standing.

Your credit report determines how you will be perceived by potential lenders and suppliers. You should be familiar with the information on your credit report because you may find errors that you will want to have corrected. To get a copy of your credit report, refer to one of the three major credit bureaus: Equifax (<http://www.equifax.com>), Experian (<http://www.experian.com>), or TransUnion (<http://www.transunion.com>).

Now that you understand the importance of using at least a small amount of your own money to start your company and some steps for getting your personal finances in order, we can move on to the topics of borrowing money and sharing ownership to get funding.



THE SMALL BUSINESS ADMINISTRATION: GUARANTEEING YOUR LOAN

The Small Business Administration (SBA) has a variety of programs to assist small businesses. The SBA works with banks and other lending institutions to provide loans and financing to small business that may not otherwise have access to them. The SBA does not give loans directly to small businesses, but guarantees the bank that the loan will be repaid and charges a 2 percent fee for the insurance policy.

SBA GUARANTEED

LOAN: *The SBA does not directly give loans to businesses. Once approved by the SBA, your loan will be given to you by the bank, but the SBA will cosign (guarantee) the loan.*

A guarantee from the SBA that the loan will be repaid makes the loan very attractive to a bank. The bank can get the money from the SBA if you default (cannot pay back) the loan. Where does the SBA get the money to pay back the loan if you default? Taxes! The SBA is a Government organization paid for by tax dollars.

However, don't assume that you need an SBA guarantee to get a loan. First, fill out a loan application at the bank of your choice, which will require your personal financial information and a business plan. Should you not meet the bank criteria for lending, ask if they would approve the loan if you had a loan guarantee from the SBA. The bank will then contact the SBA, and if the SBA approves, the loan will be funded from the bank with an SBA guarantee. The bank approves the loan if the SBA provides an 80-90 percent repayment guarantee.

There are several different SBA loan types and they change on a regular basis. Contact your local SBA office and listen to one of their introductory talks, which lasts about 1 hour. This information provides a solid basis for understanding how to work with a bank to obtain a loan.



SMALL OFFICE/HOME OFFICE LOAN

The Small Office/Home Office Loan (SOHO) program is a co-sponsored project between the SBA and the National Community Reinvestment Coalition. It is designed to assist the increasing number of small and home-based businesses with obtaining SBA-guaranteed loans. It is also intended to help overcome the historical reluctance of conventional loan providers to work with low return-rate financing, as the loan amount is from \$5,000 - \$15,000. Among the many advantageous aspects of this loan program is that, with a completed application, the process takes only about 20 days to fund. The one-page application requires NO business or personal tax returns and NO collateral. The average loan size is \$5,000, with minimal paperwork. No tax returns or business plans are needed.

COLLATERAL: *Property that someone offers to give up if they cannot repay a loan.*



Businesses not eligible for these loans include:

- ✓ Any business earning 30 percent or more of its revenue from gaming;
- ✓ Nonprofit enterprises;
- ✓ Multi-level marketing (e.g., Mary Kay, Herbal Life);
- ✓ Speculative real estate; and
- ✓ Adult-oriented businesses (includes Web sites, bookstores, clubs).

Generally, the loan is a 7-year term loan, with no prepayment penalty and low monthly payments of less than \$100.

Loan proceeds may be used for most business purposes, such as:

- ✓ Startup expenses
- ✓ Expansion
- ✓ Equipment purchases
- ✓ Inventory needs
- ✓ Working capital
- ✓ Requirements
- ✓ Real estate acquisitions
- ✓ Purchase business

Credit scoring is done on a credit matrix basis, which includes a credit report, industry code, average monthly sales, length of time in business, and total liquid assets, which cannot be more than \$100,000.

To get more information about the SOHO program, contact your local SBA or SBDC office (see Chapter 2 for more information).

SBA LOW DOC PROGRAM

If your financial needs are greater than what can be covered by the SOHO program, you should look into other SBA financing programs. One of the more easily accessible loans is the Low Doc Program. It was designed to increase the availability of loans under \$100,000 to the small business community to make the SBA loan review process a faster one. This program uses a simple, one-page application form and rapid turnaround on loans of up to \$100,000. Completed applications are processed quickly by the SBA upon receipt from the lender, usually within a few days.

CERTIFIED PREFERRED SBA LENDERS

There are preferred SBA vendors who do substantial business with the SBA. These banks are known to give the most SBA-backed loans to small businesses and are more likely to lend you the money you need to start your businesses. A listing of these banks can be found at <http://www.sba.gov/gopher/Local-Information/Certified-Preferred-Lenders>.

SECURED LINE OF CREDIT

If you find it difficult to get a general loan for your company, you can get a loan to purchase a piece of equipment. Banks are more likely to lend for equipment, because if you fail to repay, they can take the equipment back and they will not have lost as much money. This is called a secured line of credit. In this scenario, the bank loans the company the money to purchase an asset, such as new equipment or a new building. The

asset is then used to secure the loan until the company pays it back, just as a house secures a mortgage. In this case, the company typically must provide at least 20 percent of the purchase amount. (A \$50,000 purchase requires \$10,000 invested by the company and \$40,000 by the bank.) If the loan can't be repaid, the assets are sold to recover the bank's investment. Liquid assets, such as a certificate of deposit, a receivable note, or inventory are the most desirable and easiest to loan against because they are the easiest to sell if the company defaults. Next best are

fixed assets, such as equipment and computers.

You may also be able to get short-term loans (under a year) by using receivables or inventory as collateral. This type of loan is really a line of credit with special provisions. You provide a monthly summary to the bank showing that your company has a certain level of liquid assets (e.g., accounts receivables from customers, inventory, certificates of deposit) that can be used as security on the loan. They will only loan 70-80 percent of the value of the assets, which is recalculated each month. The danger is that if your assets are declining from one month to the next, you would have to come up with some additional money.

For example, assume that you secured your line of credit last month with \$50,000 in receivables, giving you \$35,000 in credit (70 percent of \$50,000). If your receivables drop to \$40,000 the next month, your collateral would be worth only \$28,000 (70 percent of \$40,000). The \$7,000 difference between \$35,000 and the \$28,000 value of your assets would have to be paid to the bank immediately to meet the terms of your original loan agreement. This can be a tough check to write if you haven't planned for it.

UNSECURED LINE OF CREDIT

Lastly, if you find it difficult to get business financing, you can attempt to obtain personal financing and loan the money to your business. An unsecured line of credit can be

given on a personal basis to the company officers. This is essentially a personal loan to officers (based on the personal credit history of the individuals), who then loan it to the company. This loan will not be given directly to the company, since the company has not proven that it can pay the loan back. The officer(s) then arranges reasonable repayment terms with the company. If you are the officer of a corpora-

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SECURED LINE OF CREDIT: Occurs when a loan is given, but some form of property or equipment is used as collateral to guarantee repayment.

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UNSECURED LINE OF CREDIT: Occurs when a loan is made without the requirement of any property or equipment in collateral to repay debt.

tion, make sure the loan conditions, such as the interest rate and the term of the loan, are similar to those you would see in normal business transactions.

To get the right amount of money from your lender, you should understand exactly how much money you need, as described in the next section.

If you ask for too little money you will have to ask for more at a later date and may not get it. If you ask for too much money, you will be paying interest on money that you are not using, and will actually be losing money.



ESTIMATING COSTS: HOW MUCH MONEY DO YOU NEED?

To determine how much seed money you will need, estimate the costs of your business for at least the first several months. Every business is different and has its own specific cash needs at different stages of development, so there is no universal method for estimating startup costs. Some businesses can be started on a shoestring budget, while others may require considerable investment in inventory or equipment. It is vitally important to know you will have enough money to launch your business venture.

To determine your startup costs, you must identify all the expenses your business will incur during the startup phase. Some of these expenses will be one-time costs, such as the fee for incorporating your business or the price of a sign for your building. Some will be ongoing, such as the cost of utilities, inventory, insurance, etc.

When identifying these costs, decide whether they are essential or optional. A realistic startup budget should only include those things that are necessary to start that business. These essential expenses can then be divided into two separate categories: fixed and variable. Fixed expenses include rent, utilities, administrative costs, and insurance costs. Variable expenses include inventory, shipping and packaging costs, sales commissions, and other costs associated with the direct sale of a product or service.

The most effective way to calculate your startup costs is to use a worksheet that lists all the various categories of costs (both one-time and ongoing).

THE FIVE C'S: HOW BANKS DETERMINE WHETHER OR NOT TO LEND YOU MONEY

You should understand how banks determine who they will fund and who they will not fund. Generally, there are "5 C's of Credit" that determine whether or not a bank will fund you: Character, Capacity, Capital, Conditions, and Collateral.

Character: How do you conduct both your business and personal life and how are you likely to handle your responsibilities as president of the company? Oftentimes, banks do not differentiate between us and our businesses. This is one of the reasons why the credit scoring process evolved, with a large component consisting of personal credit history.

Capacity: What is your company's borrowing history and track record of repayment, as well as the amount of debt your company can handle? A bank wants to know if you will be able to honor the obligation and repay the debt. There are numerous financial benchmarks, such as debt and liquidity ratios, that investors evaluate before advancing funds. Become familiar with the expected pattern in your industry. Some industries can take a higher debt load; others may operate with less liquidity.

Capital: How much money do you have invested in the business? Investors often want to see that you have a financial commitment and that you have put yourself at risk in the company. Both your company's financial statements and your personal credit are keys to the capital question. If the company is operating with a negative net worth, for example, will you be prepared to add more of your own money? How far will your personal resources support both you and the business as it is growing? If the company has not yet made profits, this may be offset by an excellent customer list and payment history. All of these issues intertwine and you want to ensure that the bank perceives the business as solid.

Conditions: What are the current economic conditions and how does your company fit in? If your business is sensitive to economic downturns, for example, the bank wants a comfort level that you're managing productivity and expenses. What are the trends for your industry, and how does your company fit within them? Are there any economic or political hot potatoes that could negatively impact the growth of your business?

Collateral: While cash flow will nearly always be the primary source of repayment of a loan, bankers look at what they call the secondary source of repayment. Collateral represents assets that the company pledges as an alternate repayment source for the loan. Most collateral is in the form of hard assets, such as real estate and office or manufacturing equipment. Alternatively, your accounts receivable and inventory can be pledged as collateral.

The collateral issue is a bigger challenge for service businesses, as they have fewer hard assets to pledge. Until your business is proven, you're nearly always going to pledge collateral. If it doesn't come from your business, the bank will look to your personal assets. This clearly has its risks – you don't want to be in a situation where you can lose your house because a business loan turned sour. If you want to borrow from banks or other lenders, you need to think long and hard about how you'll handle this collateral question.

Keep in mind that in evaluating the 5 C's of Credit, investors don't give equal weight to each area. Lenders are cautious and one weak area could offset all the other strengths you show. For example, if your industry is sensitive to economic swings, your company may have difficulty getting a loan during an economic downturn—even if all other factors are strong. And if you're not perceived as a person of character and integrity, there's little likelihood you'll receive a loan, no matter how good your financial statements may be. As you can see, lenders evaluate your company as a total package, which is often more than the sum of the parts. The biggest element, however, will always be you.



IMPORTANT POINTS

- ✎ Before you think about borrowing money or even starting your business, make sure that your personal financial situation is in order. If it is not, your business is likely to fail. Even if you have to wait a while before you can start your business, make sure that the time is right.
- ✎ The SBA does not loan money, but they can help you get the right loan for your business through their loan guaranty programs.
- ✎ There are many banks that are preferred SBA lenders. Try to work with one of these banks. Your chances of getting the loan will be higher.
- ✎ By understanding how banks decide to fund businesses, you can make sure that you portray yourself and your business in the best light possible according to the 5 C's.

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- Adams, Bob. *Small Business Start-Up: Your Comprehensive Guide to Starting and Managing a Business*. Holbrook, MA. Adams Media Corporation. 1996.
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7

**EFFECTIVE
MARKETING**

EFFECTIVE MARKETING

LEARNING OBJECTIVES

- 👉 Why marketing is important for your business
- 👉 How to develop a marketing plan

Effective marketing strategies identify potential customers, design attractive product or service offerings, set the product or service's price range, and convey an advertising message and presentation likely to interest customers. Marketing involves product development, pricing, packaging, distribution, and communication of the marketing message, including the steps involved in making the sale. All marketing processes follow the same cycle, regardless of how big or small the business:

- ✓ Get information about the different kinds of people that may want to buy your product or service;
- ✓ Tailor your strategies to meet customers' needs while making a profit;
- ✓ Use your customer and product knowledge to create and project marketing messages that will inspire, interest, and move your customer to action;
- ✓ Go for the sale; and
- ✓ Once the sale is made, move into a "customer service" phase, working to ensure that the customer is happy and will want to come back again.

Now that you have an overview of the marketing cycle, let's look at the best way to plan for accomplishing these goals: the marketing plan.

MARKET SIZE: *The number of potential customers that will be able to purchase your product or service*

COMPETITOR IMPLICATIONS: *The actions your competitors might take when reacting to your product or service.*



THE MARKETING PLAN

A marketing plan is used to keep yourself on track as you manage your business to marketing success. Unlike the business plan, the marketing plan is primarily for you so that you can adequately judge whether or not your product or service has what it takes to be successful in the market. Also, it serves as a blueprint for you to follow in terms of getting your product or service known and recognized.

A marketing plan can also be a terrific tool for evaluating whether or not you should launch a new product or service. If you focus on broader issues in your marketing plan such as market size, competitor implications, pricing, and projected sales, you will learn whether your product or service has what it takes to thrive in the market.

A documented marketing plan should contain the following sections:

- ✓ Table of Contents
- ✓ Executive Summary
- ✓ Current Situation
- ✓ Competitor and Issue Analysis
- ✓ Marketing Objectives
- ✓ Strategizing
- ✓ Action Program
- ✓ Budget
- ✓ Summary

TABLE OF CONTENTS

The Table of Contents shows readers the information they will find in the coming pages and gives a good first impression.

MISSION STATEMENT:

Describes what the organization does, who it serves, and what makes the organization unique

EXECUTIVE SUMMARY

The Executive Summary allows you to introduce your company and explain the major points of your plan. Write the Executive Summary after the other sections have been written, providing an overview of major points. Some of the key points to cover are detailed below.

- ✓ Introduce your company by briefly describing the nature of your business and the products or services you offer;
- ✓ State your founding philosophy—often called a mission statement—and company objectives;
- ✓ Introduce your management team (if you are the entire team, describe the duties you will have); and
- ✓ Close the Executive Summary with a brief statement about the primary marketing objectives and strategies in the plan.

B

CURRENT SITUATION

In the Current Situation section of the marketing plan, provide information about your location, target market, and competitive environment. Briefly describe the competitive environment and key issues faced by your company. More detail will be provided in the Competitor and Issue Analysis section that follows.

TARGET MARKET: *The type of people to whom you will try to sell your product or service, for example, teenagers, senior citizens, or outdoor enthusiasts.*



COMPETITOR AND ISSUE ANALYSIS

The purpose of this section is to explain, in detail, the external challenges and opportunities your business may face. Even though preparation of the analysis will take time, it will be worth it. You will benefit in a number of ways:

- ✓ You'll discover your company's competitive advantage—the reason customers will want to do business with you instead of your competition. Then you'll be able to communicate your competitive advantage effectively to win potential customers.
- ✓ The analysis may spur ideas for innovative improvements to your product offerings.
- ✓ You may find there are some categories of customers whose needs are not being met. For example, if you plan to prepare and deliver gourmet meals, you may discover that a particular part of town is not currently being served by your competitors. If you can satisfy unmet needs, you'll develop a market "niche."
- ✓ By observing the actions of your competitors, you learn more about your market. For example, does a successful competitor offer reduced prices during a particular season? If so, what does that tell you about your customers' spending habits?
- ✓ If you find that your market is saturated with capable competitors, you can avoid the costly mistake of starting a business without adequate demand and redirect your efforts toward something that will pay off. (For example, your research may tell you that there's already an ample number of thriving gourmet meal services in your targeted market area.)

The Competitor Analysis should also contain:

- ✓ Names of competitors;
- ✓ Summary of each competitor's products;
- ✓ Competitors' strengths and weaknesses;
- ✓ Competitors' strategies and objectives; and
- ✓ Strength of the market.

To get information about your competitors you should research the following sources:

- ✓ Internet;
- ✓ Personal visits;
- ✓ Conversations with customers;
- ✓ Competitors' ads;
- ✓ Speeches or presentations;
- ✓ Trade show displays; and
- ✓ Written sources, such as
 - ✎ General business publications

- ✎ Marketing and advertising publications
- ✎ Local newspapers and business journals
- ✎ Industry and trade association publications
- ✎ Industry research and surveys
- ✎ Computer databases (available at many public libraries)
- ✎ Annual reports
- ✎ Yellow Pages.

The Issue Analysis addresses various obstacles your business will face, in addition to those posed by the competition. Half the battle in overcoming these external obstacles is gaining an understanding of them. You can benefit from “lucky breaks” by staying on top of new developments and events that can be used to your advantage.

Threats and Opportunities (from the outside): Identify, and rank by order of importance, any threats or opportunities your business may face from outside influences. Threats and opportunities come from a variety of sources.

Strengths and Weaknesses (from inside your company): Identify the internal strengths and weaknesses of your company. For example, your education, experience, and reputation in your area of expertise are strengths. A weakness, if you have employees, might be a lack of supervisory experience.

Summarize the Main Issues in an Issues Statement: Finally, determine which issues are most significant and integrate them into a summarizing Issues Statement. Use your carefully researched Issues Statement as you set your marketing objectives and strategy.

MARKETING OBJECTIVES

Marketing objectives should answer the question “What do you want to achieve?” Meeting these objectives should lead to sales. Determine a projected amount of sales that you want to reach as a result of your marketing plan. To gauge whether your marketing plan is working or not, you must have a measuring stick to compare your results. The projected results of your marketing should be clear, measurable, and have a stated time for achievement.

STRATEGIZING

The marketing strategy section outlines the game plan to achieve your objectives. It is the heart of the marketing plan. This section should include information about the “four P’s”:

- ✓ Product—your product(s) and services;
- ✓ Price—what you’ll charge customers for products and services;
- ✓ Promotion—how you will promote or create awareness of your product in the marketplace; and
- ✓ Place (distribution)—how you will bring your product(s) together with your customers.

Product

A product can be a physical item, service, or idea. Describe in detail your products or services in terms of the features and benefits they offer customers. Describe how you provide your product or service.

Price

List the price of your products and describe your pricing strategy. List price ranges for product lines. For example, if your product is a line of cosmetics, include information in this section about your lipsticks “ranging in price from \$5.00 to \$15.00 per item” rather than a detailed product price list. (You should, however, consider including a detailed price list in a Supporting Documents section.)

Describe any price flexibility or negotiating room, as is common with large purchases, such as houses or cars. Outline any discounts you offer for long-term customers, bulk purchases, or prompt payment. Also, include the terms of sale, such as “net due in 30 days,” extended payment plans, and whether you accept credit cards.

Promotion

A promotion plan describes the tools or tactics used to accomplish your marketing objectives. Examples of promotion plans:

If your marketing objective is to:	Then tools or tactics might be to:
Create awareness of baby care products among mothers of newborns.	<ul style="list-style-type: none">● Advertise in baby care or motherhood magazines.● Distribute product samples to obstetricians.● Offer free baby care seminars to expectant mothers.
Increase sales of potato chips to teens.	<ul style="list-style-type: none">● Distribute free samples or discount coupons at high school football games.● Sponsor an event attended by teens.

In the *Action Programs* section, you’ll describe in detail the steps that need to be taken, when they should be done, who will do them, and so on.

Placement

In the *Placement* section, describe how your products and customers “meet” or come together through sales and distribution. Describe your sales philosophies and methods. Do you employ an aggressive sales method to net a large number of quick sales, or a relaxed method, that places an emphasis on customers feeling comfortable enough to come back another time if they don’t buy now? Do you use contract salespeople or employees? Explain your approach to sales issues.

Describe your distribution system. Where will your product be placed so customers have access to it? A few points about distribution that should be addressed in your marketing plan are:

PRODUCT LINE:
The different types of products your company sells.



- ✓ Is the exchange of the product made in a store? Through the mail? Through a direct sales representative?
- ✓ What are your production and inventory capacities? How quickly can you make products and how many can you store?
- ✓ Are there cyclical fluctuations or seasonal demands for your products? For example, if you produce Christmas decorations, how will you manage peak production and sales periods, as well as slow periods?
- ✓ Do you sell to individuals or to re-sellers? Your company may use more than one method. For example, you may sell directly to customers who place large orders, but also sell to customers who buy small quantities of your product through retail outlets.

ACTION PROGRAM

In the Action Program section, you will develop a detailed promotional “to do” list. It’s a task list that describes what will be done, when it will begin and be completed, and who will accomplish the tasks.

The Action Program activities pick up where the promotion plan leaves off. Whereas the promotion plan might state that your company will participate in industry trade shows, the Action Program lists the trade shows and their dates, your objectives for attending each one, which company representatives will be sent, the results you expect, and the marketing tactics you will employ.

BUDGET

Estimate the cost of the marketing activities you’ve described in the plan, so you’ll have a budget to keep everyone on track over the course of the year. Typical marketing expense categories are marketing communications, market research, promotions, advertising, events, and public relations.

Because marketing needs and costs vary widely, there are no simple rules for determining what your marketing budget should be. A popular method with small business

owners is to allocate a small percentage of gross sales for the most recent year. This usually amounts to about 2 percent for an existing business. However, if you are planning on launching a new product or business, you may want to increase your marketing budget figure to as much as 10 percent of your expected gross sales. Another method used by small business owners is to analyze and estimate the competition’s budget and either match or exceed it.

MARKET RESEARCH:

Surveys of the area in which a product or service is to be offered, which are done to determine the cost of doing business, any competition, potential sales, and other factors.





IMPORTANT POINTS

- ✎ Marketing is a cycle of events that starts with identifying potential customers and ends with great customer service after the sale.
- ✎ A marketing plan is a must if you want to have an effective strategy for getting customers to use your product or service.
- ✎ Don't underestimate the importance of marketing, because it is directly associated with sales.

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8

**COMPLIANCE
WITH
LICENSING
REQUIREMENTS**

COMPLIANCE WITH LICENSING REQUIREMENTS



LEARNING OBJECTIVES

- ☞ What a license is and whether or not your business needs one
- ☞ Organizations to contact if you need a license for your business
- ☞ Local and Federal licensing information

Chances are you will need to obtain some type of license or permit if you plan on doing business in the Washington metropolitan area. Depending on the type of business you intend to start, you will probably need to apply for one or more licenses from the State, city, or county; and, in some instances, from the Federal Government. Before you begin doing business, make sure you have the proper licenses and permits.

Failure to do so can result serious in serious consequences, including fines or even the loss of your business.

In some cases, a temporary waiver will allow you to get started.

If you will be working in more than one city or State, you may need to apply for a license in each jurisdiction. The requirements for multiple licenses vary depending on the type of business you own. For example, electricians generally need licenses for different jurisdictions, but Maryland, Virginia, and the District of Columbia have a reciprocal licensing relationship for beauticians and barbers. Those professions require licensing in only one jurisdiction, but allow work in all three. Consult the State agencies that license your profession to obtain specific information. (Contact information is provided later in this chapter.)

Although the licensing process may seem complicated, a number of tools are available on the Internet and through various offices to assist you in determining the licenses you will need and, in some cases, in simplifying the application filing process. Requirements vary in different jurisdictions throughout the country. Although information on the licenses and application processes for Washington,

LICENSE: *In business, the term license refers to permissions to perform certain activities and are issued by governmental agencies that regulate that type of activity.*



DC; Maryland; and Virginia are provided below, similar resources are available in any region of the U.S.

LICENSING IN THE DISTRICT OF COLUMBIA

In the District of Columbia, most types of retail businesses or services performed outside an office require a Basic Business License (BBL). It currently costs \$35 to apply for the BBL plus a \$10 endorsement fee. An additional licensing fee of at least a \$100 is assessed according to the size and type of business. The BBL license is good for 2 years. A separate license is also required for each location from which you will do business.

To determine whether you need a BBL to do business in DC and how much it will cost, consult the BBL Web site at <http://mblr.dc.gov/information/bbl/index.asp> or call 202-442-4311.

In addition to the BBL, certain other licenses may be required, depending on the nature of your business:

- ✓ If you intend to sell alcoholic beverages, you need a license from the Alcoholic Beverage Regulation Administration—See <http://www.abra.dc.gov/services/licenses/index.shtm> or call 202-442-4423.
- ✓ If you are involved in any kind of banking or financial business (including check cashing), you need a license from the Department of Banking & Financial Institutions. See <http://dbfi.dc.gov/index.asp> or call 202-727-1563.
- ✓ If you work in a healthcare profession, contact the Health Professional Licensing Administration. See http://doh.dc.gov/prof_license/services/main.asp or call 202-442-9200.
- ✓ If you intend to sell insurance or securities, the Department of Insurance and Securities Regulation must license you. See <http://disr.dc.gov/main.shtm> or call 202-727-8000.

LICENSING IN VIRGINIA

To find out what licenses are required to do business in the Commonwealth of Virginia, go to the license and permit guide Web site at <http://www.dba.state.va.us/licenses>, or contact the appropriate agency by phone (see the information provided below). At this Web site, hosted by the Department of Business Assistance, you can search for information on licensing by type of business, or look for the agency that oversees a specific trade or industry. While the information on the Web site is generally up-to-date, the Department of Business Assistance cautions that changes do occur and business owners should contact each agency involved for complete and accurate information. However, the Web site is certainly a good place to start.

The primary licensing agencies are:

Department of Agriculture and Consumer Services

This agency licenses anyone involved in the production, marketing, or distribution of agricultural or food products. They register every pesticide manufactured, distributed,

sold, offered for sale, used, or offered for use in Virginia. See <http://www.vdacs.state.va.us> or call 804-786-2373.

Department of Alcoholic Beverage Control

This agency licenses businesses involved in the production, distribution, storage, transportation, and/or sale of alcoholic beverages. See <http://www.abc.state.va.us/licensing.html> or call 804-367-0649.

Department of Aviation

This agency distributes rules and regulations governing the licensing of airmen, aircraft, and airports. See <http://www.doav.state.va.us> or call 804-236-3637.

Department of Education

This agency credits, licenses, or regulates private schools, including elementary, secondary, and nursery schools; trade, technical, business, and correspondence schools; and schools for the handicapped. Call 804-225-2020.

Department of Environmental Quality

This agency issues pollution control permits for any business that emits particles or gases into the air and oversees water discharge and management of solid and hazardous waste materials. Regulations apply to businesses as small as car washes. See <http://www.deq.state.va.us> or call 804-762-4570.

Department of Forestry

This agency licenses and regulates the use of State forests and forest reserves, including mineral exploration. See <http://www.vdof.org> or call 804-977-6555.

Department of Game and Inland Fisheries

This agency regulates the taking, possession, and sale of wild animals, birds, and freshwater fish; endangered species; and any form of wildlife. They license shooting preserves, fur farming and dealing, hunting dog trails, commercial trout rearing, fishing, seine hauling, breeding and raising game birds and animals, game bird and animal exhibits, and stuffing and mounting of birds and animals. The agency also titles and registers motorboats and licenses watercraft dealers, regattas, and boat races. See <http://www.dgif.state.va.us> or call 804-367-1000.

Department of Health

This agency licenses emergency medical agencies, vehicles, and attendants; bedding and upholstery service businesses; commercial blood banks; hospitals, nursing homes, and related institutions; home health agencies; hotels; summer camps; campgrounds and other lodging facilities; restaurants; milk processors; and companies that work with radiation materials and equipment. See <http://www.vdh.state.va.us> or call 804-786-3561.

Department of Health Professions

This agency oversees the process of examining, licensing, and disciplining healthcare practitioners governed by one of the 13 State healthcare boards (i.e., the Board of Audiology & Speech-Language Pathology, Board of Counseling, Board of Dentistry, Board of Funeral Directors & Embalmers, Board of Medicine, Board of Nursing, Board of Nursing Home Administrators, Board of Optometry, Board of Pharmacy, Board of

Physical Therapy, Board of Psychology, Board of Social Work, and Board of Veterinary Medicine). See <http://www.dhp.state.va.us/boards.htm> or call 804-662-7636.

Department of Housing and Community Development

This agency establishes regulations for local licensing of plumbers, electricians, and building-related mechanical workers. See <http://www.dhcd.state.va.us> or call 804-371-7000.

Department of Labor and Industry

This agency administers and enforces compliance programs for commercial and industrial establishments, including construction, logging, demolition, and excavation sites, and issues permits for lead and asbestos abatement projects. See <http://www.dli.state.va.us> or call 804-371-2327.

Department of Professional and Occupational Regulation

This agency regulates practice accounting, architecture, professional engineering, land surveying, landscape architecture, auctioneers, barbers, contracting, cosmetology, geology, hearing aid specialists, interior designers, opticians, professional soil scientists, branch pilots, real estate sales and appraisers, water and wastewater works operators, polygraph examiners, asbestos and lead abatement occupations, tradesmen, and waste management facility operators.

See <http://www.state.va.us/dpor/indexie.html> or call 804-367-8500.

Department of Social Services

This agency licenses businesses that operate residential facilities for children, day care centers, assisted living facilities, and adult day care centers. Providers must meet specific standards to obtain a license. See <http://www.dss.state.va.us> or call 804-692-1900.

Department of Taxation

This agency requires registration by new businesses, which may be done online at <https://www.ireg.tax.state.va.us/Login.jhtml> or by contacting them at iFile@state.va.us or 804-367-8037.

Department of Transportation

This agency regulates the use of State highways and issues permits for use of highways and adjacent areas, including bridges, tunnels, ferries, rest areas, weigh stations, and commuter parking lots. See http://virginiadot.org/default_myvdot.asp or call 804-786-2801.

State Corporation Commission

The State Corporation Commission has authority over utilities, insurance, State-chartered financial institutions, securities, retail franchising, and railroads. They also license mortgage lenders and brokers, money transmitters, payday lenders, and check cashers. See <http://www.state.va.us/scc> or call 800-552-7945 (in Virginia) or 804-371-9967 from outside the State.

Virginia Employment Commission

You may need to register with this Commission if your business employs others. See <http://www.vec.state.va.us/vecportal> or call 804-786-1485.

If you will be working in a profession or occupation regulated by one of the Boards within the Virginia Department of Professional and Occupational Regulation (see: <http://www.state.va.us/dpor/indexie.html>), you will also need to apply for a license or obtain regulatory status. Professions that require licenses in the Commonwealth of Virginia include real estate appraisers, architects, asbestos removers, auctioneers, barbers, cosmetologists, cemetery workers, certified home inspectors, certified interior designers, geologists, hearing aid specialists, land surveyors, landscape architects, opticians, polygraph examiners, engineers, soil scientists, real estate agents, landlords, and a variety of tradesmen and contractors (e.g., electricians, plumbers, gas fitters). Separate phone numbers for each licensed profession are available on the Department's Web site (address above), or call 804-367-8500 for assistance.



In addition to acquiring State licenses, you must determine any additional requirements of the local county or city.

In Fairfax, Arlington, and Loudon counties, for example, you must pay a business tax, assessed according to your gross receipts or purchases, before your license is issued. However, for new businesses, a flat fee may be substituted. In Virginia, incorporated cities are not part of any county and you will need to consult the city regulations rather than the county regulations.

Links to various county Web sites are available at <http://www.vaco.org/onlinetext.htm>.

Links for license and other business information in cities in northern Virginia are:

- ✓ Alexandria: <http://ci.alexandria.va.us/city/busguide/toc.html>
- ✓ Fairfax City: <http://www.fairfaxva.gov/business/business.htm>
- ✓ Falls Church: <http://www.ci.falls-church.va.us/business.html>
- ✓ Fredericksburg: <http://www.efredericksburg.org/>

LICENSING IN MARYLAND

In Maryland, the easiest way to determine the business licenses needed is to consult Maryland's Business License Information System (BLIS) at <http://www.blis.state.md.us/client/Blis.jsp>. This Web site provides information on the licenses you will need and whom to contact for answers to your questions. The Web site simplifies the application process by making information available from different agencies. It is accessible 24 hours a day, 7 days a week.

When you enter the BLIS Web site, you must first identify the type of business you plan to operate. The Web site then lists the permits and licenses that may be needed for that type of business. You can view information on each type of permit or license, including how to obtain the license, how long it will take to get it, and how much it will cost. Your license requirements may be as simple as registering the name of your business for tax purposes (see Chapter 5). Using BLIS, you can also download electronic application forms, and, in some cases, apply for licenses online.

Businesses that require a license in the State of Maryland include accommodation and food service; administrative and support services; agriculture, forestry, fishing, and hunting; arts, entertainment, and recreation; construction; educational services; finance and insurance; healthcare and social assistance; information management of companies and enterprises; manufacturing; mining; other services; professional, scientific,

and technical services; real estate, rental, and leasing; real trade; transportation and warehousing; utilities; waste management and remediation services; and wholesale trade.

You may also need a State environmental permit if your business involves waste, water, or air management or work with radioactive materials. See <http://www.mde.state.md.us/Permits/busGuide.asp> or call 410-537-3772 or 800-633-6101, extension 3772.

In addition to State licenses, you may (depending on the type of business) need a license from the county in which are located, or in which you wish to do business. For Maryland counties:

- ✓ Montgomery County—See <http://207.96.37.52/dpstmpl.asp?url=/permitting/l/licenses.asp> or call 240-777-6300
- ✓ Prince Georges County—See <http://www.goprincegeorgescounty.com/Business/index.asp?h=40&n=0> or call 301-952-3330
- ✓ Baltimore County—See http://www.co.ba.md.us/Directory/Business/Directory_Business_LicensingandPermits or call 410-887-3616
- ✓ For other counties—See <http://www.mec.state.md.us/meccount.html>

FEDERAL LICENSING REQUIREMENTS

Most businesses will not require licenses from the Federal Government, but there are a few exceptions. These include radio and television stations and companies that produce transmitting equipment; manufacturers of alcohol, tobacco products, or firearms; companies that manufacture drugs or process meats; companies that provide interstate transport; securities brokers or investment advisors; and firms that export to other Nations. For each of these types of business, the appropriate Federal agency and its Web site are listed below.

- ✓ Radio and television stations and companies that produce transmitting equipment: The Federal Communications Commission (<http://www.fcc.gov>)
- ✓ Manufacturers of alcohol, tobacco products, or firearms: The Bureau of Alcohol, Tobacco, and Firearms (<http://www.atf.gov/>)
- ✓ Companies that manufacture drugs or process meats: Food and Drug Administration (<http://www.fda.gov>)
- ✓ Companies that provide interstate transport: Surface Transportation Board (<http://www.stb.dot.gov/index.htm>)
- ✓ Securities brokers or investment advisors: Securities and Exchange Commission (<http://www.sec.gov>)
- ✓ Firms that export to other Nations: Bureau of Export Administration (<http://www.bxa.doc.gov>)



IMPORTANT POINTS

- ✎ Before you begin to do business, make sure you have researched and received any licenses required from the State, county, city, or Federal Governments. It is your responsibility to do so, even for a part-time business.
- ✎ Keep your files in order and properly display permits and licenses at your place of business, if so required.
- ✎ Don't forget to renew your license. The required renewal times vary depending on the licensing office; for example, in DC, business owners must renew the BBL every 2 years.



9

**COPYRIGHTS,
TRADEMARKS,
AND PATENTS**

COPYRIGHTS, TRADEMARKS, AND PATENTS: WHEN THEY ARE NECESSARY AND HOW TO GET THEM



LEARNING OBJECTIVES

- 👉 Familiarity with the concept of intellectual property
- 👉 How to protect your work with a copyright
- 👉 How to register a trademark
- 👉 How to patent an invention

Copyrights, trademarks, and patents all deal with intellectual property and how to protect it.

Intellectual property covers a wide range of products. A book, a musical composition, a work of visual art, a play, a mechanical invention, even a plant—any of these diverse endeavors are considered intellectual property. If you are the owner of an intellectual property, you can get financial compensation for the property, and thus need to protect the ownership.

INTELLECTUAL PROPERTY: *A product based on an idea that comes from a person's mind and has some sort of commercial value.*



The laws covering intellectual property state that a person can own an idea and provides legal mechanisms to protect a person's ownership rights. The U.S. Patent and Trademarks Office (USPTO) and the U.S. Copyright Office are the Federal agencies that implement these mechanisms. USPTO is part of the Department of Commerce, and the Copyright Office is part of the Library of Congress.

Copyright protection and the right to patents and trademarks are guaranteed by the U.S. Constitution. Article 1, Section 8 of the Constitution gives Congress the power to "promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries."

Sometimes these three areas overlap, but as you will see in the following discussion, they are distinct, each with a specific purpose.

Over the years, the body of laws and regulations related to intellectual property has grown increasingly complex. In an attempt to streamline its operations, USPTO has adopted a 21st Century Strategic Plan focusing on reducing paperwork, moving toward a predominantly electronic system, automating and accelerating the patent application process, and streamlining intellectual property systems worldwide.

COPYRIGHTS

Copyrights protect individual creative expression—not the underlying ideas, but the specific way those ideas are expressed. This protection is automatic, but it can be strengthened by registering a work with the U.S. Copyright Office. Registering makes it easier to bring suit and recover damages in cases of copyright infringement. The registration fee is \$30 per work.

The Federal Copyright Act of 1976 specifies how to register a copyright. There are no State copyright laws. The Federal copyright law is an extremely detailed explanation of what copyright means—nearly 300 pages! The discussion here presents an overview; for further details you can go online or refer to a number of books available about copyright.

The copyright law in its entirety, including amendments, can be found at: <http://www.copyright.gov/title17/circ92.pdf>.

In most circumstances, copyrights for works published since January 1, 1978 are good for the life of the creator of the work plus 70 years. There are some exceptions, as in the cases of copyrights owned by an employer or works published anonymously or under a pseudonym. In those cases, the copyright lasts 95 to 100 years, depending on the date of publication. When a copyright expires, the work goes into the public domain.



B If a work is in the **PUBLIC DOMAIN**, anyone can use it without permission from the author or the author's heirs. Work might be in the public domain if its copyright has expired, if it consists solely of facts, if the author placed it in the public domain, or if it was created by the Federal Government (like this manual).

There is no global copyright that provides protection throughout the world. However, copyrights are protected in many foreign countries by major international treaties, most notably, the 1971 Berne Convention for the Protection of Literary and Artistic Works.

Books, songs, plays, and works of art are among the most commonly copyrighted materials, but copyrights apply to many other properties, such as software, games, engineering plans, and architectural and landscape designs. In recent years, the copyright world has been somewhat disrupted by the hugely growing

field of electronic publishing, as on the Internet, and related issues, such as music distribution and piracy over the Internet.

Three criteria must be met for a work to be protected by copyright:

- ✓ The work must be original.
- ✓ It must be fixed in a concrete form of expression, such as printed on paper, on audio or videotape, or on a computer disk.
- ✓ The work must exhibit some creativity.

Works that cannot be protected by copyright include:

- ✓ Something that is not fixed in a tangible format; for example, an improvised speech or a non-recorded choreographic work.
- ✓ Titles, names, short phrases, and slogans. (See the Trademark section, below, for more information on how these can be protected.)

- ✓ Familiar symbols.
- ✓ Listings of ingredients or contents.
- ✓ Ideas or concepts.
- ✓ Works composed entirely of information that is common property with no original authorship; for example, a standard calendar, tape measure, or ruler.

Notice of copyright is not required, but it can be useful to inform the public that a work is copyright-protected and prevent an infringement in which the violator does not realize the work is copyrighted. Anyone can put the copyright symbol on his or her original work—you don't have to register with the U.S. Copyright Office to use it. A notice usually includes the copyright symbol © or the word “copyright,” the year of first publication, and the name of the copyright owner. For sound recordings, the symbol ℙ is used.

Copyrights are usually owned by the authors or creators of the work, but there are some exceptions:

- ✓ An employee who creates a work in the course of employment—in these cases, the employer owns the rights.
- ✓ In the case of a commissioned work-for-hire, the copyright is owned by the person who commissions the work.
- ✓ Copyright can be sold to another party. Transferred copyrights must be conveyed by written agreement, signed by the original holder.
- ✓ Copyrights also can be co-owned by co-authors or co-creators of a work.

Copyright encompasses the right to reproduce, display, distribute, or adapt a work, and the owner of a copyright may transfer some or all of these rights to a publisher, exhibitor, or other party. This can be done either with limitations or unconditionally.

Publication is not a requirement of copyright, but it is an important related concept. The 1976 Copyright Act defines publication as “the distribution of copies or phonorecords of a work to the public by sale or other transfer of ownership, or by rental, lease, or lending.” Also, a work is considered published for copyright purposes when copies or phonorecords are distributed for

the purpose of further distribution, public performance, or public display. However, public performance or display of a work does not in itself constitute publication.

The year of publication may determine the duration of copyright protection for anonymous works or works in which a pseudonym is used for the author. Every work published in the U.S. is required to file with the Library of Congress.

*Cases of unconditional transfer of all copyright rights are known as a **LICENSE**. If a copyright is infringed, the owner can file suit asking the court to prevent further infringement and award monetary damages, including attorney's fees. One form of infringement is **PLAGIARISM**, which is passing off another person's original work as one's own. In cases called **FAIR USE**, a copyrighted work can be used without the owner's permission. Usually, this involves a situation in which the work is used for scholarly or journalistic purposes.*



HOW TO REGISTER COPYRIGHTS

The U.S. Copyright Office explains how to register six different types of works: literary works, visual arts works, performance works, sound recording, serials and periodicals, and mask works.

These types of works are explained in detail on the Office's Web site at <http://www.copyright.gov/register/index.html>.

In general, registration requires that three items be sent to the Library of Congress:

- ✓ Completed application form;
- ✓ Nonrefundable filing fee of \$30 for each application; and
- ✓ Nonreturnable deposit of the work being registered.

Send the application, fee, and work in the same package to: Library of Congress, Copyright Office, 101 Independence Avenue, SE, Washington DC, 20559-6000. Checks or money orders should be made out to the Register of Copyrights. To renew a copyright, an application form and nonrefundable fee of \$60 is required.

The Copyright Office receives 600,000 applications each year. After you apply, you will receive either a certificate of registration or a letter or telephone call from the Copyright Office indicating that further information is needed.

Works by the U.S. Government are not eligible for copyright protection.

TRADEMARKS

A trademark is a brand name—a distinctive sign, logo, slogan, symbol, or other emblem used by businesses to identify their company and products and to distinguish their products from others.

There are several variations of the trademark. A **SERVICE MARK** is the same as a trademark, but it applies to a service, rather than a product. Service marks are often referred to as trademarks. A **CERTIFICATION MARK** is a word, name, symbol, device, or combination of these used in commerce to certify certain characteristics of goods or services, such as geographic origin, material, mode of manufacture, or quality. A **COLLECTIVE MARK** is a trademark or service mark used by members of a collective group or organization, such as a union or an association. Another variation of the trademark is **TRADE DRESS**, the broad term for distinctive and identifying packaging or shape of a product—for example, a Mrs. Butterworth syrup bottle or the color scheme of a Subway sub shop.

Trademarks do not expire and can apply indefinitely. They are protected internationally, in some countries, by the Paris Convention for the Protection of Industrial Property, which was first established in 1884 and most recently revised in 1967.

As with a copyright, registration is not required for a trademark. Just using a mark establishes a commonlaw right to it. However, trademarks and service marks can be registered on the Federal Principal Register.

Trademark registration offers several advantages, including:

- ✓ Notice to the public of ownership of the mark;
- ✓ Legal presumption of ownership;
- ✓ Ability to bring a mark-related action in Federal court;
- ✓ Basis for obtaining registration in foreign countries; and



- ✓ Ability to file with the U.S. Customs Service to prevent importation of foreign goods that infringe on the trademark.

The symbols, ™ and SM (service mark) can be used by anyone who wishes to protect a mark. The registration symbol ® can only be used after the U.S. Patent and Trademark Office registers the trademark. While these symbols are not regulated by the Federal Government, some local, State, and foreign jurisdictions have laws concerning them.

Trademark law regulates any conflicting use of trademarks, service marks, and trade dress by businesses. Unfair competition laws prohibit one business from using another's trademark or name in a way that is likely to confuse the public. Usually, rulings about who is entitled to use a trademark are based on who used it first.

Therefore, an important step in establishing and registering a trademark is finding out if someone else has already registered it. Trademark searches can be performed at the USPTO office; searches for word trademarks also can be conducted at any of the 70-plus Patent and Trademark Depository Libraries located around the country. A listing of these offices can be found online at <http://www.uspto.gov/web/offices/ac/ido/ptdl/index.html>. Trademarks can also be searched online at <http://tess2.uspto.gov/bin/gate.exe?f=tess&state=i98889.1.1>.

The USPTO recommends a search of trademarks before filing an application. Common law trademarks (those that have not been registered) can be searched through State registries, telephone directories, industrial directories, and other sources. Professional search firms are also available; they can be found in the Yellow Pages of your local phone book or on the Internet. (For example, a Google search of the words "trademark", "common law," and "search" turns up dozens of possibilities.)



HOW TO REGISTER TRADEMARKS

For trademark purposes, the USPTO lists 45 different classes of goods and services. Some examples are chemicals, paints, cosmetics, pharmaceuticals, machinery, hand tools, medical apparatus, jewelry, firearms, musical instruments, paper goods, furniture, housewares, clothing, toys, foods, advertising services, building construction services, and telecommunications services. For the complete list, see <http://www.uspto.gov/web/offices/fac/tmfaq.htm>.

Only the owner of a trademark can file to register it. Applications can be filed by mail or in person at the USPTO, 2900 Crystal Drive, 2nd Floor, Arlington, VA, 22022-3514, or over the Internet through the Trademark Electronic Application System (TEAS) at <http://www.uspto.gov/teas/index.html>. Forms can also be printed out from this Web site and mailed. Address applications to the Assistant Commissioner for Trademarks at the above address.



A trademark application must include:

- ✓ The application form;
- ✓ A specimen of each mark;
- ✓ An example of how the mark is used in the real world, such as in the form of a label, tag, or container; and
- ✓ A filing fee.

In the case of a service mark, the specimen can be in the form of an advertisement or brochure. If the specimen is bulky or larger than 8½ by 11 inches, a photograph or high-quality photocopy can be used. A drawing of the mark, as used or as intended for use, is also required.

The filing fee for a trademark is \$335.00 per class of goods and/or services. Only one mark per application is permissible, but a mark may consist of several elements joined to form a composite whole, such as words plus a visual design. It is not required that a mark already be in use at the time of filing, but there is an additional \$100 per class fee if the application is based on a future “intent to use” in interstate commerce. Three payment options are available—credit card, automated deposit account, or electronic funds transfer. Details are found on the TEAS Web site.

The filing fee covers the costs of processing a trademark application and is not refundable, even if the registration is denied.

You don’t need an attorney to file a trademark application, although there are lawyers who specialize in trademark law and expert assistance might be helpful.

Generally, it takes about 6 to 7 months from the time of application for a trademark to be registered, but it may take longer, depending on legal issues that might arise. You can check on the status of a pending application by calling the status line at 703-305-8747, or by looking online at the Trademark Application and Registration Retrieval Web site: <http://tarr.uspto.gov>.

When the USPTO receives an application, it determines answers to number of questions:

- ✓ Are there any errors in the application?
- ✓ Is the mark the same or similar to an existing mark?
- ✓ Is the mark on a prohibited or reserved list?
- ✓ Is the mark generic?
- ✓ Is the mark solely descriptive?

If the answer to all these questions is no, the mark is published in the USPTO’s Official Gazette as a candidate for registration. If existing mark owners object to the registration, a hearing is scheduled to resolve the dispute. If there is no opposition, the mark is placed on the Principal Register.

Registrations granted before 1989 have a 20-year term; those granted after 1989 have a 10-year term. For registration to remain valid, an Affidavit of Use must be filed between the fifth and sixth years after registration and subsequently within 1 year of the end of every 10-year period after registration. The fee for a renewal application is \$400 and must be filed within a year before expiration of the registration. A 6-month grace period is allowed, with an additional \$100 fee.

In some cases, the USPTO will turn down a request to register a mark. A number of grounds might be cited, including the fact that the mark is merely a generic name; it contains immoral or deceptive material; it disparages someone or something or suggests a connection that does not exist; it is comprised of the flag or coat of arms of the U.S., a foreign country, or a State or other municipality; it includes a photograph of a living person without their consent; or it closely resembles or is easily confused with an existing mark.



PATENTS

A patent is the grant of a property right for an invention to the inventor, issued by the United States Patent and Trademark Office. The USPTO receives over 300,000 patent applications each year. Patents are divided into 400 classes and more than 136,000 subclasses.

The first patent law was enacted in 1790, and the latest general revision was in the 1950s. The law is codified in Title 35 of the United States Code. In addition, on November 29, 1999, Congress enacted the American Inventors Protection Act of 1999 (AIPA), which further revised the patent laws. U.S. patent grants are effective only within the United States, U.S. territories, and U.S. possessions. However, patent rights are recognized abroad by international agreements, such as the Paris Convention and the Patent Cooperation Treaty.

What is granted is not the right to make something, use or offer it for sale, or sell or import it, but the right to exclude others from making, using, offering for sale, selling, or importing the invention. Once a patent is issued, it is up to the patentee to enforce the patent without the aid of USPTO.

A patent gives an inventor exclusive use of his or her invention for a specified period of time. Generally, the term of a new patent is 20 years from the date on which the application for the patent was filed, depending on the type of patent.

Only the inventor can apply for a patent. USPTO officers and employees are prohibited from applying for patents. If two people invent something together, they can apply for a joint patent; companies or groups of people can also hold patents.

Individual and some other patent holders are classified as small entities; this designation applies to for-profit companies with fewer than 500 employees and any nonprofit organization. The fee for small entities is half what it is for larger companies. To claim this reduced fee, the application must state that it comes from a small entity.

The statute states that a patent can be obtained by any person who “invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof ...” “New” means it cannot previously have been described, known, or used anywhere in the world, and differences must be more than obvious changes, such as a change in color or size.

The terms used to describe these two requirements for a patent are “novel” and “non-obvious.” The Patent Office cannot supply information about the novelty and patentability of an application before a patent has been filed or give advice about possible infringement.

A **PATENT** can be described as a monopoly awarded by the Government that allows an inventor to be paid if anyone else uses his or her invention. Patents protect inventions and improvements to existing inventions.



There are three types of patents: A **UTILITY PATENT**, the most common type, is granted to anyone who invents or discovers any new and useful process, machine, article of manufacture, or compositions of matters, or any new useful improvement of any of these. It expires 20 years after application. A **DESIGN PATENT** is granted to anyone who invents a new, original, and ornamental design for an article of manufacture. The design is inventive but nonfunctional. A design patent expires 14 years after the date it is issued. A **PLANT PATENT** is granted to anyone who invents or discovers and asexually reproduces any distinct or new variety of plants. It expires 20 years after issue.



The Scientific and Technical Information Center of the USPTO has an extensive library that the public can use to research novelty and patentability of an invention. The public can research U.S. patents at the Patent Search Room, Crystal Plaza 3, 1A01, 2021 Jefferson Davis Highway, Arlington, VA. Inventors can also conduct searches at designated Patent and Trademark Depository Libraries around the country.

HOW TO APPLY FOR A PATENT

Filing a patent application is a detailed and somewhat technical process, and the information here is only an overview of what is involved. The particulars of how to proceed are explained on the USPTO Web site, including detailed instructions for drawings, and in a number of books on the subject, listed at the end of this section.

While some inventors prepare their own patent applications and do their own searches, knowledge of patent law and regulation is necessary, and many inventors use a patent lawyer or agent at some point in the process. The USPTO has a register of patent lawyers and agents. A directory is available at: <http://www.uspto.gov/web/offices/dcom/olia/oed/roster/index.html>.

Patent applications and correspondence relating to patent matters should be addressed to the Commissioner for Patents, P.O. Box 1450, Alexandria, VA, 22313-1450. The personal presence of applicants at the USPTO is unnecessary. Patent applications are generally filed by mail, but utility patents can now be filed electronically. Electronic filing can be done through the USPTO Web site at <http://www.uspto.gov/ebc/efs/index.html>.

Patent applications fall into two categories: non-provisional or provisional.



The **CLAIM** (or claims) is an important part of the patent application. It is a precise description of the structure of the invention. Most applications contain a number of claims describing the invention from various viewpoints. A claim may be broad or specific, but if it is too broad, it is likely to be rejected because it lacks sufficient novelty and distinction from existing products.



A non-provisional application includes a written document with a specific description of the invention, a claim of the subject matter, and an oath or declaration of its novelty; a drawing, when necessary; and the filing fee. Infrequently, the Patent Office might request a working model of an invention. This is the case, for example, for perpetual motion machines.

Basic filing fees are \$770 for utility patents (\$385 for a small entity); \$340 for a design patent (\$170 for a small entity); and \$530 for a plant patent (\$265 for a small entity). Additional

fees are collected when a patent is issued and for maintenance. A detailed breakdown of fees can be found at <http://www.uspto.gov/go/fees/fee2003oct01.htm#patapp>.

A provisional patent application (PPA) provides an avenue to register an invention in a less comprehensive format at a reduced fee, but without all the benefits of the full application. This interim process requires a complete description of the invention and any drawings necessary to explain it, but does not require claims, formal drawings, or other paperwork. If the regular patent application is filed within 1 year of the PPA, the applicant receives the benefit of the PPA application date in the case of a conflicting claim, and the full 20-year term before expiration after the regular patent filing. The filing fee for a provisional patent is \$160; \$80 for small entities.

The work of examining applications for patents is divided among a number of examining technology centers (TC), with each TC having jurisdiction over certain assigned

fields of technology. Applications are examined in the order in which they were filed. Examiners also identify applications that claim the same invention and may initiate proceedings, known as interferences, to determine who the first inventor was.

The applicant (or attorney or agent) is notified in writing of the examiner's decision by an Office "action." Rejection is not uncommon—relatively few applications are accepted as first filed. Objections or requirements missing from the denied application are identified, along with constructive information on how to improve the application.

If an applicant wants reconsideration, he or she must reply in writing, with specific responses to the identified errors or problem areas. The application can be rejected with the second consideration. A rejection can be appealed to the USPTO's Board of Patent Appeals and Interferences. An alternative to an appeal for a rejected patent is a request for continued examination. Both of these procedures require fees paid by the applicant.

When the patent application is accepted, the applicant is notified and the fee for issuing the patent is due within 3 months. Issue fees are:

	Large entity	Small entity
Utility issue fee	\$1,330	\$665
Design issue fee	\$480	\$240
Plant issue fee	\$640	\$320

Maintenance fees are also required at various points throughout the life of the patent.



IMPORTANT POINTS

- ✎ A person's intellectual property can be protected by a copyright, trademark, or patent.
- ✎ These protections, based on the Constitution and supporting laws, are administered by Government agencies, the U.S. Office of Copyright, and the U.S. Patent and Trademark Office.
- ✎ Copyrights and trademarks are in place simply by stating so, if a work qualifies and there is no infringement of another existing work. However, for best protection against infringement of your property, it is a good idea to register it with the appropriate Government office.
- ✎ A patent protects your invention from being marketed or otherwise providing profit to others. Applying for a patent is a complicated, lengthy, and somewhat expensive process, but it has been used for centuries and has allowed American inventors to pursue and profit from their ideas.

RESOURCES

FOR MORE INFORMATION ON COPYRIGHTS:

A complete explanation of copyright laws and procedures is available at the U.S. Copyright Office Web site, <http://www.copyright.gov>.

Information by telephone is available by calling the Copyright Public Information Office, 202-707-6737, from 8:30 a.m. to 5 p.m. (Eastern time) Monday through Friday, except on Federal holidays. Information is also available via fax by calling 202-707-2600.

For information by mail, write to: Library of Congress, Copyright Office, Publication Section, LM-455, 101 Independence Avenue, SE, Washington DC, 20559-6000.

The World Intellectual Property Organization (WIPO), an agency of the United Nations, administers international treaties related to intellectual property.

For more information about this organization, visit the Web site: <http://www.wipo.int/about-wipo/en>.

BOOKS ABOUT COPYRIGHT:

The Copyright Handbook: How to Protect & Use Written Words, 7th Edition, by Stephen Fishman, Nolo Press, 2003.

The Copyright Permission and Libel Handbook: A Step-by-Step Guide for Writers, Editors, and Publishers, by Lloyd J. Jassin and Steve C. Schechter, John Wiley & Sons, 1998.

Digital Copyright: Protecting Intellectual Property on the Internet, by Jessica Litman, Prometheus Books, 2001.

The Illustrated Story of Copyright, by Edward Samuels, St. Martin's Press, 2002.

You can get answers to questions about trademarks from the Trademark Assistance Center, 800-786-9199 (703-308-9000 from Northern Virginia).

BOOKS ABOUT TRADEMARKS:

Trademark: Legal Care for Your Business & Product Name, 6th Edition, by Stephen Elias and Kate McGrath, Nolo Press, 2003.

The Trademark Guide, by Lee Wilson, Allworth Press, 1998.

How to Register Your Own Trademark: With Forms, 3rd Edition, by Mark Warda, Ron Idra, James L. Rogers, Sourcebooks Trade, 2000.

Essentials of Trademarks and Unfair Competition, by Dana Shilling, John Wiley & Sons, 2002.

For further information about the patent process, call the USPTO Information Line and Patent Assistance Center at 800- PTO-9199.

Many books are available on getting a patent and marketing an invention once it has been patented. The following list is just a sampling:

- ✎ Patent It Yourself, 9th Edition, by David Pressman, Nolo Press, 2002.
- ✎ Patents, A Practical Handbook, by U.S. Department of Commerce, Dover Publishing, 2000.
- ✎ Nolo's Patents for Beginners, 3rd Ed, by David Pressman and Richard Stim, Nolo Press, 2002.
- ✎ How to License Your Million Dollar Idea: Everything You Need To Know To Turn a Simple Idea into a Million Dollar Payday, 2nd Edition, by Harvey Reese, John Wiley & Sons, 2002.
- ✎ The Complete Idiot's Guide® to Cashing in on Your Inventions, by Richard C. Levy, Alpha Communications, 2001.
- ✎ Patent Law Essentials: A Concise Guide, by Alan L. Durham, Quorum Books, 1999.
- ✎ Patent, Copyright & Trademark, An Intellectual Property Desk Reference, 6th Edition, by Stephen Elias and Richard Stim, Nolo Press, 2003.



10

**WHAT IS
BONDING?**

WHAT IS BONDING?

LEARNING OBJECTIVES

- ☞ What bonding is and whether or not your business needs to be bonded
- ☞ How to get bonded
- ☞ Programs and organizations that can help you get bonded

Depending on the size and activity of your business, you may need to be bonded. Bonding is similar to insurance, but there are some differences as well. Bonds protect your company and your customers from certain problems, but unlike insurance, the bond is issued after the bonding company has thoroughly investigated the company to determine that it is able to meet its obligations. In this way, the process of bonding is more like securing a bank loan than getting an insurance policy.

There are several types of bonds that a small business may need: surety bonds, fidelity bonds, and commercial bonds, described below.

Bonding. This is the process of getting approved by a bonding company that will guarantee that a business or its employees will perform a particular task (e.g., manage funds, complete a construction project), often within a certain period, or avoid committing some negative action (e.g., stealing from a customer). If the company that purchased the bond fails to fulfill its obligation, the bonding company pays the customer. When employees are bonded individually, the bonding company may either pay the customer or, if the employee cheats the employer they work for, the employer may receive payment.

BONDS protect your company and your customers from certain problems, but unlike insurance, the bond is issued after the bonding company has thoroughly investigated the company to determine that it is able to meet its obligations.



Surety Bonds. The bonding (or surety) company agrees to compensate a person or company (the obligee) if a third party (known as the principal) fails to pay a debt or meet an expectation. For example, if a contractor who has a surety bond fails to complete work, the surety company may pay to finish the job. Different types of surety bonds include bid bonds, performance bonds, and payment bonds.

Bid Bonds. This type of surety bond guarantees that the bidder on a contract is able to enter into that contract at the price that was bid if they win the contract.

Performance Bonds. This type of surety bond protects a customer from financial loss if the principal fails to perform a contract in accordance with its terms and conditions.

Payment Bonds. This kind of surety bond ensures that the contractor will pay workers, subcontractors, and suppliers as required.

Fidelity Bonds. These bonds protect your business or your customers from the actions of your employees. For example, if an employee embezzles funds from your company or steals property from a customer, the bonding company will reimburse for the loss. Surety bonds may be blanket bonds that cover all employees at a company or individual bonds that cover a specific employee.

Commercial Bonds. These bonds are typically required by law in certain situations for certain companies, and they cover specific events. For example, a tax bond guaranteeing that a company will pay appropriate taxes may be required by certain Government agencies.

GETTING BONDED

To get your business bonded, you will need to contact an agent or broker (often these are the same as insurance agents). The broker can guide you through the bonding process. You will probably want to shop around to find someone in the area offering bonds with a low premium.

Premiums for surety bonds usually range in cost from 0.5 to 2 percent of the contract amount, depending on the size, type, and duration of the project and the contractor. There is usually no cost for a bid bond, since the bonding company will make money on other bonds if the bid is accepted. Performance bonds tend to incorporate payment bonds and maintenance bonds, so there is no additional premium charged for those services.

All bond premiums are considered service fees. The bond company will first investigate your company and will only provide a bond if they believe there will be no loss. The company will investigate your credit history, references, reputation, financial soundness, ability to meet business obligations, experience, equipment (if needed for the project), your relationship with your bank, and your level of credit.

To find companies who deal in surety bonds, you can contact the National Association of Surety Bond Producers (NASBP) through their Web site at <http://www.nasbp.org/bond.cfm> or by calling (202) 686-3700. More information on surety bonding is available from the Surety Information Office of the NASBP [see <http://www.sio.org/index.html> or call 202-686-7463].



WHEN ARE BONDS REQUIRED?

By law, bidders on all Federal public work contracts for more than \$100,000 must have performance and payment bonds. Most States and local jurisdictions also require bonds for large contracts.



Some private companies will require that companies bidding on projects be bonded, and a primary contractor may request that a subcontractor be bonded to participate in a contract.

In addition, laws may require that certain types of businesses be bonded before they can be licensed to operate in a community.

For example, a health club or gym in the District of Columbia must have a surety bond of \$25,000.00 if it has annual membership sales of up to \$100,000, and a bond for \$50,000.00 if its annual sales exceed that amount. Fidelity bonds may also be required for employees in certain industries. For example, in Virginia, workers at cemeteries must be bonded.



PROGRAMS TO ASSIST WITH BONDING

Several programs are available to help small businesses get bonded. The Federal Government's Small Business Administration has a surety bond guarantee program that can assist small contractors or service companies. This program can guarantee bid, performance, and payment bonds for small businesses that are unable to get bonds through commercial channels (for contracts up to \$2 million). For more information on this program, see <http://www.sba.gov/opc/pubs/fs21.html> or call the mid-Atlantic Surety Bond Guarantee Office at 215-580-2706.



The Federal Government also provides assistance in obtaining fidelity bonds for employees who are considered "high-risk" (e.g., ex-offenders, recovering substance abusers) and are therefore unable to get commercial fidelity bonds. For information on this program see <http://wtw.doleta.gov/documents/fedbonding.asp> or call 1-800-233-2258.

States may also have programs to help businesses get bonded. In this area, the State of Maryland's Small Business Development Financing Authority has a surety bond program that helps small contractors get bonded for Government or public utility contracts that require bid, performance, and payment bonds. For more information about this program call 410-333-4270.



IMPORTANT POINTS

- ✎ To get your business bonded, you will need to contact an agent or broker who can guide you through the process.
- ✎ By law, bidders on all Federal public work contracts for more than \$100,000 must have performance and payment bonds. Most States and local jurisdictions also require bonds for large contracts.
- ✎ Some private companies require that companies bidding on projects be bonded, and a primary contractor may request that a subcontractor be bonded to participate in a contract.
- ✎ Community laws may require that certain types of businesses be bonded before they can operate in a community.
- ✎ Before bidding on contracts, find out if bonding is required and take steps to obtain the bonds needed.
- ✎ The Federal Government's Small Business Administration has a surety bond guarantee program that can assist small contractors or service companies.



11

**COMPLIANCE
WITH ZONING
REGULATIONS**

COMPLIANCE WITH ZONING REGULATIONS



LEARNING OBJECTIVES

- 👉 What is zoning, and how does it apply to your business?
- 👉 Various zoning requirements
- 👉 Local resources to help you address zoning issues

The location of your business is important for many reasons, but before selecting a location, you need to determine whether your business activities will comply with the zoning laws for that location. Through zoning laws, city, county, and municipal governments control development and use of properties in their communities. Zoning laws specify where residential, industrial, recreational, or commercial activities can take place. They may also limit the size of lots, the density of building development, the use of natural resources, and changes to structures that have historical importance.

Typically, areas are zoned according to certain broad categories. The most common are residential, industrial, commercial (i.e., for non-industrial businesses), and agricultural, but there are many subcategories. For example, an area may be zoned for light industry, or part of a commercial district may be limited to particular types of businesses. Some areas may be zoned for combinations of these categories (e.g., both residential and commercial).

The following terms relate to zoning practices.

Variance. This is a legal request to make an exception to current zoning requirements. Approval of the variance does not change the zoning overall, but will allow one individual to use property in a way that's "at variance" with current zoning laws in one instance (e.g., adding a garage to one's property).

Permitted Uses. These are exceptions to the general zoning rule that are built into the law. For example, the law may state that doctors or other professionals are allowed to have offices in a neighborhood zoned as residential.

ZONING specifies where residential, industrial, recreational, or commercial activities can take place and may limit the size of lots, the density of building development, the use of natural resources, and changes to structures that have historical importance.



Special Use Permit. These permits are sometimes required to allow certain types of businesses or buildings in a specific zone. For example, a funeral home may only be allowed in a residential area if the business obtains a special use permit.

Non-Conforming Use. When a location is already being used for a particular purpose and new zoning laws disallow that use or add new requirements, the location will often be given permission for a “non-conforming use.” For instance, new zoning regulations may require doctors’ offices to have a certain amount of off-street parking, but an office already in operation may be allowed to ignore the new regulation.

Easement. An easement allows use of someone else’s property for a particular purpose. For example, the electric company may be given an easement that allows them to run wires across an individual’s property.

HOME BUSINESSES



You may be considering starting a new business in your home, but even if you own your home, local regulations may not allow your business to operate there.

A number of factors can influence whether your business will be allowed under current zoning, including the nature of the business, whether there will be employees or customers on the premises, the hours you’ll be working, and the availability of parking.

While some residential areas are zoned to exclude home-based businesses, most zoning will place some restrictions, without banning all home business activities. Limits may be placed on the amount of building space devoted to the business, the hours of operation, the number of employees, the use of signs, changes to the appearance of the building, the storage of inventory, the use of mechanical or electrical equipment, the parking of commercial vehicles on the property, and the use of on-street parking by customers.



Even if there are businesses already operating in your neighborhood, do not assume that current zoning will allow you to open a business.

Those businesses may have been in operation prior to new zoning regulations that made the area strictly residential. The businesses may have been granted permission to continue operating or the owners may have obtained a variance that makes an exception to the zoning rules in their cases.

While you should always check local zoning to determine whether you can operate your business in your home, zoning is not always clear-cut. Zoning laws may say that “customary home occupations” are allowed, without specifying what those occupations are. In many places, old zoning laws are on the books that do not take into account contemporary business practices. In fact, there are many home businesses operating in the United States in violation of local zoning laws. In many places, such violations are ignored if neighbors have no reason to complain and the local government is not inconvenienced.

HOW TO CHANGE ZONING

In an area that is not zoned for the type of business you wish to start, you can pursue one of two options. You can try to change the zoning rules for the area where your business will be located, or you can apply for a variance for your business. The latter option

is easier in most cases, but if other business operators want a zoning change as well, you may be able to work together to change the zoning for a whole area.

To obtain a variance, you must usually start by filing an application and paying an application fee to the local zoning board or office. Once the application is filed, the zoning office usually notifies other property owners in the area of the request and asks them to comment, either in writing or at a meeting. In some cases, a public notice must be posted and a public hearing held.

To make a case for a variance, you may need to demonstrate that the use you intend for the property will preserve the neighborhood's appearance and character, will only apply to your specific property, and that without the variance, you will suffer some form of hardship.

Communities have different attitudes about zoning changes. However, if others have obtained a similar variance in a given neighborhood, chances are good that your request will also be successful.

While you probably will be able to handle the forms required for a variance by yourself, if there are special difficulties involved or if you want to improve your chances, you should seek the assistance of a lawyer.



Zoning issues should be addressed before you invest money in a property, but there are a several things you can do to move ahead in securing a property before a decision on new zoning is reached. You can ask that your sales contract include a provision that you are not obligated to close the deal unless you obtain a zoning change. You can also get an option to buy, and then look into the possibility of changing the zoning.

If the zoning decision does not go as you hope, you will not have to exercise the option. In any event, a seller or landlord who wants to make a deal may be able to help you get a zoning change.



IMPORTANT POINTS

- ✎ Before selecting a location for your business, determine whether your business activities will comply with the zoning laws for that location.
- ✎ Investigate the zoning for any property in which you are interested before you sign a sales contract or lease.
- ✎ If you are operating a business from your home, be aware that zoning may limit what you can do there.
- ✎ In an area that is not zoned for the type of business you wish to start, you can try to change the zoning rules for the area or you can apply for a variance.

RESOURCES

Many counties and cities post zoning maps online. Those available for the greater Washington Metropolitan area are listed below.

DISTRICT OF COLUMBIA

- ✎ <http://dcoz.dc.gov/info/map.shtm>

MARYLAND

- ✎ Montgomery County: http://www.mc-mncppc.org/gis/large_maps/index.shtm and <http://gis.montgomerycountymd.gov/apps/gis/maplist.asp>
- ✎ Baltimore County: <http://www.co.ba.md.us/Agencies/myneighborhood/zoning.html> (maps are shown by neighborhood)
- ✎ Prince Georges County: <http://www.mncppc.org/html/pubs.htm> (limited information available)

VIRGINIA

- ✎ Arlington County: <http://magellan.co.arlington.va.us/>
- ✎ Alexandria: http://ci.alexandria.va.us/city/planning_zoning/gis/gis_maps.html
- ✎ Fairfax County: <http://www.co.fairfax.va.us/maps/nofind/PdfLoader/default.htm>
- ✎ Falls Church: <http://www.ci.falls-church.va.us/government/eda/cfceda/zoning.html>

✎ Fairfax City: <http://www.ci.fairfax.va.us/Services/CommDevPlan/zoningmap.htm>

✎ Loudon County: <http://gisinter1.loudon.gov/weblogis/agree.htm>

Further information on zoning in local areas is available from the following offices:

DISTRICT OF COLUMBIA

See <http://dcoz.dc.gov/main.shtm> or call 202-727-6311

MARYLAND

✎ Prince Georges County: <http://www.mncppc.org/pgco/home.htm> or call 301-952-3065

✎ Montgomery County: <http://www.mc-mncppc.org/community> or call 301-495-4600 or 301-495-4610

✎ Anne Arundel County: http://www.co.anne-arundel.md.us/pace/default_pace.htm or call 410-222-7437

✎ Baltimore County: http://www.co.ba.md.us/Agencies/planning/about_office or call 410-887-3480

Links to Web sites and other contact information for additional counties in Maryland can be found at http://www.daveandlisa.com/buying_a_home/building_codes_zoning.htm

VIRGINIA

✎ Arlington County: See <http://www.co.arlington.va.us/cphd/planning> or call 703-228-3525

✎ Alexandria: See http://ci.alexandria.va.us/city/planning_zoning or call 703-838-4666

✎ Fairfax County: See <http://www.fairfaxcounty.gov/gov/ocp/default.htm> or call 703-324-1290

✎ Falls Church: See http://www.ci.falls-church.va.us/government/eda/cfceda/zoning_info.html or call 703-248-5040

✎ Fairfax City: See <http://www.ci.fairfax.va.us/Services/CommDevPlan/CDP.htm> or call 703-385-7820.

✎ Loudoun County: See <http://www.loudoun.gov/b&d/home.htm> or call 703-777-0118.



12

**COMPLIANCE
WITH STATE
AND LOCAL
REGULATIONS**

COMPLIANCE WITH STATE AND LOCAL REGULATIONS



LEARNING OBJECTIVES

- 👉 How to find information on State and local safety laws and regulations
- 👉 How to find information on local smoking regulations

Much of what you need to know about State and local laws and regulations is explained elsewhere in this publication in the chapters on taxes, licenses, legal structures, and zoning. While there are many other laws on the books in Virginia, Maryland, and the District of Columbia, most will not affect the daily operations of your business. Exceptions are those that govern health and safety and, if your business has employees, specific labor laws.

Many health and safety laws affect small businesses, but their impact varies greatly, depending on the nature of the business. There are laws addressing everything from the packaging of eggs to the removal of asbestos. It is beyond the scope of this chapter to list all of these regulations, but more information can be found through the following resources.

For general information on State and DC laws, see the Web sites provided by the Small Business Administration:

- ✓ District of Columbia: <http://www.businesslaw.gov/viewstate.cfm?catid1=10363>
- ✓ Maryland: <http://www.businesslaw.gov/viewstate.cfm?catid1=10354>
- ✓ Virginia: <http://www.businesslaw.gov/viewstate.cfm?catid1=10355>

In addition, information on business regulations and laws in smaller jurisdictions is available on the Web at the following addresses:





Maryland

- ✓ Montgomery County (and the State of Maryland):
<http://www.montgomerycountymd.gov/siteHead.asp?page=/content/ded/sbs/sbdc.asp>
(click on the Small Business Guide link)
- ✓ Prince Georges County:
<http://www.goprincegeorgescounty.com/Business/index.asp?h=40&n=0>
- ✓ City of New Carrollton: <http://www.new-carrollton.md.us/BusinessOrdinances.html>

Virginia

- ✓ Fairfax County: <http://www.fairfaxcountyeda.org/reference.htm>
- ✓ Arlington County: <http://www.co.arlington.va.us/portals/scripts/business.asp>
- ✓ Fairfax City: <http://www.ci.fairfax.va.us/Business/EconDev/EconDev.htm>
- ✓ Falls Church: <http://www.ci.falls-church.va.us/business.html>
- ✓ Loudoun County: <http://www.loudoun.gov/cor/bpol.htm>

For information on specific occupational safety rules in the Washington metropolitan area, consult the following offices:

- ✓ District of Columbia Department of Employment Services, OSHA Consultation Services: call 202-671-1800
- ✓ Maryland Occupational Safety and Health Consultation Services: See <http://www.dllr.state.md.us/labor/mosh.html> or call 410-537-4512
- ✓ Virginia Department of Labor and Industry: See <http://www.doli.state.va.us> or call 804-786-6613.

Summaries of State labor laws relating to minimum wage, child labor, and other topics can be found at: <http://www.dol.gov/esa/programs/whd/state/state.htm>.



LAWS GOVERNING SMOKING

Many jurisdictions have laws that limit smoking; this can affect your business if you have employees or deal with the public. District of Columbia laws ban smoking in healthcare facilities, Government buildings, and the public areas of retail stores. Smoking is allowed in restaurants that can seat more than 50 people, but only if half of the restaurant is set aside for nonsmokers. In Virginia, smoking is banned in check-out lines and public restrooms and the law concerning restaurants is the same as in the District. Smoking in retail stores is only allowed in areas set aside for that purpose. Maryland law allows smoking in a separate, enclosed room of a restaurant or in a bar area, as long as this area does not take up more than 40 percent of the space.

In Virginia, local laws on smoking cannot be more restrictive than the State law, but in Maryland that is not the case. A law in Montgomery County banning smoking in all bars, restaurants, and workplaces recently passed after a long court challenge.



IMPORTANT POINTS

- ✎ Check with State and local small business offices to obtain assistance with specific questions about State and local laws.
- ✎ Do some research on the State and local laws that govern the type of business activity you intend to engage in.



13

**INSURANCE
CONSIDERATIONS**

INSURANCE CONSIDERATIONS



LEARNING OBJECTIVES

- 👉 To learn the benefits of proper insurance coverage
- 👉 To determine what type of insurance is best for your company

The insurance agent is another professional that should be included in the business startup process. It may be most efficient to have one agent handle all of your insurance needs. There are policies available specifically designed to cover small businesses that, in one package, will cover most types of insurance.

Insurance will be important not only to you, but to your business relationships. For example, if you choose to lease office space, the landlord will typically require that you furnish a certificate of insurance or be listed as an additional insured on your policy, as assurance that your business will not disappear overnight in the event of a loss.

This chapter addresses some of the protections afforded to your business through various types of insurance.

BUSINESS PROPERTY INSURANCE

Property insurance should include a broad form of coverage to protect you from a wide variety of losses, including:

- ✓ The building occupied by your business. If you lease a location, your landlord should provide coverage.
- ✓ Business personal property, which includes tables, desks, chairs, and equipment. You will also want to include any improvements you make to leased premises. Examples are: a room divider, a display case, or a custom-built counter that forms a reception area for your clients.
- ✓ Loss of income.
- ✓ Earthquake.
- ✓ Flood (which may or may not be available in some areas).

Keep in mind that an all-risk policy can be structured to cover all equipment, including computer hardware and software, plus your valuable records. A properly written policy will include loss of income that might result from breakdowns, as well as loss of income from other hazards that might temporarily close down your business.

LIABILITY INSURANCE

A Comprehensive General Liability (CGL) policy is designed to provide coverage to third parties for the following:

- ✓ Personal and advertising injury.
- ✓ Fire legal liability, which is often mandatory if you lease your premises. This protects you in the event that your negligence results in damage or loss to your landlord's property. For example, you mistakenly leave a small electric space heater running and go home for the evening. During the night, the heater shorts and starts a fire, resulting in fire and smoke damage to your landlord's building. In this case, the negligent act of leaving the space heater on caused the loss. This is where fire legal liability insurance protects your investment.

COMPREHENSIVE: *Covering completely or broadly.*

LIABILITY: *The ability to be held responsible for something.*

- ✓ Products and completed operations.
- ✓ Medical expense or medical payments.
- ✓ General liability for your premises. The best illustration is the common "tripping over the torn carpet, resulting in an injury" loss.

MALPRACTICE: *A recklessness of professional duty or a failure to exercise an accepted degree of professional skill or learning when rendering professional services resulting in injury, loss, or damage.*

ERRORS AND OMISSIONS: *Also known as professional liability insurance, is the coverage professionals have to guard against malpractice or similar suits.*

On occasion, some policies will exclude Products and Completed Operations and/or Personal Injury and Advertising coverage, depending on the services your business provides. In these instances, a Professional Liability or an Errors and Omissions Policy might be available for your type of operation that will cover the errors and omissions that might result in suits against your company. This is particularly true of professions that are held to a higher degree of care or standard, for example, attorneys, engineering consultants, insurance agents, realtors, doctors, and dentists.

WORKER'S COMPENSATION INSURANCE

If your business has employees, Worker's Compensation insurance will be mandatory. See Chapter 15, *Basic Principles of Human Resources*, for greater detail on Worker's Compensation insurance.

OTHER INSURANCE

- ✓ Auto coverage for company vehicles (liability, comprehensive, collision, and uninsured/underinsured motorists).

- ✓ Health insurance plans tailored to fit the size of your business (this coverage gives you an edge when recruiting good employees).

EXCESS LIABILITY COVERAGE

These liability limits are available over and above the maximum limit your carrier of choice may offer, and can be accomplished in two ways:

1. Excess limits, which can typically be added at extra cost to the underlying package policy in “chunks” of \$500,000 or \$1 million dollar layers, sometimes up to \$5 million.
2. Purchasing what is called a “commercial umbrella,” which can typically provide excess coverage over and above most underlying package policies, including the business policy, business auto, and worker’s compensation.

Your carrier of choice may offer lower limits, which may look attractive from a premium standpoint. But savvy business owners should contemplate liability limits of at least \$1 million. The additional cost is usually affordable and in today’s touchy environment makes good sense.



EMPLOYMENT PRACTICES LIABILITY COVERAGE

More companies are starting to carry employment practices liability insurance, the premiums for which exceed \$2,000 annually for \$1 million of coverage. While employment practices are rarely encountered in a small operation, the threat of wrongful termination or sexual harassment lawsuits, which are excluded under most business policies, becomes more prevalent as the size of your organization grows.

LIFE INSURANCE

As mentioned earlier, if you have a partner, your buy-sell agreement can be funded by life insurance in the event of the partner’s death. As your business grows, this insurance can be increased.



IMPORTANT POINTS

- ✎ It may be most efficient to have one agent who can handle all of your insurance needs.
- ✎ Determine exactly what types of insurance you need for the business you plan to operate.
- ✎ Property insurance should include a broad form of coverage to protect you from a wide variety of losses.
- ✎ If your business has employees, Worker's Compensation insurance will be mandatory.

REFERENCE

<http://www.myownbusiness.org>, My Own Business, Inc. 2003.



14

**BASIC
ACCOUNTING
PRINCIPLES**

BASIC ACCOUNTING PRINCIPLES



LEARNING OBJECTIVES

- ☞ Why accurate accounting is key to a successful business
- ☞ Methods for keeping financial records
- ☞ When and how to choose an accountant

Bookkeeping and accounting are critical tasks for any business. To run a successful small business, you must be able to accurately understand your financial situation and respond appropriately to events that impact your finances.

Sound accounting and bookkeeping practices will allow you to see when you've been successful financially and when you have not. It will also help you make decisions about your business activities (when to trim expenses and when to expand activities), get financing (as banks and others will want to see accurate financial records), budget for major purchases and expenditures, and prepare your taxes (see Chapter 5 for more information on taxes).

It is beyond the scope of this chapter to explain how to "keep the books" for your business, but we can give you some basic information and suggestions for learning more. Your first decision is whether to hire an accountant to do your bookkeeping or whether you'll do it yourself. Some information on how to make this decision is provided below.

If you plan to do your own books and you don't have experience with accounting, you should seek out additional assistance.

Local community colleges or continuing education programs at universities offer programs on accounting that will provide you with the basic knowledge you need. Or you may want to teach yourself about the subject by buying a book on basic accounting; check your local library for other written resources.

Computer programs such as Quicken, Peachtree, and QuickBooks (described in more detail below) can simplify bookkeeping tasks, but you will still need to learn the basics of accounting and to become familiar with the software package you've decided to purchase—again, a course or book is advisable.



WHAT IS INVOLVED IN BOOKKEEPING FOR A SMALL BUSINESS?

Keeping your accounts in order means keeping receipts for every payment you make and every sum you are paid, regularly adding up your income and expenditures to summarize these transactions (preferably on a daily basis, although depending on the amount of business you do, a weekly or monthly schedule is possible), and using your summaries to analyze financial data and prepare reports on the current value of your business or your monthly profits. Whether you use a software program or keep paper records, these basic procedures are pretty much the same.

The following terms will help you understand basic accounting.

ACCOUNTS PAYABLE: *The money your business owes to others.*

ACCOUNTS RECEIVABLE: *The money owed to your business by others.*

ASSETS: *The things owned by your business, including property, cash, and inventory.*

LIABILITIES: *Your business's financial obligations and debts.*

There are a couple ways to keep a financial ledger, which is the summary of financial transactions your business has made. These are known as the cash basis and accrual basis methods for bookkeeping. The cash basis is easier to use, but is not really adequate for businesses that give credit to their customers or that have to maintain a large inventory. Further, the accrual method is preferred by banks and other lenders; using it makes it easier to secure loans.

An online tool is available that can help you decide whether to use the cash basis or the accrual basis method: see http://www.nfconline.org/main/info/notables/note93/93_3_c.htm.

While this tool is designed for nonprofits, it can also be a helpful guide for a business.

CASH BASIS: *This method of bookkeeping requires only that you record financial transactions when money is either paid or received. You do not record accounts receivable until you actually get the money, nor do you record accounts payable until you have made payment.*

Your summary of financial transactions is often referred to as a ledger or your “books,” even though many people today keep track of such transactions on a computer, rather than in paper books. What is important is that there is a record of every financial transaction you make that notes the time and amount of the transaction, as well as other information you think may be helpful. While not every business needs a computerized cash register system, the more financial transactions you make, the better your filing

system needs to be and the more frequently you will need to post transactions to your ledger, because you need to track daily changes and do not want to fall behind in your recordkeeping.

Blank ledger books designed for financial recordkeeping can be purchased from any office supply store. Your other option, which is advisable for most businesses, is to purchase a software accounting package. Such software will make the preparation of regular reports a much simpler process.

ACCRUAL BASIS: *This type of bookkeeping reports income when earned and expenses when incurred, not when the actual money changes hands. Using this system, you would record sales as accounts receivable before the money is collected.*

regular reports a much simpler process.

The three most popular software packages are Quicken, QuickBooks, and Peachtree. Quicken is the most basic and is really designed for personal finances, but can be used for a small business if you need only simple accounting. QuickBooks works more like a traditional double-entry accounting ledger and can handle invoices, payroll, and sales

taxes. Peachtree and similar programs are more professional systems with a greater number of features. You can expect to pay more for packages with additional features.

WORKING WITH AN ACCOUNTANT

For a small business, chances are that you can teach yourself enough about accounting to handle your books, but you may feel more comfortable working with a professional accountant.

It is wise to use the services of a professional to prepare your taxes and possibly your monthly or annual financial statements as well.

Another possibility is that you could hire an accountant to help you set up your book-keeping system, but take care of the books yourself from then on.

If you decide to hire an accountant, there are several possibilities to consider. All accountants are not the same; three of the more experienced types of accountants are:

- ✓ Certified Public Accountants, who must pass a national exam from the American Institute of Certified Public Accountants. They have the most expertise and there are certain services, such as auditing, that only they can perform.
- ✓ Enrolled Agents, who are tax specialists and must pass a 2-day exam given by the Internal Revenue Service (IRS).
- ✓ Accredited Accountants, who must pass an exam from the Accreditation Council of Accountancy and Taxation. These accountants often specialize in small business accounting.

However, your accounting needs may not require a highly trained professional and there are many experienced accountants who are not accredited and who will generally charge less for their services.

It is important to select an accountant you trust and whose skills meet your needs. You should speak with a number of accountants and compare their experience with businesses like yours, their knowledge of accounting and tax law, their computer skills, and the cost of their services before deciding. It is a good idea to ask other business people you know for their recommendations.





IMPORTANT POINTS

- ✎ Keep receipts for every payment you make or receive—these should be well organized and safe.
- ✎ Speak with a number of accountants and compare their experience with businesses like yours, their knowledge of accounting and tax law, their computer skills, and the cost of their services.
- ✎ Regularly add up your income and expenditures, preferably on a daily basis. The more transactions you make, the more often you will need to post this information.
- ✎ If you're using a computer to keep your financial records, make sure to back up all data whenever a change is made. Store the data on CD, diskette, or other portable storage unit, and make more than one copy. You may want to keep a printout of important data as well, in case your computer becomes temporarily unavailable.



15

**BASIC
PRINCIPLES
OF HUMAN
RESOURCES**

BASIC PRINCIPLES OF HUMAN RESOURCES



LEARNING OBJECTIVES

- 👉 General guidelines on hiring practices
- 👉 Basic information on compensation and benefits
- 👉 How to set up a payroll system
- 👉 Key management principles
- 👉 Legal guidelines for terminating employees

The Human Resources (HR) organizational function deals with hiring, compensating, and managing employees—your most important resource. This section addresses fair treatment of staff, not just because it is against the law to do otherwise, but also because such practices will make your employees more productive and successful.

RECRUITING AND HIRING

Finding good employees is crucial. The better the employees, the more likely that your company will be successful. Similarly, employees who perform poorly can waste valuable time and resources. It is best not to take shortcuts in the hiring process if you want to find the best candidates.

Here are some resources that are available to you during the hiring process:

Temporary personnel agencies. Temporary (temp) agencies can provide you with virtually any type of employee. With temporary employees, you have the opportunity to observe their performance, with the possibility of hiring them on a permanent basis. The downside is that the temp agency will charge you a fee if you hire one of their temps full-time.

Employment agencies. Many agencies can supply you with permanent employees for a fee. They have many candidates and usually perform screening and reference checks.

“Headhunters”. For executive-level employees, you can turn to executive search firms, often called headhunters. Be prepared to pay a significant fee (typically one-third of the

first year's salary of the employee), which is payable up front when the employee is hired.

Internal candidates. Look at your own employees first to fill vacant positions. You may have someone who is ready for a promotion. You already know the work habits of this person and the candidate already knows the organization. Promoting from within is good for employee morale, as other employees will see opportunities for advancement.

Bounty rewards. Some companies give a "bounty" reward to employees for recruiting candidates to the organization. Even though this reward will cost you, it's going to a good cause—your employees—and is still less costly than an outside agency's fee.

Your Web site. Post your open positions on your company Web site. Anyone who applies for a job listed on your Web site will probably be well informed about your company.

Want ads. Want ads in local newspapers or trade magazines are a traditional way of getting your message to a great number of potential employees.

Job Web sites. The Internet has many sites with job postings, want ads, and resumes of prospective employees (e.g., Monster.com, HotJobs.com, CareerBuilder.com).

INTERVIEWING

Once you have a list of potential candidates, you must narrow it down to the best candidate. Picking the best employee can be tricky, and if you don't have the right interviewing skills, you risk losing a brilliant candidate—or worse, —hiring someone who is not qualified for the job. While you're sizing up a candidate, that person is also considering you as a potential employer. Here are some tips to help you effectively screen candidates, make a good impression, and ensure that candidates get the information they need about the job and your company.

Understand the purpose of the interview. An interview is your chance to collect information about the candidate—in person. Consider whether the applicant is qualified for a particular job, if they are truly interested in the available position, and if they fit the company culture.

Develop a list of desired skills. You can't formulate insightful questions until you know what skills to look for.

Create a list of interview questions. Make a list of interview questions that will help you learn more about the candidate. Construct open-ended questions that invite candidates to share information and talk about their experiences.

Be specific in your questions. General questions such as, "Where do you see yourself in 5 years?" won't tell you much about the candidate. Many standard interview questions sidestep what you really need to know, which is how the person will perform in a specific role. You must adopt smart interviewing tactics that uncover a candidate's abilities, talents, strengths, and weaknesses.

Relax. After you introduce yourself, put the candidate at ease by telling them about the basic structure of the interview. You want them to relax, speak freely, and provide detailed answers to your inquiries.

Prepare for questions. Make sure you have adequate information about the company so you can answer a candidate's questions.

Take notes. Interviewing requires superb listening skills, but listening isn't enough. Capture the details of the interview on paper to jog your memory, noting key actions and outcomes.

ILLEGAL AND INAPPROPRIATE QUESTIONS

There are many questions you should not ask during a job interview. Even if your motives are pure, such questions could make you vulnerable to charges of discrimination if the prospective employee isn't hired. You must also be careful about information volunteered by potential employees for the same reasons. However, you can take comfort in the fact that most "illegal" questions are unrelated to any legitimate hiring criteria.

DISCRIMINATION: *Showing bias against or favoritism toward a person because of their religion, race, age, national origin, or any characteristic in which you could group people.*



Here are general types of questions to avoid:

How old are you? ...and other age-related questions. State and Federal laws prevent discrimination against people over 40. For this reason, you shouldn't ask any question designed to directly or indirectly discover a person's age.

What is your religious background? Even if a prospective employee volunteers this information, don't engage in a conversation about religion. Just move on.

Do you have a disability? Never ask this question. While physical capabilities may be directly relevant to job performance in certain types of jobs, you must never use the word "disabled" or "handicapped" in a job interview. Ask whether the individual is capable of performing particular job duties. You should also steer clear of questions about medical history or whether an applicant has previously received workers' compensation. These questions are regarded as potential surrogates for inquiries about disability status.

Are you planning to have children? You cannot discriminate against someone because the person has or will have children. You can ask about a potential employee's capacity and willingness to travel or work overtime, if those issues are legitimately job-related.

Are you married? While this is a friendly question and may naturally come up in conversation, marital status is a protected category under Federal and State employment laws.

What's your maiden name? Because surnames often reveal ethnicity, this question could be perceived as potentially discriminatory. The same is true of the question "Are you an American citizen?" even though the employee would have to furnish proof of citizenship when being hired. Instead, you could ask whether the person can provide proof of the right to work in the U.S.

Rather than focusing on what you shouldn't say, focus on things that are relevant, such as education, job skills, and work history. If you stay away from forbidden areas and remain professional, your interviews should be fine.

DO YOU NEED TO GET A BACKGROUND CHECK?

In some industries, it might be helpful to get background checks for prospective employees. Here are some of the items that most employment screening firms check for:

- ✓ Social Security records (to confirm that the person is who they say they are)
- ✓ State-by-State driving records
- ✓ Credit reports (if the prospective employee will have access to cash at your office)
- ✓ Past employment history
- ✓ Formal education
- ✓ Occupational and professional licenses
- ✓ Criminal record
- ✓ Military record
- ✓ Applicant's right to work in the United States
- ✓ Character references

COMPENSATION AND BENEFITS

When developing sick leave and vacation policies for your company, there are some things you must do because you're required to by law, and some things you should do because they'll help you retain your top people.

COMPENSATION:

The agreed-upon payment or reward someone receives in return for performing a particular job or task.

The Fair Labor Standards Act (FLSA) does not require payment for time not worked, such as vacations, sick days, or holidays. These benefits are matters of agreement between an employer and an employee (or the employee's representative). Believe it or not, the only legally required benefit employers are obligated to maintain is workers' compensation insurance; employers aren't required to give paid time off for sick days or vacation days.

The Family and Medical Leave Act (FMLA) entitles eligible employees to take up to 12 weeks of unpaid, job-protected leave in a 12-month period for specified family and medical reasons. The FMLA applies to all public agencies, as well as any private sector employers who employ 50 or more employees in 20 or more work weeks in the current or preceding calendar year. Eligible employees include those who have worked at least 1,250 hours over the previous 12 months.

Beyond your legal duties, you should adopt policies that make sense for your employees and your business. Good benefits are a key component of employee satisfaction

EMPLOYEE MANUAL:

Staff rules and procedures provided in written form so they are clear to employees and management.

and retention. Traditionally, companies have set up programs in which employees receive a certain number of days for paid sick leave and a certain number of days for paid vacation. This type of plan is easy to institute; you simply decide how many sick days and vacation days to give employees per year, put the policy in writing in an employee manual, and let everyone know.

While this system works well for many companies, you might want to consider altering it to give your employees more respect and autonomy. There are ways to do this that won't cost you anything extra. For example, some companies pool different types of leave into a unified bank of hours that employees draw from; instead of giving employ-

ees 10 vacation days and 5 sick days a year, you might decide to give each person 120 hours of paid time off each year to use as they see fit.

The amount of paid leave you give employees is up to you, but there are industry standards to keep in mind. On average, new employees usually get about 17 or 18 days off per year, allocated evenly between sick and vacation days. Professional, long-term employees could accrue 30 or more days off per year. To learn more about the norms in your industry, check the Chamber of Commerce salary and benefits reports for your area. Industry associations might also be able to provide this type of information.

CHAMBER OF COMMERCE: *An association of business people that promotes commercial and industrial interests in the community.*



SHOW ME THE MONEY—AND OTHER MOTIVATIONS

If you don't know what a fair wage is for certain positions, check with your local Chamber of Commerce for industry norms. If you are employing salespeople, keeping them happy and motivated is not just important; it's essential to the continued success of your business. Commissions and bonuses keep salespeople "charged up" because they know that the more they sell, the more they'll make. It's good to set realistic bonus structures for salespeople, who should be pushed to improve on past performance.

You can also effectively manage and inspire your staff through a variety of motivational techniques other than money. Create an atmosphere in which employees feel they can offer their input. If they have suggestions on improving the way things are done, they should be encouraged to share their ideas. Hold regular staff meetings, one-on-one meetings to gather input, or create an old-fashioned suggestion box. This will give employees a greater role in the operation of the company. Make sure to give employees proper credit for any ideas used. Furthermore, offering training will not only show employees better techniques on how to perform their job, but will also show that you are willing to make an investment in them.

Provide ongoing guidance and constructive advice to help employees improve performance. People who perform well should not only be rewarded financially, but should be offered promotions within the organization. Avoid pressure tactics. Some managers try to motivate through intimidation and fear. This management style can produce short-term results, but normally increases stress, makes the workplace an unpleasant environment, and ultimately makes employees less productive and more likely to leave. Finally, build trust with your staff. If you say you'll do something, do it. Not only will this keep your staff committed to you, but it will teach them by example how to conduct themselves with their coworkers and customers.

WORKERS' COMPENSATION BENEFITS

Workers' compensation benefits provide coverage for medical expenses, as well as reimbursement for lost wages when employees are injured on the job. Workers' compensation coverage includes two types of protection: workers' compensation and employer's liability. The workers' compensation portion of the policy pays for claims made by employees and

WORKERS' COMPENSATION: *A system of insurance that reimburses an employer for damages that must be paid to an employee for an injury occurring in the course of employment.*



the employer's liability portion pays the cost of defending lawsuits filed against the company by an employee or an employee's family.

Workers' compensation insurance may not be at the top of your list of things to think about, but it should be on that list for three reasons:

1. Workers' compensation insurance is required by law in all 50 States.
2. Workers' compensation insurance can protect your business from lawsuits. Without the right coverage, an injured worker might sue your business to recover medical costs, disability costs, and damages.
3. If you understand how the system works, you can take advantage of simple ways to reduce workers' compensation costs.

Each State enacts its own workers' compensation statutes, so check with your State insurance commissioner's office or your insurance agent to find out about the rules that govern your business.

Depending on where you live, you can buy coverage through a State-run fund or a private insurer; some States offer a choice of either.

CUTTING WORKERS' COMPENSATION COSTS

Workers' compensation (comp) premiums depend on the nature of your business, the jobs your employees perform, and the number of hours they work. Each job type is assigned a classification code. Riskier work is classified as such and assigned a higher premium. Thus, you might pay 48 cents in premiums for every \$100 in payroll that goes to a clerk in a retail store. By contrast, a truck driver's premiums might set you back \$9 per \$100 of payroll. But there are ways to control your costs. Try these strategies:

- ✓ Review your classifications to make sure you're using the proper codes. Ask to review your case with your State workers' compensation rating bureau. If you aren't satisfied with the result, request an onsite inspection and rating.
- ✓ Consider a deductible. More than half of States allow small companies to cut premiums by paying a deductible on workers' comp claims. Paying deductibles, which typically range from \$100 to \$1,000 per claim, can reduce your premiums by as much as 25 percent.
- ✓ Check your payroll. Most States don't require you to include overtime in the payroll numbers used to compute your premiums. If your State is one of them, make sure you don't add in overtime.

ASSIGNED-RISK POOL:

All of the companies that provide worker's compensation insurance in a particular State that are assigned high-risk cases in ratio to the percentage of business they do in the State.

STAY OUT OF THE POOL

If you're in an assigned-risk pool due to a poor safety record or unusually high risk, you'll pay high premiums for relatively poor service. An assigned-risk pool is composed of all of the companies that provide worker's compensation insurance in a particular State. If you can't obtain insurance on your own, the State randomly assigns you to a participating insurance company. Each insurance company is

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assigned businesses from the pool in relationship to the percentage of businesses they insure in the State. Find out why you're in the pool. If the problem is your firm's safety record, you should take steps to improve safety and reduce the chance of accidents in your workplace. Enhancing workplace safety will improve your workers' quality of life as well as your bottom line. Consider some of the following ideas:

- ✓ Give each employee a workplace safety manual that details rules and safe work practices.
- ✓ Conduct regular inspections of the facility to identify and correct hazards, such as poor lighting, unsafe warehouse conditions, and ergonomically incorrect workstations.
- ✓ Communicate to employees the importance of safety in the workplace. Reward and recognize safe operations.
- ✓ Write safety procedures and distribute them to anyone who drives a vehicle for your business.
- ✓ Keep detailed records of all accidents and set quantifiable goals for improvement.
- ✓ Create return-to-work programs for injured employees and stay in close contact with employees who are out.
- ✓ Use ergonomic products. The right chairs, keyboards, mats, and tables can sharply reduce claims.
- ✓ Provide protective equipment. Goggles, helmets, gloves, and other safety gear make sense in many situations.

PAYROLL

Paying employees involves much more than writing a check every 2 weeks. There are dozens of laws governing employee compensation. If you want to comply with these laws, you have to be well organized and stay up-to-date on Federal and State guidelines. The key is to set up a good system in the beginning. To get started, try this step-by-step approach to creating a simple payroll system:

Step One: Get an Employer Identification Number (EIN). You can apply for a number by filling out IRS Form SS-4.

Step Two: Get State and local identification numbers if they are required in the area or areas where your business operates.

Step Three: Separate your independent contractors and full-time employees. You don't have to withhold taxes from an independent contractor's pay. Don't think that you can save time by classifying all of your employees as independent contractors, because the IRS may penalize your business heavily if you designate regular workers as independent contractors. For details, see IRS Publication 15 Circular E, The Employer's Tax Guide.

Step Four: Have each employee fill out and sign IRS Form W-4. The form provides two critical pieces of information: the employee's Social Security Number and the allowances the employee is claiming for income tax withholding purposes. New work-

ers should fill out a W-4 as soon as possible. Employees who marry or divorce, have children, gain or lose a dependent, or want to change withholding amounts for any other reasons should also complete and sign a new W-4. If you do not have an employee's W-4 on file, you are required by law to treat the employee as a single person with no exemptions for withholding purposes.

Step Five: Establish a pay period. Most States require that employers pay workers on regular paydays. A few States allow some employees to be paid once a month, but most require that you pay your employees at least twice a month. Check with your State Department of Labor for specific guidelines.

Step Six: Establish payroll records. For Federal tax purposes, you must keep the following information on file:

- ✓ Name, address and Social Security Number of each employee
- ✓ Total amount and date of each payment
- ✓ Portion of each payment that constitutes taxable wages
- ✓ Copies of each employee's W-4
- ✓ Dates and amounts of tax deposits
- ✓ Copies of returns you filed
- ✓ Copies of any undeliverable W-2 forms

Step Seven: Decide if you will pay workers for time spent in orientation, sick days, meals, or working from home. Your State Department of Labor can tell you if you are required to pay for this time.

Step Eight: Check your local overtime rules. According to most State laws, any work that exceeds 40 hours per week must be compensated with at least one and a half times the employee's hourly wage.

Step Nine: Figure out what you need to withhold. The IRS expects you to withhold a portion of every employee's paycheck. Chances are your State and even local Governments require withholding as well. The Government provides tax tables that calculate the amount you must withhold once you've established the appropriate amount of taxable wages. All States except Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington, and Wyoming impose a personal income tax. Like the Federal Government, most States provide tables to help you compute withholding amounts.

Many business owners save time and reduce the risk of errors by hiring a bookkeeper or payroll service. An outside payroll person or service can perform basic payroll-related tasks, deposit tax payments, prepare W-2s, and take care of insurance and retirement plans.

PERFORMANCE APPRAISALS

If you expect employees to take on increasingly difficult challenges, you'll need to provide them with feedback and coaching and help them meet performance goals. Performance appraisals provide a productive forum for identifying and correcting poor performance and encouraging good performance. They give you the chance to sit down with each employee at least once a year and let them know where they stand in the organization—and you can receive feedback from them.

Prepare carefully for an appraisal. Give yourself adequate time to review an employee's file, complete an evaluation of their performance, and outline topics for the discussion. The employee must also prepare in advance. Notify the employee 1 to 2 weeks prior to the review and give them an evaluation form to assess their performance. Ask them to jot down concerns, questions, and opinions about their work and suggestions for improvement.

To close the appraisal, summarize the major points and end on a positive, encouraging and upbeat note—even if the employee is very troubled or deficient. If you can't provide the employee with immediate feedback, follow up as soon as you can, and finalize the appraisal in a timely fashion. The final appraisal becomes the official document that is placed in the employee's personnel file.

MANAGING PROBLEM EMPLOYEES

The first step in dealing with a problem employee is to identify the trouble. Many times, a simple, honest talk with an employee will resolve issues such as occasional tardiness or minor attitude problems. But chronic behavior or performance problems usually require more than conversation.

There are two courses of action you can take with a problem employee. The most obvious is disciplinary, which may consist of issuing the employee a written warning or reassigning them to other duties or to another department. This action is most appropriate for serious infractions, such as ongoing problems where company policies or rules have been broken or ignored.

The second choice is coaching or mentoring. This is usually the best choice for first-time offenses or work performance problems with entry-level or nonprofessional employees. Coaching requires a manager to work one-on-one with problem employees or to assign another employee to work with the individual to overcome their shortcomings. The mentor should provide the employee with feedback and solutions for improving their performance. Coaching requires patience and a substantial time investment, but it can help modify an employee's behavior.

SEXUAL HARASSMENT

What constitutes sexual harassment? The law says that illegal sexual harassment occurs when there are unwelcome sexual advances, requests for sex, and other acts or statements of a sexual nature that create a hostile or abusive workplace. Needless to say, the legal definition of sexual harassment is extremely difficult to enforce or identify in practice. Examples of employee allegations include:

- ✓ Telling dirty jokes
- ✓ Remarks about an employee's body
- ✓ Commenting inappropriately on an employee's outfit
- ✓ Continually asking out an employee who is not interested
- ✓ Suggesting that the way to advance in the company is to sleep with the supervisor
- ✓ Posting or circulating nude or explicitly sexual pictures

SEXUAL HARASSMENT:
Unwelcome sexual advances, requests for sex, and other acts or statements of a sexual nature that create a hostile or abusive workplace.



- ✓ Keeping pornographic Web sites on a computer terminal within view of coworkers
- ✓ Unwelcome touching, pinching, or other physical contact

Your best defense against these behaviors and the potentially disastrous lawsuits they can elicit is to take explicit and concrete steps to notify your employees that sexual harassment will not be tolerated in the workplace. How do you implement this as a policy?

- ✓ Take reasonable steps to show that sexual harassment will not be tolerated.
- ✓ Investigate every complaint.
- ✓ Consider disciplinary action or termination of an offender.
- ✓ Show compassion and understanding.
- ✓ Establish procedures for making complaints.
- ✓ Consider an in-house seminar to raise employee awareness of the issues surrounding sexual harassment.

EMPLOYMENT LAWS

Have you taken a look around your office recently to see whom you've hired? If not, you should. Both Federal and State Governments care about who you hire—and more importantly, who you don't hire. There are a variety of Federal and State laws governing hiring practices to discourage discrimination. But how do you keep up with all of these laws? The eight laws listed below provide a good overview:

Title VII of the Civil Rights Act of 1964. Prohibits discrimination on the basis of race, color, religion, national origin, or sex. It also prohibits sex discrimination on the basis of pregnancy and sexual harassment.

The Equal Pay Act of 1963. Prohibits employers from paying different wages to men and women who perform essentially the same work under similar working conditions.

The Civil Rights Act of 1966. Prohibits discrimination based on race or ethnic origin.

The Immigration Reform and Control Act of 1986. Prohibits discrimination on the basis of national origin or citizenship of persons who are authorized to work in the United States.

The Americans with Disabilities (ADA) Act. Prohibits discrimination against persons with disabilities.

The Bankruptcy Act. Prohibits discrimination against anyone who has declared bankruptcy.

The Equal Employment Opportunity Act. Prohibits discrimination against minorities based on poor credit ratings.

The Age Discrimination in Employment Act (ADEA). Prohibits discrimination against individuals who are age 40 or above.

Depending on the size of your company, it may be exempt from some discrimination laws. For example, the Age Discrimination in Employment Act only applies to employers with 20 or more employees.

Regardless of the size of the business, it's important to watch your hiring practices. Hiring 10 white males in a row is never a good practice. Remember that any size employer can be sued based on employment patterns and not employing enough minorities and women.

DRUG TESTING

Although business owners have the legal right to insist on a drug-free workplace, enforcing that right can be a touchy issue. With any steps you take to maintain a drug-free workplace, you must respect workers' legal rights to privacy and nondiscrimination. Before you implement a drug testing policy, make sure you understand how the law governs drug testing.

FEDERAL AND STATE LAWS ON DRUG TESTING

Drug testing falls under the ADA, described above, which includes several key features:

- ✓ The ADA makes it illegal for any employer to test a prospective employee without first making a conditional offer of employment.
- ✓ The ADA also says you can't discriminate against prospective employees on the basis of past drug-related problems. Then again, you may refuse to hire people if you have reason to believe they will return to substance abuse or endanger the safety and health of your workers. If you aren't sure how to proceed with an applicant who has a history of drug abuse, consult an attorney. The ADA doesn't prohibit asking a person with a history of substance abuse to enroll in a rehabilitation program before joining your firm.

Laws on drug testing vary from State to State and change frequently. You can find out the details of your State's drug testing laws by contacting a trade organization, your State Government, or an employment lawyer. Your right to test workers for drug use depends on several factors:

- ✓ **The job itself.** If a job has the potential to place the employee, coworkers, or the public in danger, there may be stronger legal justification to test for drugs (e.g., a bus driver).
- ✓ **Evidence of a drug problem.** Some States require you to show probable cause that employees are impaired before testing them for drugs.
- ✓ **Whether the worker is already on staff.** Once applicants are hired, your rights to test them for drug use may diminish. Some States require visible evidence of substance abuse, such as an accident, a visible decline in work quality, or the discovery of illicit drugs in the workplace before you have the legal right to test a current employee. Testing current employees at random or without prior notice is also illegal in many States.

EMPLOYEE RECORDS

For organizational and legal purposes, you should maintain and update an employment file on each employee. A file allows you to keep credentials and performance reviews

at your fingertips and it also lets you present information to others quickly. Many companies maintain files electronically or in databases, but plain manila folders can work well in many cases. Use whatever is most comfortable for you and most likely to encourage you to keep your employment folders up-to-date.

When organizing your employee folders, try to keep the information in order by date, beginning with the worker's resume, references, and employment application. Also, keep the original job description for each new hire and create room to note any changes in responsibilities over the coming months and years. That will make it easy for both you and the employee to track how the position and skill set required for the position have changed. This part of the employment file should also include the date set for the first performance evaluation. Once that takes place, a written review should be added. Keep all such reviews, just in case. You may be called upon someday to justify a firing or a bad review.

New employees should fill out a Form W-4 for payroll withholding for tax purposes on the first day of work and it should be added to the employment folder. In some cases, immigration and naturalization forms such as Form I-9 are also needed. If your company offers a 401(k) and health benefits, you'll need to keep copies of any related paperwork completed by employees. Because health care paperwork contains especially sensitive information, it's smart to keep it separate from all other employee paperwork, in a folder with tighter access control.

Keeping good records also means creating standard forms for things you'll do all the time. You'll need a standard form for salary increases, another for performance reviews, and another for disciplinary actions.

By law, in most States, employees have the right to review their own employee files. While they can't demand to see them on the spot, you must produce them within a reasonable time frame—about 48 hours or so. In most States, employees also have the right to make a copy of any document in their employee file. If the State your company operates in does not require you to allow employees to see their personnel folders, it would be smart to allow them access anyway. Having an open employee file rule builds trust. On the other hand, barring employees from reading about themselves sends a very negative image.

EMPLOYEE TERMINATIONS

When can you legally fire an employee? This isn't an easy question to answer, as laws and case rulings have become increasingly protective of employees. Although the "at will" doctrine is still prevalent in many States (meaning that you can freely fire an employee at any time), there are many exceptions. Employees are increasingly suing managers and companies for "wrongful termination," harassment, discrimination, and other reasons.

Here are some reasons for termination that should generally stand up:

Consistent incompetence. If an employee just isn't able to do a competent job, and you have given the employee a reasonable opportunity to succeed, then termination will often be seen as appropriate.

Violation of company policy. If you have established clear, legal, and consistent policies and the employee has violated them in a meaningful way, then termination is appropriate. Violation of anti-harassment, discrimination, or confidentiality policies are particularly actionable.

Repeated unexcused absenteeism or tardiness. Your company depends on its employees to show up for work and perform their jobs. Continual absence or tardiness jeopardizes the ability of an employee to complete important tasks. If absenteeism or tardiness is continual and unexcused, then termination may be justified.

Physical violence. If an employee commits or threatens physical violence, you will want to fire the person immediately. All employees are entitled to a safe work environment, and employers have a duty to take reasonable steps to provide for that.

Drugs and alcohol. Depending on the circumstances, being under the influence of drugs at the office may be grounds for immediate suspension or termination. Some companies now offer treatment and rehabilitation counseling as an alternative to immediate firing.

Illegal acts. If you find the employee committing illegal acts, such as theft or embezzlement, immediate termination is justified. Before you fire the accused employee, however, make sure you know all the facts and have gotten the employee's side of the story.

Falsified information. Sometimes employees lie on their employment applications or resumes (listing fake degrees or jobs they've never held). When you discover this and the falsification appears deliberate and material, termination of the employee is usually warranted.

If you fire an employee, you should have adequate backup documentation and proof as to the rationale for your activities, in case a lawsuit is brought against your company.

TERMINATION SITUATIONS THAT REQUIRE ADDITIONAL CAUTION

Listed below are conditions you should pay special attention to when terminating an employee.

- ✓ **The employee has prior complaints.** The employee has made prior complaints about harassment, illegal or wrong company activities, or safety or health conditions in the workplace. If the employee you want to fire has a history of complaints, termination can be seen as wrongful retaliation.
- ✓ **The employee is 40 years old or older.** The Age Discrimination in Employment Act protects many workers who are age 40 or over. You can't fire someone because you want to fill your office with younger and less expensive employees.
- ✓ **The employee is a member of a minority group.** Various laws prohibit discrimination because of race, color, gender, religion, or national origin. Make sure the termination isn't a willful or deliberate attempt to discriminate against a minority.
- ✓ **The employee has an employment contract.** Review any employment contract you may have with a particular employee. Also, before you fire anyone, review the written policies your company has about terminating employees. Information on firing employees should appear in your company's employee handbook. See whether you have to give the employee a 30-day warning to improve or if you have to pro-



vide severance pay, for example. Don't be caught not knowing your company's employment rules.

- ✓ **You've made inconsistent promises or statements to the employee.** Before you fire someone, review whether the employee was given promises about terms of employment or how termination would be handled. Did you make any commitments about "job security?" Employees often claim that they were promised job security or a long tenure in wrongful termination lawsuits.
- ✓ **You're laying off more than one person at once.** If you find that you need to fire a number of employees at once, you have to carefully avoid any discriminatory pattern in the layoffs.



IMPORTANT POINTS

- ✎ The success of your company has a lot to do with the employees you hire.
- ✎ Workers' compensation is not optional and steps need to be taken to reduce workers' compensation risk.
- ✎ You should know how to recognize sexual harassment in your workplace.

REFERENCE

<http://www.allbusiness.com>. 2003.



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**EMPLOYEE-
OWNED
ORGANIZATIONS**

ADVANTAGES AND DISADVANTAGES OF EMPLOYEE-OWNED ORGANIZATIONS



LEARNING OBJECTIVES

- 👉 How employee ownership can help your business
- 👉 Methods for providing employees with an interest in the business
- 👉 How an employee stock ownership plan can benefit you

Motivated employees can increase the profitability of a business. Generating this motivation can be especially difficult in a small or new business with limited capital to spend on salaries and fringe benefits. One way to motivate employees is to provide them with an interest in the business. It is then in their financial best interest for the business to succeed.

Providing employees with an interest in the business dilutes the interest of the principal owner, who receives a smaller proportionate share of the profits available. However, under the employee-owned business model, it is expected that the total profits will be greater than if the employees did NOT have an ownership interest. Therefore, the total paid to the principal owner should be greater than if the employees did not have an interest.

In addition to smaller profits paid to the principal owner, the owner runs the risk of reducing his or her control over the business. This concern can be overcome by using an entity structure that provides the employees with a non-voting interest. The principal owner retains the only voting interest and is therefore able to control the course of the business.

Most States allow the owners of a business access to its books and records. Employees would therefore be entitled to see all financial records if given an ownership interest.

This could complicate salary negotiations with an employee.

An employer that provides its employees with an interest in the business must have a carefully crafted agreement that allows the principal owner to buy the interest of the employee—and forces the employee to sell his or her interest—if the employee leaves the company.





If the agreement is not carefully prepared, the terminated employee, as an owner in the business, may have the right under State law to terminate the business entity through legal proceedings.

The agreement should specify in great detail the method and price for purchasing the terminated employee's interest in the business. Otherwise, the business could be faced with considerable legal fees if a lawsuit is filed by the former employee.

If the business is a corporation, even though the employee is a minority owner, the employee may be entitled by law to object to actions that he or she believes are harmful to his or her interest in the corporation. Such an action is called a "derivative shareholder action."



These types of actions can be time-consuming and expensive for a business.

Depending on the number of employees and the restrictions placed on the employee's ability to transfer their interest in the business, under certain Federal and State laws, the business may have to register with the United States Securities and Exchange Commission (SEC) or the State counterpart. This can be costly to file and there are added costs for complying with the reporting requirements.



EMPLOYEE STOCK OWNERSHIP PLAN (ESOP): A retirement plan established by an employer for its employees. The ESOP must invest primarily in qualifying employer securities. Under an ESOP, the employer makes a contribution to the ESOP in the form of stock or in cash used to acquire stock.

One method for providing employees with an interest in a business is to establish an employee stock ownership plan (commonly referred to as an "ESOP"). An ESOP is a retirement plan established by an employer for its employees. The ESOP must invest primarily in qualifying employer securities. Under an ESOP, the employer makes a contribution to the ESOP in the form of stock or in cash used to acquire stock. Contributions are held in trust for the employees who participate. The employer receives a tax deduction for the contribution. Each employee who participates in the ESOP has an

account under the plan. The account consists of the employee's share of the employer's contribution, plus any earnings or appreciation. The account is paid when the participating employee retires, dies, or terminates his or her employment. These plans are subject to strict requirements in the Internal Revenue Service Code and Regulations. As a result, there is a cost associated with setting up and maintaining the ESOP that must be taken into consideration.

As with many other decisions to be made when setting up and running a business, the issues associated with providing employees with an interest in the business must be carefully considered in the context of your particular situation.



IMPORTANT POINTS

- ✎ One way to motivate employees is to provide them with an interest in the business, as it is then in their best interest for the business to succeed.
- ✎ An employer that provides its employees with an interest in the business should have a carefully crafted agreement that allows the principal owner to buy the interest of the employee—and forces the employee to sell his or her interest—if the employee leaves the company.
- ✎ An employee-owned business may have to register with the United States Securities and Exchange Commission (SEC) or the State counterpart.
- ✎ One method for providing employees with an interest in a business is to establish an employee stock ownership plan, commonly referred to as an ESOP.



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**IMPORTANCE OF
AN INTERNET
PRESENCE**

THE IMPORTANCE OF AN INTERNET PRESENCE

LEARNING OBJECTIVES

- 👉 Familiarity with the advantages of having a Website
- 👉 How to get a Website up and running
- 👉 How to let people know where to find you on the Web

Many business owners wonder how the Internet can help them. Some think they have to be technically skilled to have a Web site. This section provides some insight on the advantages of having a Web site, discusses steps to get a site up and running, and encourages you to let people know where to find you on the Web.

INTERNET SERVICES

A variety of Web-based services are described below, including definitions and the ways they might enhance your business.

Service	What is it?	Why do you need it?
Domain Name	A unique address on the Internet, like www.abccompany.com , where customers, clients, and colleagues can find information about your business.	<ul style="list-style-type: none"> ● First step to take in getting your business online ● Secures a customized address for a future Website or for email accounts ● Protects your business brand from competitors
Business Email	Personalized email addresses that match your business domain name (jdoe@abccompany.com).	<ul style="list-style-type: none"> ● Standardizes your company communications ● Gives your company a more professional image when you communicate with customers and colleagues ● Eliminates expensive, complex, and time-consuming maintenance of an in-house mail server

Service	What is it?	Why do you need it?
Web Hosting	A service that provides server space, network connectivity, management tools, and more—so that businesses can publish their Web sites on the Internet.	<ul style="list-style-type: none"> ● Builds credibility: Customers expect to find you online ● Makes it easy for prospects to learn about your company, contact you, or get directions to your location ● Expands your reach beyond your local geographic area ● Enables you to pursue a host of targeted, low-cost marketing strategies
E-commerce	A service that gives you everything you need to sell products from your Web site.	<ul style="list-style-type: none"> ● Lets you sell to a global audience ● Gives customers the convenience of 24-hour service and sales ● Allows you to merchandize your entire inventory. You can sell all your products without being limited by the dimensions of your physical location ● Provides room for detailed product information to help customers make purchase decisions
Marketing Tools	Online marketing services such as listings in search engines and yellow pages, email marketing tools, and online advertising.	<ul style="list-style-type: none"> ● Increases your visibility and makes it easier for customers to find you in the crowded Internet marketplace ● Provides cost-effective and highly targeted ways to drive traffic to your site and acquire qualified customers ● Helps retain existing customers and increase the frequency of return visits
DSL Internet Access	DSL provides a constant high-speed connection to the Internet using your existing telephone lines.	<ul style="list-style-type: none"> ● Gives you faster access to online services and increases your productivity ● No more waiting for a dial-up connection—your service is always on ● Allows you to talk on the phone and surf the Internet at the same time

ESTABLISHING A WEB PRESENCE

Developing a Web site might help you attract more customers, which will boost your earnings. A Web site is basically a series of Web pages or computer files stored on a computer and connected to the Internet for the dissemination of information. Here are some other reasons you may want to consider putting your business on the Web:

- ✓ **Open 24 hours**—A Web site will allow potential customers to find out about your products and/or services 24 hours a day, 7 days a week. This provides greater convenience for your customers and allows you to avoid calls at awkward hours from customers in different time zones.
- ✓ **Enhanced company image**—Done properly, a Web site will let potential clients know that your company is professional and credible.

- ✓ **Quick updates**—If you need to make product or service changes in brochures and catalogs, it will be difficult and costly to update them—or to make changes at a moment's notice. However, with a Web site, you can make changes in seconds, with just a click of the mouse and a minimal charge.
- ✓ **Promotion of specials**—If you are launching a new line of products for your company, you want your customers to know as soon as possible. Sending faxes, telemarketing, or printing flyers or brochures takes time and is costly. With a Web site, you can simply post the information on your homepage or send an email to your best customers, informing them about the new products.
- ✓ **Respond to frequently asked questions**—You can post answers to frequently asked questions on your Web site and free up your time to deal with more pressing issues.
- ✓ **Customer feedback**—Through your Web site, you can give customers an opportunity to provide immediate feedback about your products and services.
- ✓ **Exposure to international markets**—You can promote your product or service to potential customers around the world. The expense of maintaining a Web site will be far less than advertising in various publications around the world.
- ✓ **Communicating in different languages**—Having a Web site affords you the opportunity to translate your messages into foreign languages. Your site can be viewed in English or another language. Offering this type of service can do wonders for your business and provide convenience to customers who are more comfortable communicating in their native tongue.

YOU WANT A WEB SITE...WHAT NOW?

You need to decide how much money you want to devote to developing and maintaining your Web site. A quality site doesn't require deep pockets; however, you will have to spend money on set-up costs, hosting fees, maintenance costs, and site publicity.

It is important to think through what you want your Web site to do for your business. There are also important design questions you need to ask:

- ✓ What content are you going to put on your site?
- ✓ Do you want to post photos and graphics in addition to text?
- ✓ Will you incorporate sound?
- ✓ Do you want to provide an email link so that visitors can send questions and comments?
- ✓ Will you ask visitors to sign a guest book?
- ✓ Are you going to sell products on the Web?

You will also have to decide how you want to structure your Web site. The best research you can do is surfing the Internet and seeing what is already out there. Look at what your competitors are doing. Bookmark the sites that have ideas you like and refer to them when you begin designing your Web site. If you plan to sell products via your Web site, you will face the issue of security. Customers are cautious about giving out their credit card numbers online. You must provide them with a secure and convenient way of doing business online.



Once you've decided on the content and structure of your site, you need to decide whether to build it yourself or hire an outside professional. You don't have to be too technically inclined to build your own Web site, but you will have to learn HTML (hyper-text markup languages) coding. There are numerous books and software packages available to help you with this. Microsoft's FrontPage (<http://www.microsoft.com/FrontPage>) and FileMaker's Home Page (<http://www.filemaker.com>) are two popular packages that are user friendly. FrontPage gives you the blueprint for creating customized Web pages, whereas Home Page provides polished pages as templates for you to use when constructing your site.

If you don't feel comfortable or don't have the time to develop your own Web site, you can enlist the services of a professional Web site designer. Their fees vary, but you can expect to pay a minimum of \$500. Choose your site developer as you would choose any other professional for your business. Check out the designer's online work and check his or her references. Shop around for the best price, but do not sacrifice quality.

Once your site is completed, you will have to find a host (a place to store your site). The three ways people normally set up hosting for their Web sites are:

1. Set up their own Web server
2. Place it on an existing server for a monthly rental fee
3. Join an Internet Mall or Cyber Mall

For most new business owners, setting up a site on an existing server is the most cost-efficient method. Building a Web server is somewhat complex and a significant expense is involved (as much as \$250,000 in some cases), whereas most Internet service providers will host your Web site for a monthly fee ranging from \$25 to \$100.

If you haven't done so up to this point, you will need to register your domain name (i.e., www.abccompany.com). The Network Information Center (InterNIC) is a division of AT&T and the governing entity of Internet addresses that end in .com, .org, .net, and .gov. Registration is \$100 for two years and the process of registering your site should take no more than 3 weeks.

PROMOTING YOUR WEB SITE

Your Web site is finally done, but how are you going to get people to visit it? There are several methods you can use to bring traffic to your site. For starters, you should list your Web site address with the major search engines, such as AltaVista (<http://www.altavista.com>), Go (<http://www.go.com>), Lycos (<http://www.lycos.com>), and HotBot (<http://www.hotbot.com>), as well as Internet directories, such as Yahoo (<http://www.yahoo.com>). Each search engine and directory will explain the procedure for registering your site.

You could also enroll in a link exchange program. These free programs will display your company banner on other sites, provided that you display the other banners on your site. An Internet banner is an icon that allows surfers to link to your Web site when they click on the banner. Two link exchange programs to check out are: LinkExchange (<http://www.linkexchange.com>) and Smart Clicks (<http://www.smartclicks.com>). To register for these programs, all you have to do is fill out and submit an enrollment form.



Another low-cost way to spread the word about your site is place your domain name on all of your printed materials, including: business cards, office stationery, company brochures, press materials, fax cover sheets, sales slips, and signage.

ADDITIONAL ADVANTAGES OF THE WEB

The following list suggests some of the ways you can use the Internet to your advantage as you start your small business:

- ✓ **Immediate access to information.** The Internet is a quick and easy medium for retrieving much of the data you need. You can quickly find information on venture capital, business plan writing, advertising, and insurance.
- ✓ **Increased customer base.** If you set up a Web site, you have the potential to build your client base faster than if you were to take out an ad in the local newspaper or rely on word-of-mouth.
- ✓ **Advertising of products or services.** By using the Internet, many business owners find that they can reach a broader market, as opposed to a brochure or Yellow Page advertisement, which primarily focuses on a local market.
- ✓ **Recruitment of employees.** The Internet contains resume databases, listservs, and local bulletin boards filled with qualified applicants in search of employment.
- ✓ **Low-cost transfer of documents.** Sending a document via fax or standard carriers can cost you much more than transmitting materials via the Internet. If you ship important documents through regular mail or even overnight, you run the risk of late delivery, loss, or damage; all of which translate into greater costs for your operation. However, if a document fails to transmit over the Internet, you can simply send it again with little hassle and no additional cost.
- ✓ **Communication tool.** E-mail provides a quick way for you to touch base with anyone you need to reach (as long as they have Internet access). As a new business owner, it's important that you maintain consistent contact with your customers, suppliers, bankers, consultants, and others who could impact the success of your operation.
- ✓ **Market research assistance.** By using the Internet, you can distribute surveys to a large number of potential consumers and gauge the feasibility of your business ideas before investing a lot of time and money.
- ✓ **Advice and consultation.** The Internet is filled with experts and resources across a variety of fields and industries that can assist you in your new business venture.
- ✓ **Electronic commerce.** If you want to do business with the Federal Government, you need to be able to accept electronic commerce (e-commerce). Many Federal agencies use Internet-based applications for business transactions, including: purchasing, pricing, shipping, receiving, invoices, payment, order status, and other day-to-day contacts with vendors. If a client pays you via e-commerce, most likely you will receive your payment faster than with traditional payment methods.



IMPORTANT POINTS

- ✎ You can have a quality Web site up and running at a reasonable cost with only limited computer knowledge.
- ✎ You will have a global audience to market your services and products.
- ✎ An attractive, user-friendly Web site will let potential clients know you are professional and credible.

REFERENCES

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<http://www.smallbusiness.yahoo.com>