KEY GUIDE

Setting up a new business

The business idea

You have a business idea, but can you turn it into a viable enterprise? Is there a market for the goods you will produce or the services you will supply? Are there enough customers who will pay for your product or services so that you can make a profit? Can you compete with others in the same line? Will you need finance?

Some of the decisions and actions that you take when starting a business can have significant effects for some time. The foundations you put in place at the outset are very important and can affect the business's survival. With careful planning and good advice, starting your own business may prove to be one of the best steps you ever take.

First you need to research and develop your business idea, and review the market for it. Market research can be as basic as asking your friends and colleagues what they think or as sophisticated as employing a market research agency. You might be able to test your product or services on a small scale by working part-time around your current employment before making a final decision.

Your business plan

The next stage is to prepare a business plan. This should describe the business, its objectives, its strategies and its financial forecasts. Every business should have a business plan, but it is especially important at the beginning. It is essential if your business will need external funding such as bank finance, but equally importantly it will allow you to measure how well your business is doing once you start trading. The business plan should include:

Focus point

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- **An executive summary**. This is an overview of the business you want to start, and will give lenders the all-important first impression of your ideas.
- **A description of the business** – what you plan to sell or the services you will provide, why customers will buy your product (or services), and how you plan to develop the business in the future.
- Your **marketing and sales strategy**.
- Your **management team** and personnel.
- Your **operations** – premises and facilities, book-keeping and management information systems.
- **Financial projection** – pricing and costs, sales and profit forecasts, how much capital you will need and projected cashflow statements for the first three to five years.

The financial projection is a particularly important aspect as it will establish how much capital your business will need. If you start with insufficient capital, your business may be dead in the water before it even begins. Of course without any track record, the initial financial projections will not be much more than an educated guess and their accuracy will depend on how much research you have done. If you have initially run the business on a part-time basis, the projections will be derived from some past figures and should therefore be that much more accurate.

One way to deal with the inherent inaccuracy of the initial projections is to prepare figures based on best and worst case outcomes. You should also remember that income does not necessarily equal cash, whether you are selling goods or providing services. For example, just because you set 30-day payment terms, does not mean that customers will pay you on time. Once your business actually starts, you should keep updating your financial projections and, because they will be based on actual figures, they should become increasingly accurate.

Finance and grants

Despite its limitations, your financial projection should give you an idea about how much finance you will need. Having adequate finance is probably going to be the biggest hurdle for many people starting a new business, and if you do not have a track record in business, your only option will likely be to remortgage your home. The credit crunch has meant that remortgaging is not as easy as it was a few years ago, but it's still possible to arrange deals – although with higher costs than previously. The risk of financing your business with a remortgage is that if the business fails, you will not only lose your source of income, but you will also be saddled with much higher debt. So you also risk having your home repossessed if you cannot keep up with the increased mortgage repayments.

There are several other possible sources of finance, with a variety of pros and cons. The main ones are:

- Your own savings – but be careful of the tax consequences if cashing in investments.
- Loans from friends and family.
- A bank overdraft.
- Bank business loans.
- Specialist loans, such as a loan of up to £4,000 from the Prince's Trust for young people aged 18 to 30.
- Commercial mortgages – useful if you are buying business premises.
- Grants from government, the European Union, local authorities and other sources.

Focus point

When you start in business, you may be asked to give personal guarantees to lenders, suppliers and your landlord if you have business premises. You need to take this into account in working out the risks when you go into business.

The Enterprise Finance Guarantee Scheme guarantees loans from banks and other financial institutions for small firms that have viable business proposals, but have tried and failed to get a conventional loan because of lack of security. The Government underwrites 75% of the loan, so in theory there is more chance of securing a loan even though you cannot provide any security. Information about this and other government programmes to help new businesses to access finance is available from the Department for Business Innovation and Skills.

If your business will be set up as a limited company, you might find individuals prepared to invest by buying the company's shares. Investors could be friends and family, or business angels. These are individuals who invest in small to medium size businesses with high growth prospects. They may be attracted by tax relief under the enterprise investment scheme (EIS) or seed enterprise investment scheme (SEIS).

Other issues

If you intend to trade through a company, you might have the choice of raising finance either by issuing share capital (equity) or as a loan (debt).

- **Equity finance** means that you will be bringing in outside shareholders, who may want a role in deciding how the company is run. Because shares can be sold, you could end up with a troublesome outside shareholder. There is no requirement to pay a dividend on equity, although if you pay yourself a dividend then the same rate of dividend will be payable to the outside shareholders.
- **Debt finance** allows you to retain complete control of the business, although ultimately the debt will have to be repaid. You will also have to pay interest on the debt even if your business is suffering a downturn.

Of course, there can be benefits to bringing in a co-shareholder, or having a partner instead of running the business alone. It's a good way of obtaining complimentary skills – for example, you may be good at developing the business but lack sales, marketing or financial skills. There will also be cover when one of you is away, and it can often be good to have someone to discuss problems with.

Business entity

You will have to decide whether to set up your business as a sole trader, partnership or limited company. Many start-ups are as a sole trader, because this is the simplest, most flexible, business structure. But it can result in you paying more tax. Where two or more people are in business together, a partnership may be preferable; although partners need to be sure they can work happily together.

Focus point

Outside investors will prefer equity if there are high growth prospects for your business because they potentially stand to make substantial gains. But be careful when it comes to deciding how much of the equity you give away in return for cash.

A limited company structure has several benefits but also some disadvantages. You may pay less tax and find it easier to raise finance, but there is more administration involved and your financial statements are available for anyone to look at – at least in an abbreviated form. Sometimes it is best to start off as a sole trader or partnership, and then to incorporate later. This can be beneficial if you expect your business to take a while to become profitable, as losses from a sole trader business or partnership can be offset against your other income for the previous three years. It is much more difficult to change business structures in the opposite direction. Other factors to take into account when deciding whether or not to trade as a company include:

- The tax position with a company is much more complicated, and more care has to be taken when extracting profits either by way of remuneration or dividends.
- It is cheaper to start as a company rather than incorporate later.
- In theory, a company offers you personal protection from your business debts. However, this protection is reduced if you have to give personal guarantees.
- It is much easier for your family and others to become involved in the running of the business given a company structure – they can be made directors without you losing any control.

- Some suppliers and lenders prefer to deal with a company.
- The ongoing annual costs will be greater with a company – especially your accountancy fees.

Where several people are setting up in business together, there is also the choice of trading as a limited liability partnership (LLP). This is a relatively new type of business structure, and is something of a hybrid between a partnership and a company. Members of an LLP are normally taxed in the same way as partners in a partnership, but in other aspects an LLP is more like a company – the main advantage being one of limited liability.

Premises and equipment

You want premises that enable you to operate effectively but without any unnecessary costs. You also need to consider the future – you don't want to be tied to premises that might be unsuitable when your business grows. The main choices are:

- Working from home – maybe a spare room or a cabin in the garden.
- Renting – this usually has minimum upfront costs and your rent is a tax-deductible expense.
- Buying outright or taking a long lease.

Focus point

Consider negotiating a break clause in a lease as this will act as a safety net if things go wrong. Not surprisingly, break clauses often contain conditions which are hard to meet, so try to negotiate less onerous terms.

Whether you are renting, buying or leasing business premises, make sure you budget for all the related costs. Business rates can be a substantial cost, so make sure you apply for small business rate relief if you qualify. Then there will be the costs of adapting premises to your business's needs. If renting or leasing, do not forget to allow for services charges. They can often be surprisingly large in relation to the rent. High overheads have resulted in many business failures, and you must be particularly careful if your business is seasonal – the costs will continue despite a reduced off-season income.

If you are trading as a company and renting or leasing property, the landlord may request a personal guarantee. So be aware that your personal assets, including your home, could be at risk if the business fails.

If you are taking a lease on a property, an important decision will be whether to agree a short or long lease term. A longer term will give you security, but it means you might be stuck with the lease if the business fails.

Tax relief for buying equipment is provided through the system of capital allowances. These give tax relief in the year of purchase or spread it over several years. Sometimes enhanced capital allowances are available. The annual investment allowance currently gives 100% tax relief on expenditure of up to £500,000 on plant and equipment (but not cars). Writing down allowances provide tax relief at 18% on plant and machinery or 8% on other capital expenditure. Alternatively, you can lease the equipment you need, which can be more tax-efficient. And leasing high value items such as cars could be much healthier for your cash flow during the first few years of trading.

Tax and national insurance contributions

If you are in business as a sole trader or partnership, you will need to register with HM Revenue & Customs (HMRC) as soon as you start working for yourself. Registration will also trigger payment of class 2 national insurance contributons (NICs), which will entitle you to the state pension and some other benefits. HMRC is normally aware of new limited companies and should contact you.

VAT

You must normally register for VAT if your sales exceed the registration threshold, which since 1 April 2014 has been £81,000. Sometimes it is a good idea to register for VAT even if your turnover is below the threshold, so that you can recover the VAT that you are charged on your purchases.

There are some special schemes for small businesses, such as cash accounting and the flat rate scheme, as well as schemes for retailers and some other types of business. Choosing the right scheme can simplify your VAT administration and may produce VAT savings.

Taking on employees

You might start off doing everything yourself, but when your business grows you will probably need to employ staff.

Focus point

The real time reporting requirements have made running a payroll more difficult. You might therefore decide to simply outsource your payroll function.

Employers must deduct tax and NICs from employees' pay under the PAYE system. You will have to register with HMRC as an employer and run payroll software that reports real time PAYE information online to HMRC whenever you pay your employees. An option to consider if you have no more than nine employees is to use HMRC's Basic PAYE Tools package. Although it is not a full payroll package, this free basic package works out PAYE deductions and reports the relevant information to HMRC. The real time reporting requirements can make running payroll quite difficult, especially if you are not altogether comfortable with using a computer. You might therefore decide to simply outsource your payroll function. There are additional rules for taking on subcontractors in the construction industry.

Here are some other issues to consider:

- Recruitment, management and motivation of staff.
- Training and improving staff performance.
- Creating a written statement of terms of employment.
- Equal opportunities.
- The national minimum wage and employee rights.
- Employer's liability insurance.
- Health and safety.
- Pension arrangements, including automatic enrolment.

Financial controls

Good accounting systems will allow you to see how your business is doing. Budget for your income and expenses and make business plans, control cash flow and try to anticipate any problems before they materialise. It is particularly important to control stocks of goods and work in progress, and ensure you collect debts that are due to you efficiently.

How we can help

We have helped many new businesses start up and grow. We can advise you on all the matters mentioned in this briefing and many other issues that you might encounter at any time in the life of your business.

We can keep you aware of changes in regulations affecting businesses and smooth your dealings with HMRC.

Our aim is to help you steer clear of the hazards of business life, but we can provide expert help if you do encounter them.

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