New Business Start-Up Errors and Oversights

In all of my years of preparing business plans, I have noticed some common errors made by people starting a business. These errors account for the reason why between 80% to 90% of new businesses fail in the first five years. The number one reason per the Small Business Administration (S.B.A.) is because they run out of money. The number two reason quoted by various sources is due to lack of proper planning. If you do your (business) planning properly, you will know how much funding you will need so that you will not run out of money. I know this is true, because I always ask a new business plan client how much start-up cash they think they will need. By the same percentage as the failures, the client usually drastically underestimates the amount of start-up cash that is required, where often the actual amount required is double their original estimate (or <u>more</u>).

Also, I have noted common reasons why a start-up company doesn't get financed by either a bank or an investor. Here are some of the common business plan errors made by entrepreneurs trying to get a new business funded or other errors they make getting a new business started:

- **<u>Lack of logic in the development of your numbers</u>**: If your business plan does not have logic in the development of your revenues and expenses, you will not get funded. You must break down your sales and expenses on what is called a "unit" basis: What does one unit sell for and how much does one unit cost? Then, how many units are you going to sell each month? Are the unit sales per month reasonable?
- **<u>Lack of accounting for variables in your business</u>**: Most companies do not "hit the ground running" when they open the doors. Even though you expect to sell 1,000 widgets per month, it will probably take you some time to get sales to this level. Allow for ramp-up time, usually over several months. I often allow for one year or more (minimum of 6 months) for clients to get up to selling capacity, unless other logics prevail. Don't forget about seasonality and inflation for additional variables.
- **<u>Do not skimp or ignore up front marketing and advertising</u>**: So many new start-ups think that once they open the doors, customers will come! Sadly, when they ignore the up-front marketing and advertising, they learn the hard way that they missed a critical step. Because so many businesses depend on referral business from existing clients, there is a compounding effect that is missed if you ignore this area at start-up.
- **<u>Location, location, location</u>**! Before you sign that long-term lease, make sure that you are in the right location. This requires two things: You need to know where your competition is in relation to your proposed location and you must be in an area that is growing, with a lot of traffic. High traffic alone is not the only criteria, as I had a beauty supply client that came to me and told me they had found the "perfect" location. The area was in a high traffic area, but it was also hard to see from the main traffic in the area. I looked at the competition as defined by my client in a 3 mile radius (instead of the normal 5 mile radius) and reported back to them that I had found 39 competitors as defined by them. Second, I noticed that there were only one or two cars parked in their parking lots. Those were the workers! Where were the customers? Instead of signing the 5 year lease there (whereby the customer would have died in the first year), he signed his lease in a Publix shopping center and is still there, 8 years later!

- **<u>Do your research on the major purchases and expenses you need up front:</u>** I am amazed by how many clients have not done an in-depth look at the cost of opening an office. They often forget about minor details such as office furniture, computers, telephone systems, signage, alarm systems, etc. They also don't consider the fact that landlords often have build-out expenses of the new rental space that they often pass on some or all of it to you. They also usually require a first and last month's rent in advance. There are also usually utility and phone deposits required up front.
- **<u>Allowances for Accounts Receivables and Payables:</u>** If you deal with inventory, how much will you need to purchase up front before you open your doors? How long will it take to collect your money from your customers? Will you have to pay for labor, materials, shipping, etc. up front for a customer that you must invoice and wait 30 to 45 days for payment? These factors add significant costs up front and can sink your boat very quickly.
- **<u>Don't forget to include a salary for you in your plan:</u>** All too often, people go to the bank for funding, telling them that they are going to leave their former place of employment and start this new business. When the bank sees that you have eliminated a major source of personal income and have not replaced it with income from the new business, they do not see your capacity to pay back the loan if the business fails (yes, they will look to you to guarantee the loan in the event the company fails). Too many people make the mistake of thinking that they will forego their salary until the business takes off. In reality, this may happen, but for financing, include your <u>reasonable</u> salary.
- **<u>Don't expect to capture a major market share or even make a profit in the first year:</u>** These two items are usually looked at as being unreasonable in the eyes of a banker or investor and will actually be red flags on your business plan. You do not want a business plan that is often referred to as being "pie in the sky". If it looks too good to be true, it probably is!
- **<u>Back up your numbers with actual quotes for products, services and equipment:</u>** Where possible, back up the numbers you put in your business plan with actual quotes from service providers for services, equipment, products and services. This will give a comfort level to the banker or investor that these are real numbers instead of the "pie in the sky" numbers referred to above. I know of some banks that have a normal policy of discounting down business plans by 25% due to the above unless you back up the numbers.
- **<u>Don't get your funding and put your business plan up on the shelf:</u>** Your business plan should be your operating guide for the first <u>three</u> years! Enter the business plan numbers into your accounting software as your budget for each year and then compare your actual results to your budget! I have many business plan clients that update their business plan every year.
- **<u>Choose your operating entity wisely:</u>** If you will be exposed to potential liabilities, you need to incorporate of form an L.L.C. Work with your tax advisor to make sure you are protected. You want to build a wall between your personal assets and the company's assets. Please know, however, that you will still be personally liable for bank loans, investor funds and payroll tax liabilities (and probably rent payments, too), as personal guarantees are often required by the banks and landlords. The IRS will not require you to sign a personal guarantee, but I can promise you, they look to both the company and to the officers for payment of taxes!

I hope the above helps you to avoid many of the pitfalls that cause new start-ups to fail. Remember, a failure to plan is a plan to fail! Another caption I like (author unknown) is: "Failure is not an option. It is just a nagging possibility that helps keep me focused!"

Thanks,
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President