

Startup Feasibility Workshop

THE FIRST STEPS TOWARD STARTING A SMALL BUSINESS



A Practical Guide for Local Entrepreneurs

- Assess your skills and evaluate ideas for your new business
- Learn what is required to start a new business
- The importance of a business name and legal structure
- Taxes, licenses, other requirements
- Next steps to using the SBDC and other resources to build your business plan

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About the Small Business Development Center

Maricopa Community Colleges Small Business Development Center serves Maricopa County and is one of eleven statewide centers.

The SBDC offers confidential, no-cost counseling services. Clients may utilize counseling time as agreed upon by the SBDC. We guarantee that anything we discuss with a client will be held in the strictest confidence.

The center staff and consultants work with clients to identify problem areas and help the client with strategies to deal with the problem. We provide quality educational programs, access to resources, and "one-on-one" assistance throughout the region.

We can help you with:

**Evaluating business ideas
Creating business plans
Start up cost projections
Business financial projections
Loan packaging
SBA loan programs
Business expansion studies
Business valuation studies
Marketing Plans
Bookkeeping skills
Customer service skills
Employee issues
Government contracting
Computer classes
Small business management, and more.....**

So, You Want to be an Entrepreneur?

Do you remember when you first moved out on your own? You probably couldn't wait to set your own rules and be independent. But, once you got out there, it was a lot harder than you expected. There were more bills than you anticipated, keeping an income took most of your free-time, and the world was a lot more competitive than it appeared.

Owning a business is a lot like venturing out on your own. It is a scary, exciting and risky journey and most people can not grasp the magnitude of the transition. To be successful, you need to anticipate risks and manage them. The entrepreneurial journey can be much less complex if you remain objective and take the time now to thoroughly think through your choices and make sound plans.

If you don't look before you leap, you may wish you had never left the nest.

Lack of adequate planning is one of the main reasons that businesses do not succeed. Ultimately, you will want to write a business plan for your idea. A business plan will serve three very important functions:

- Force you to make business decisions in a logical, objective process.
- Be your guide and map in creating and maintaining a successful venture.
- Fulfill the requirement for securing lenders and investors.

For most people, the thought of swimming with snakes sounds better than drudging through a business plan. But, take a look around and you'll find that leading businesses have written plans of their intended journey. A business plan is essential to your success. Because business planning can be demanding, you will first want to conduct preliminary research and evaluate yourself and your ideas. These early steps will increase your chances of pursuing a winning business idea and will lead you to a business plan that clearly identifies why and how your idea will be successful.

Preliminary steps toward opening your business:

- ✓ Analyze your motives for wanting to start a business
- ✓ Identify your personal characteristics/traits
- ✓ Identify if entrepreneurship fits for your life
- ✓ Identify and evaluate your business ideas
- ✓ Consider starting from scratch or buying existing
- ✓ Assemble a team of experts to assist you
- ✓ Consider how customers will find your product
- ✓ Determine your initial financial needs
- ✓ Plan the name and legal structure
- ✓ **Prepare a business plan**

Why Do You Want to Be an Entrepreneur?

A first and often overlooked step in becoming an entrepreneur is finding out why you want to go into business. Investigating your motivation for owning your own business will help flush out misconceptions and avoid disappointments.

Motivation is typically emotional. Will your business venture satisfy the desires that motivated you to begin it in the first place?

While it might be easy to think of several reasons why you would like to own your own business, it's important to be objective about the downsides of owning a small business. Here are some pro's and cons:

*"I can't stand working for someone else"
As the boss, you are responsible for everything*

You'll be the boss and make the decisions that are crucial to your success or failure, but you'll work long hours, sacrifice your free-time, and you'll spend a lot of time on details - not on the "fun" parts of the business. You'll have to do unpleasant things like firing people, denying a friend or relative a job and complicated employee and tax paperwork.

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*"I will be able to make a lot of money"
You can lose money*

You have the chance to make a lot more money than you can make working for someone else but you risk losing your financial investment and time if the business doesn't work. If you don't make the sales, you don't earn a paycheck but you still owe your employees their payroll.

*"I need a job and I can't get fired"
You may not get paid*

You'll have job security — no one can fire you, but you are responsible to pay the bills and there may be times you will work for much less than your employees.

*"I have a lot of talent and skills in this area"
You will spend many hours on "housekeeping" rather than creating.*

You'll learn more about every aspect of a business and gain experience in a variety of disciplines. But, you'll be in charge of many new disciplines, such as filing and bookkeeping, inventory control, production planning, advertising and promotion, market research, and general management.

*"I want to experience personal satisfaction and achievement"
You risk failure*

You'll have the personal satisfaction of creating and running a successful business, but the ultimate responsibility for your success or failure is with you; the buck stops here!

The Small Business Development Center can help you evaluate your ideas and skill set and help you on your journey of opening a small business.

Are You Right for Entrepreneurship?

Starting a small business takes a lot of courage. But, as they say, courage doesn't pay the bills.

To be successful — to stay in business — you need more than courage. You need a combination of hard work, skill, perseverance, confidence, passion, innovation and resources. Most successful entrepreneurs have the following traits:

- ✓ **Aware** - Anticipate needs and find solutions
- ✓ **Independent** – Natural leaders
- ✓ **Passionate** – Thrive on hard work
- ✓ **Risk-taker** – Self-confident in their choices
- ✓ **Planners** – Don't take the easy road; Stay the course
- ✓ **Decision-makers** – Quickly analyze and draw conclusions
- ✓ **Adaptable** – Use change to their advantage
- ✓ **Focused** – Handle daily stress by focusing on long-term goals
- ✓ **Disciplined** – Crave personal success and achievement
- ✓ **Objective** – Judge success by the profit margin

The two most common reasons that businesses fail are that (1) the business is poorly managed because the owner lacks the necessary skills and (2) the owner underestimates how much money and time it will take to start the business.

Do you have the personality, skills and capital you need to succeed? Are you willing to sacrifice your personal time? Do you have guts, dedication, brains and capital? Read about the minimum entrepreneurial requirements and take the entrepreneurial quiz to see if you have what it takes to start a business.

Guts and Dedication:

You must have an entrepreneurial instinct, which is an overwhelming desire to have your own business. You must have the guts and dedication to be completely devoted to your goal. Life is too short to start a business that doesn't give you satisfaction and joy. And, through good times and bad times, you will stick with something you love.

Brains:

While appropriate educational credentials are important, entrepreneurial "brains" means more than scholastic achievements. To become a successful entrepreneur, you must have a working knowledge about the business you plan to start before you start it. Common sense combined with appropriate experience is the necessary brainpower. Prudence, follow through and attention to detail are very important.

Capital:

You will need seed money of your own plus sufficient cash to maintain a positive cash flow for at least the first year. You can eliminate expenses by doing most the work yourself. The "do it yourself" start is a good way to learn everything about your business and also makes you better qualified to delegate work to others later on. You can control your risk by placing a limit on how much you invest in your business.

An Entrepreneurial Quiz

Section 1: Guts and Dedication

- I am a leader and a self-starter.
- I am physically and emotionally strong.
- I am passionate about my ideas.
- I don't give up easily and I complete what I start.
- I am willing to work twice as much and have little free-time.
- My family accepts that our life will be out of balance.

Section 2: Brains

- I am organized and pay attention to details.
- I like to plan and think things through.
- I can make decisions easily without approval of others.
- People say I communicate well.
- I can think of creative solutions to problems.
- I am good at listening to people and considering their views.
- Change doesn't bother me, I can roll with the punches.
- I've got experience in the business I'm considering.
- I'm willing to take classes to improve my areas of weakness.

Section 3: Capital

- I have access to enough cash or equity to start a business.
- I am willing to put my house and assets up as collateral.
- I have a good personal credit score.
- I am willing to write a business plan for investors and lenders.
- I am willing to put a significant portion of my net worth at risk.

Start your business plan, you have the signs of an entrepreneur.

You have potential but need to push yourself. You need to improve your weaker areas, or hire someone who has the traits you lack.

You may not want to start a business alone. Look for a business partner who can compliment you.

Self-employment may not be for you. You may be happier and more successful working for someone else. However, only you know what you can do!

Is Entrepreneurship Right for You and Your Family?

Owning a small business is not just another job. It's a totally different lifestyle. Most businesses are full time, requiring you to leave behind whatever you were doing before to commit yourself completely to your start up. When you make this commitment, you will work more and risk more than you ever did working for someone else. You have to ask yourself whether you're ready for a complete commitment to the success of your business. Just as importantly, you have to ask your immediate family and loved ones if they are completely committed. You will not be taking this journey alone.

The people that you love and support will be affected by the choices you make.

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Can You Handle the Impact?

Being self-employed is fundamentally different than being an employee. The distinction between work time and personal time blurs. If a problem arises with the business, it's your problem, and it won't go away merely because you've closed the doors for the day. Decisions you make regarding the business will have a direct and immediate impact on your personal life.

The impact is even greater if your business involves working out of your home. You may experience conflicts over the use of space for business or personal purposes. The distinction between your personal life and business life becomes even more unclear. Even when you're at home, you're also physically at work. On the upside, there's no commute and you can eat cheaper at home.

If you have a family, it's important to measure the impact opening a new business will have on them. It's best to discuss this as soon as you seriously start to consider the idea. Both you and your family must be willing to put up with the changes in your lives owning a business will bring. Some people experience emotional and physical strain from being on their own and working the hours it takes to make it.

These aspects of day-to-day living will be seriously affected by your decision to open your own business:

Certainty and Source of Income:

One of the biggest differences between being self-employed and being an employee is the source of your income. Employees can generally expect to receive a paycheck at fixed intervals and for a known amount. As the owner of a new small business, you'll be paid only when and if the business generates enough money. Even successful businesses rarely generate a profit in the beginning stages of operation. You'll have to be prepared for a period during which your expenses will exceed any income derived from the new business.

Health Insurance:

Although employees are being called upon to pay an increasingly larger share of health insurance costs, it's even tougher for a small business owner. There is no employer to pick up some portion of the premium cost. There's no pool of employees that would allow you to negotiate a more favorable rate than you can get on an individual policy. On the other hand, you may be able to join an association of other small businesses so you can take advantage of cheaper group insurance rates.

Retirement Savings:

The impact of failing to save for your retirement can be devastating, but people tend to minimize the risk because "retirement is such a long way off." It's no surprise the saving rate is higher among employees than small business owners. A small business owner has to make a conscious decision to save. That decision often can be deferred or forgotten when you feel the cash coming in has to be put right back into the business.

Identify and Evaluate Your Business Ideas

Although there are many reasons why small businesses fail, one of the most common is in choosing a small business - a lot of people simply make the wrong choice.

Chances are by the time you actually launch the business, your idea will be molded by market research, customer input, cost of development, and other information you learn in the research process. For this reason, it is important in the set-up stage not to become discouraged if you have to abandon part of your business idea or even your entire idea. You will need flexibility and perseverance to keep your business afloat once you start, so applying it during the startup phase is good practice.

The top three reasons people choose the wrong idea:

- ✓ Converting a hobby or interest into a small business without evaluating if there is sufficient demand for your product or service.
- ✓ Finding a market need that matches your skills and experi-

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ence and jumping into business without further planning. There are many other considerations, such as financial planning and projections, location, pricing and tax requirements.

- ✓ Refusing to seek help because you are too afraid or too proud. Assembling a team of objective experts is necessary. Listening to them is vital.

Brainstorming and Evaluating Ideas

On the top of a blank sheet of paper, write an activity you like to do (make this the heading) or ideas you think fill a need.

Do a separate page for each activity or idea you have.

On those same sheets list as many businesses you can think of that are related to those activities and needs.

On the same sheets list all the products or services you can think of that are related to that activity or need. Use your imagination and think of every possible product or service you could do.

On each page, highlight the ideas that interest you the most.

Using the chart on the next page, in the far left-hand column, list the business ideas you're considering by order of interest. So, in the top left-hand blank space, put the idea you think you're most interested in. Underneath it put the next idea and so forth until you've listed all of your possible ideas down the left side of the chart.

Now take each idea and rate it on a scale of 0-3 in each of the areas listed. Use the following rating system: 0-none, 1-below average, 2-average, and 3-above average.

Here's a look at each of the categories and some of the things you should consider when rating them:

Knowledge of the Business

How much do you know about the area? Will you have to spend extra time and money teaching yourself the business? Will you have to take on a partner because you don't know the business well enough?

Experience in the Field

In some cases, you may have a lot of knowledge about the subject, but not much experience. Have you ever owned or worked in this type of business before? To what extent is hands-on experience crucial to the business?

Skills

Concentrate on the skills that are unique to this business only. To what extent do you possess those skills? If you lack them, how difficult will it be to acquire them?

Ease of Entry

Consider both the costs of entering the business and the competition already in the industry. For example, a service business that you can run from your home might be relatively inexpensive to start, but if several others are already providing that service, entry in the field may be difficult. *Rating:* 0-crowded field, very difficult to enter; 1-limited entry available; 2-mix of large and small competitors; 3-virtually unrestricted entry for any size business.

Uniqueness

You don't have to be the only business in town, but what makes your product or service different from those already being offered. You're looking for some way to distinguish your product or service from others who are already in business.

Sufficient Demand

Do enough consumers need or think they need this product or service? Just because you like it, does that mean there is a big enough market of other consumers who like it or need it?

Seasonality and Economic Risks

How is your product or service going to hold up over the long-run? If you sell Christmas ornaments, summers might push you out of business. If you sell \$2000 water fountains, will people

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buy them if the economy slows down? Do you need to expand your product/service line to contend with these changes?

Now total up the numbers. Here are some tips for making sense of the numbers and for narrowing your list of business possibilities:

- eliminate any of your ideas that scored less than a total of 14
- eliminate any idea that did not score at least a 2 in every category
- eliminate any idea that did not score at least a 3 in the sufficient demand category

How many ideas are left? If the answer is “none,” then you need to use the list to identify where you need to improve and you need to develop a strategy for raising the “1’s” to “2’s” or “3’s.” If the answer is “more than one,” you have a pleasant dilemma: a choice of which business to start. If the answer is “one,” you may have just found the business that’s perfect for you.

The best place to start in picking a small business is with consumers. What do consumers or businesses want that's not being provided to them? Of course, you don't necessarily have to sell a new or different product or service in order to succeed; you can succeed if you can improve what is already being sold. But that's *still* a function of what consumers want. You must also look at trends in our society. If you can identify a trend, you may come up with a new product or service that will fit an upcoming consumer need.

Ultimately, your success will depend upon being able to meet an unmet need in the market.

Does Your Idea Meet a Need?

The Maricopa community colleges sbdc Small Business Development Center conducted a research study on resources that were not yet available in the White Mountain area. This list is included at the end of this booklet. Take time to review these topics. These topics may indicate a consumer need in this area. Does your business idea fit one of these areas?

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PROFITABLE BUSINESS VENTURES

Below is a list of the safest sole proprietorships as compiled by Bizstats.com. Of all the business owners in these categories, at least 75% of them showed a net income. Does your business idea fit into one of these categories?

Rank	Type of Business	Industry Type	Number of businesses	% with net income	% with net losses
	All Sole Proprietorships (except farming)	All	17,408,809	75%	25%
1	Surveying services	Services	15,598	99%	1%
2	Water transportation - contract pilots	Services	4,700	98%	2%
3	Bus & limo transportation - contract drivers	Services	9,777	98%	2%
4	Optometrists	Services	12,810	98%	2%
5	Other highway passenger transportation	Services	21,637	96%	4%
6	Fuel oil dealers	Retailing	3,573	95%	5%
7	Dentists	Services	91,998	94%	6%
8	Textile mill products (!)	Manufacturing	5,668	94%	6%
9	Funeral services	Services	9,272	94%	6%
10	Painting & paperhanging contractors	Construction	214,214	94%	6%
11	Drug stores (!)	Retailing	11,213	92%	8%
12	Carpentry & flooring contractors	Construction	478,025	91%	9%
13	Barber shops	Services	94,308	90%	10%

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14	Registered & practical nurses	Services	114,516	90%	10%
15	Shoe stores (!)	Retailing	5,875	90%	10%
16	Masonry tile & plastering contractors	Construction	190,962	90%	10%
17	TV, audio & electronic stores (!)	Retailing	16,239	89%	11%
18	Taxicabs	Transportation	98,145	89%	11%
19	Lumber & other building materials dealers	Retailing	16,066	89%	11%
20	Janitorial & related services to buildings	Services	441,082	89%	11%
21	Management services	Services	111,893	88%	12%
22	Physicians	Services	192,236	88%	12%
23	Grocery stores	Retailing	65,192	88%	12%
24	Ministers & chaplains	Services	212,939	87%	13%
25	Roofing, siding & sheet metal contractors	Construction	102,409	87%	13%
26	Liquor stores	Retailing	20,012	87%	13%
27	Architectural services	Services	70,786	87%	13%
28	Child day care	Services	618,457	86%	14%
29	Real estate property managers	Real Estate	93,776	86%	14%
30	Beauty shops	Services	449,286	86%	14%
31	Other miscellaneous repair services	Services	263,441	86%	14%
32	Machinery, except electrical	Manufacturing	32,967	85%	15%
33	Mailing & copying services	Services	49,724	85%	15%
34	General building contractors	Construction	383,626	85%	15%
35	Highway and street contractors	Construction	7,799	85%	15%

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36	Accounting & bookkeeping services	Services	393,993	85%	15%
37	Miscellaneous special trade contractors	Construction	485,845	84%	16%
38	Chiropractors	Services	31,285	84%	16%
39	Dry cleaning, carpet & upholstery	Services	68,121	84%	16%
40	Counseling - social assistance	Services	75,876	83%	17%
41	Medical & dental laboratories	Services	19,427	83%	17%
42	Other medical and health services	Services	295,462	83%	17%
43	Legal services	Services	318,005	83%	17%
44	Family clothing stores	Retailing	19,325	82%	18%
45	Landscape & horticultural services	Services	241,480	82%	18%
46	Plumbing & HVAC contractors	Construction	154,779	81%	19%
47	Advertising, except direct mail	Services	86,337	81%	19%
48	Automotive rentals or leasing, w/o drivers	Services	17,803	80%	20%
49	Automobile parking, except valet	Services	6,047	80%	20%
50	Electrical contractors	Construction	119,468	80%	20%
51	Jewelry stores	Retailing	32,444	80%	20%
52	Trucking - local & long distance	Transportation	419,433	80%	20%
53	Educational services	Services	292,813	79%	21%
54	Furniture stores	Retailing	20,622	79%	21%

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55	Automotive services, except repair	Services	168,094	79%	21%
56	Electrical repair, except TV & audio equip	Services	43,663	78%	22%
57	Coin-operated laundries	Services	15,920	78%	22%
58	Home furnishings dealers	Retailing	49,272	77%	23%
59	Commercial fishing	Services	78,244	77%	23%
60	Automotive repair shops	Services	138,276	77%	23%
61	Auto parts & accessories shops	Retailing	33,627	77%	23%
62	Farm labor, management & crop services	Services	42,161	77%	23%
63	Printing, publishing & allied industries	Manufacturing	36,786	77%	23%
64	Insurance agents & brokers	Insurance	294,680	77%	23%
65	Computer & data processing services	Services	48,898	77%	23%
66	Miscellaneous personal services	Services	695,606	76%	24%
67	Consulting services	Services	591,665	76%	24%
68	Real estate agents & brokers	Real Estate	686,323	76%	24%
69	Courier & package delivery	Services	182,092	76%	24%
70	Fabricated metal products	Manufacturing	29,319	75%	25%
71	Podiatrists	Services	6,296	75%	25%
72	Credit agencies & mortgage bankers	Finance	27,309	75%	25%
73	Air transportation - contract pilots	Services	11,132	75%	25%
74	Catering services	Retailing	66,380	75%	25%
75	Concrete contractors	Construction	44,023	75%	25%

Deciding on a Business Idea

The good news is you have evaluated your ideas and now you can pick one or two to focus on. The bad news is... that was the easy part!

Coming up with ideas is easy, the trick is being able to successfully implement that idea. That's much more difficult. As Einstein said, genius is one percent inspiration and 99 percent perspiration. That's as true in business as it is in science. So, not only must you come up with a good idea, but it must be a good idea that you can move on.

PRE-VENTURE CONSIDERATIONS

- ✓ Start saving money now
- ✓ Get your credit report and make improvements to it now
- ✓ Try to work for a competitor in the same industry to learn the business
- ✓ Consider starting your business as a second-job
- ✓ Objectively measure your skills in the industry and improve them now
- ✓ Talk to people in the business and get their feedback
- ✓ Don't leave your job until you have a business plan completed
- ✓ Make sure you love the field you are considering
- ✓ Don't risk all your assets. Limit the amount you will invest
- ✓ Avoid choosing an idea that competes on price or with big-box suppliers
- ✓ Don't let self-confidence talk you out of doing your home work

Start from Scratch or Buy Existing

Buying an existing business can be less risky than starting from scratch. When you buy a business, you take over an operation that's already generating cash flow and profits. You have an established customer base, reputation and employees who are familiar with all aspects of the business. And you don't have to set up new procedures, systems and policies.

On the downside, the biggest concern of most entrepreneurs is

capital and buying a business is often more costly than starting from scratch. You could adopt legal problems, reputation problems, and financial problems. If you're not careful, you could get stuck with obsolete inventory, uncooperative employees or out-dated distribution methods.

Advantages of buying an existing business:

- **Immediate operation.** Operations can start immediately.
- **Quick cash flow.** Existing inventory and receivables can produce quick cash flow.
- **Existing customers.** Customers and suppliers have already been located, and relationships with them have been established.
- **Existing goodwill.** Goodwill toward products or services has (presumably) been created.
- **Easier financing.** Financing is easier to obtain because the business has a track record.
- **Eliminate competition.** Buying a business may eliminate a competitor that you would have had to compete against had you started from scratch.

Disadvantages of buying an existing business:

- **Cost.** Buying a business is sometimes, but not always, more costly than starting one from scratch.
- **Problems.** There may be inherent problems in the business, some of which may not be apparent until after the sale.
- **Obsolete goods.** Inventories and equipment may be obsolete.
- **Personality conflicts.** Your personality may clash with existing managers and employees.
- **Uncollectable receivables.** Bills owed to the business by its customers may be old, stale, and ultimately worthless.

EXISTING BUSINESS CONSIDERATIONS

- ✓ Review the financial history of the business
- ✓ Try to get seller financing
- ✓ Assemble an acquisition team including your attorney, accountant, real estate professional and business advisor.
Due diligence is critical.

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- ✓ Review all receivables and get balance affirmation in writing from owing customers
- ✓ Conduct a location evaluation of the business
- ✓ Do not purchase anything without your attorney and accountant approving everything
- ✓ You are buying past profitability, do not rely on projections
- ✓ Make your own valuation of equipment and inventory
- ✓ Walk away from any deal that does not work for you
- ✓ Compare the costs of a new start up to purchasing this business

Franchises offer lower risk, more support and have established higher success rates, but they are expensive, limit your creativity and you pay fees no matter of your profits.

If you are looking at buying an existing business, the Maricopa community colleges sbdc Small Business Development Center can help you with a business valuation and financial projections.

Assemble a Team of Experts

You can't possibly have all the answers; but you must know where to find them!

The stupidest question is the one not asked! Don't be afraid to ask for help and feedback. Use this information to make objective decisions.

You have probably already begun discussing your ideas with friends and family. If you haven't already enlisted the help of professionals, now is the time. At this point, you will need guidance that your idea choices are sound and you'll need help evaluating locations, start up costs, financial projections, legal documents and government requirements. There is no-cost help available if you look for it. Your team should at a minimum include an attorney, accountant, banker, business advisor, other business owners, possible investors.

Where Will Customers Find Your Product

Technology and competition has opened up many avenues for new entrepreneurs. The days of brick and mortar have evolved to ecommerce, licensing and home based business. Once you've narrowed down your business idea, you must begin considering the best place to reach the customers that will be purchasing your product or service. LOCATION IS EVERYTHING! For retailers, wholesalers and manufacturers, physical location is critical.

If you think you've discovered a better widget than anyone else and customers are going to beat a path to your door, you're kidding yourself! Customers need to be able to find you and your product easily!

The most common avenues for selling your product or service are listed below along with some positive and negative aspects of each choice. Distribution channels are considered in greater detail during the marketing plan stage.

Physical Outlet ~ Brick and Mortar:

Builds image, dedicated space, easy to find, real estate investment. Start up costs, full time commitment, merchandising, employees.

Home-based:

Less risk, lower start up costs, traffic in neighborhoods, lacks professional image, mixing work and home, customers at your house, town and city codes prevent some home-based businesses.

Licensing a Product:

Your great idea/product, someone else does the work for you—less money, less risk, less commitment, selling your idea is difficult.

E Commerce:

Lower start up costs, wide customer base, open any time, flexible work hours, shipping, inventory, storage, credit cards
How to get them to your site; confidence to make a purchase.

Wholesale or Outside Sales Force:

Lower start up costs, hard to get product on shelves, employees, storage, image building.

Evaluating a Physical Location

A sound business venture can be easily destroyed by a poor location. Committing to a poorly negotiated lease or contract can be just as devastating. The following form will give you a methodical approach for evaluating the strengths and weaknesses of each potential location.

1. First, evaluate your site location for each factor on a scale of 1 to 10, number 10 being the highest.
2. Second, decide the importance of each factor to your particular business on a scale of 1 to 5, number 5 being the most important.
3. Multiply the grade by the weight to determine the points for each factor. Add up the points to get a total score. Repeat this process for each site to gain an objective comparative analysis.

To Buy or Lease

The primary concern for most start ups is the capital requirement. If you purchase a site, your initial capital requirements will be higher. However many businesses make more money on their real estate purchase than on their business. Purchasing guarantees your location and stabilizes your long-term expenses. Here are some things you should consider when buying or leasing:

- ✓ Buying will take initial start up costs; rent will be a monthly expense
- ✓ Buying will stabilize future costs; rents will change with the market
- ✓ There may be tax incentives to owning
- ✓ Do your own evaluation of the real estate location

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Site Criteria Table			
Factors	Grade 1 -10	Weight 1-5	Points
Traffic count: Cars or pedestrians			
Visibility access			
Proximity to competition			
Zoning			
Parking (include off-street)			
Condition of premises			
Proximity to customer generators			
Income level of neighborhood			
Population density			
Ethnic make-up of neighborhood			
Age factor			
Directional growth of area			
Area improving or deteriorating			
Crime/shoplifting rates			
Availability of qualified employees			
Labor rates of pay			
Supplier proximity			
Terms and rental rates			
Adequacy of utilities, gas, water			
Transportation accessibility			
Total Points			

Location Considerations

- ✓ Be sure your intended location has the correct zoning and code requirements
- ✓ Compare several locations to establish comparable values
- ✓ Review demographic data for the area to be sure you are reaching your market
- ✓ Never sign a lease or contract without the approval of your lawyer
- ✓ If leasing, try to get short-term lease agreements with options to renew
- ✓ Have all agreements put into writing
- ✓ If leasing, ask the landlord that no other similar businesses be allowed in the center
- ✓ Check with the city on code requirements such as parking, signage and ADA (Americans with Disabilities Act).
- ✓ Don't judge a location entirely on price
- ✓ Try not to personally guarantee your lease or purchase
- ✓ Do not rush into a decision or unfair terms, look elsewhere
- ✓ Subject all leases and purchases to obtaining the proper permits, zoning and licenses

Estimating Your Start Up Costs

Many small businesses fold because the owner runs out of money before the business can support itself.

Now that you have made an informed choice on a potential business idea, and the type of location you would like, it is time to decide if you can afford to start the business. It is important to schedule out the first 90 days of income and expenses for the business and your living expenses to see what it will take to start and maintain your business for the first year. Be sure to consider to affects of seasonality on your sales!

To find your initial set up costs you will identify one-time start up costs, and 90 days of income and expense. This will take some research. Ask advice from other business owners, your business advisor and accountant. Do research on similar businesses to come up with your initial set up costs. The best place to get this information is from an existing business in your industry. Contact real estate agents for prices, etc.

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Estimate your one time costs for opening the doors of your business. Do not mistake these with on-going expenses.

<i>SHEET A: Initial Setup Costs</i>		
Advertising	\$	Promotion for opening the business
Beginning inventory	\$	The amount of inventory needed to open
Building construction	\$	The amount per contractor bid and other
Cash	\$	Requirements for the cash register
Decorating	\$	Estimate based on bid if appropriate
Deposits	\$	Check with the utility companies
Fixtures and equipment	\$	Use actual bid on all F and E
Installing fixtures and equipment	\$	Use actual bids
Insurance	\$	Bid from insurance agent
Lease payment	\$	Bid from real estate agent
Licenses and permits	\$	Check with city or state offices
Miscellaneous	\$	All other
Professional fees	\$	Include CPA, attorney, engineer, etc.
Remodeling	\$	The amount per contractor bid
Rent, equipment	\$	Amount to be paid before opening
Services	\$	Cleaning, accounting, etc.
Signs	\$	The amount per contractor bid
Supplies	\$	Office, cleaning, etc. supplies
Unanticipated expenses	\$	Amount for unexpected costs (10 percent of total)
Other	\$	
Other	\$	
Other	\$	
Total Setup Dollars Needed	\$	Total Schedule A (Pre-Opening Costs)

The First 90 Days Projected Monthly Costs

Prepare an itemized statement identifying both (1) your personal living costs and (2) the anticipated monthly costs of operating the business for the first three months. On the following charts, fill in the income and expense columns, plus any other expenses that you deem appropriate for your individual situation.

Personal Living Expenses: Make a family budget. Look at your family's fixed and variable living expenses. It's important to know the amount of personal costs that you'll have to cover during the startup phase of your business.

Business Expenses: At a minimum, estimate monthly income and expenses for your business's first 90 days of operation. Do not duplicate any expenses noted under your personal budget statement or in your one time start up costs.

Starting Inventory Calculation: Inventory is critical to retailers and manufacturers. You need enough inventory to generate sales, but too much inventory eats up cash flow and results in outdated goods. A basic calculation for estimating beginning inventory is shown below.

1. Estimate annual expenses

Rent	\$ 12,000	
Insurance	3,000	
Utilities	2,400	
Labor	24,000	
Repairs & Maintenance	2,000	
Owners Salary	24,000	
TOTAL	\$ 67,400	
2. Estimate your gross margin percentage

Per \$1.00 of retail sales:	\$ 1.00	
Cost of inventory	\$.70	70%
Gross profit margin	\$.30	30%
3. Calculate the sales required to meet expenses:
 - Take total expenses (\$67,400) divide by gross margin percent 30%
 - Equals sales required \$224,667
4. Calculate the inventory required for sales:
 - Take sales required to meet expenses (#3) (\$224,667)
 - Multiply times cost of inventory percentage (70%)
 - Equals inventory required for sales \$157,267
5. Adjust inventory based on times inventory turns (see next page)
 - Take inventory required for sales (#4) (\$157,267)
 - Divide by time inventory turns (2 times)
 - Equals inventory required for startup **\$ 78,633**

Family Income	Month 1	Month 2	Month 3
Wages (take-home)	\$	\$	\$
Wages (take-home)-spouse	\$	\$	\$
Interest/Dividends	\$	\$	\$
Miscellaneous	\$	\$	\$
Total Income	\$	\$	\$
Family Expense Budget			
Auto Expenses (gas, maintenance, etc.)	\$	\$	\$
Auto Insurance	\$	\$	\$
Auto Payment	\$	\$	\$
Beauty Shop/Barber	\$	\$	\$
Cable TV	\$	\$	\$
Charity	\$	\$	\$
Child Care	\$	\$	\$
Clothing	\$	\$	\$
Credit Card Payments	\$	\$	\$
Dues and Subscriptions	\$	\$	\$
Electricity	\$	\$	\$
Entertainment	\$	\$	\$
Gas Company	\$	\$	\$
Gifts	\$	\$	\$
Groceries & Outside Meals	\$	\$	\$
Health Insurance	\$	\$	\$
Home Repairs	\$	\$	\$
Homeowner's Insurance	\$	\$	\$
Household Expenses	\$	\$	\$
Income Tax (additional)	\$	\$	\$
Laundry and Drycleaning	\$	\$	\$
Life Insurance	\$	\$	\$
Medical and Dental	\$	\$	\$
Mortgage Payments	\$	\$	\$
Other Debt Payments	\$	\$	\$
Rent	\$	\$	\$
School Expenses	\$	\$	\$
Telephone Bill	\$	\$	\$
Tuition	\$	\$	\$
Vacations	\$	\$	\$
Water, Sewer, Trash	\$	\$	\$
Other	\$	\$	\$
Total Expenses	\$	\$	\$
Net Cash Remaining	\$	\$	\$

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Sheet C: Business Income and Expenses

<i>Estimated business income</i>	<i>Month 1</i>	<i>Month 2</i>	<i>Month 3</i>	<i>TOTAL</i>
Total Income	\$	\$	\$	\$
<i>Monthly expenses</i>	<i>Month 1</i>	<i>Month 2</i>	<i>Month 3</i>	<i>TOTAL</i>
Advertising	\$	\$	\$	\$
Bank service charges	\$	\$	\$	\$
Business insurance	\$	\$	\$	\$
Credit card fees	\$	\$	\$	\$
Delivery charges	\$	\$	\$	\$
Dues and subscriptions	\$	\$	\$	\$
Health insurance	\$	\$	\$	\$
Inventory	\$	\$	\$	\$
Lease payments	\$	\$	\$	\$
Loan payments	\$	\$	\$	\$
Miscellaneous	\$	\$	\$	\$
Office expenses	\$	\$	\$	\$
Payroll other than manager	\$	\$	\$	\$
Payroll taxes	\$	\$	\$	\$
Professional fees	\$	\$	\$	\$
Rent	\$	\$	\$	\$
Repairs and maintenance	\$	\$	\$	\$
Salary of owner or manager	\$	\$	\$	\$
Sales tax	\$	\$	\$	\$
Supplies	\$	\$	\$	\$
Telephone	\$	\$	\$	\$
Utilities	\$	\$	\$	\$
Other	\$	\$	\$	\$
Total Expenses	\$	\$	\$	\$
Net Cash Remaining (Needed)	\$	\$	\$	\$

Recap of Costs		
Initial Business Setup Dollars Needed (from SHEET A):	\$ _____	
Operating Dollars Needed for First 90 Days (from SHEET C):	\$ _____ _____	
Total Dollars Needed for Setup and First 90 Days (sum of A + C):	\$ _____	
Additional Personal Cash Needed or Available (from SHEET B):		\$ _____
Net Cash Needs for Personal and Business Survival during Startup and First 90 Days:		\$ _____

Calculating Inventory Turns

The basic formula for calculating how many times inventory turned is: [Cost of Sales (COS)] divided [Average Inventory]

For example: If COS is \$100,000 and the average inventory level is \$25,000, your inventory turned 4 times during the period (typically measured annually)

However, when you are starting up a business, it is often difficult to determine inventory turn over without any data.

Maricopa Community Colleges Small Business Development Center can research industry standards to help you evaluate the average inventory turn over of businesses in your industry.

Naming Your Business

Naming your business may not be as simple as it seems. When selecting a name, try to make the name short, easy to remember, descriptive of the business, and capable of drawing attention. At this point you may want to think about the concept of your business.

CONCEPT

This is one of the most important areas for any new business to spend time on in the planning stages. A concept is what makes your small business different from the myriad of others offering your product or services today. Even if you have no competition, there is something that your customers are doing today to meet their needs. By having a concept that is unique to your business, you will be differentiating yourself from your competitors, and giving the customer something more than “price” as a means of evaluating whether to try you or not. It is hazardous at best for small businesses to try to compete with larger, well established firms on the basis of price alone. They can outlast you when it comes to operating on insufficient margins, and they already have the existing buyers as customers. Those customers may even resist trying your product or service at the lower price you offer anyway. (What is wrong with your product or service that you can afford to sell more cheaply than my existing provider?)

The concept doesn't always have to stress the “unique” over the other common factors which will make your firm successful. For instance, most businesses say they will provide good customer service. Your concept may involve providing pickup or delivery, extending your hours, or other things that your customer will appreciate. The key is that you have identified the issues that you will use to gain market share, made them part of your plan, and stressed areas that will contribute to your success in this area. In the above example, everyone in your chosen industry will say that their goal is to provide good customer service. *Your* concept, which may be built on providing free pickup and delivery will make the customer happy, and offer tangible benefits that they can see as “value added” prior to trying your product or service. More importantly, this can contribute to their decision to try you instead of your competitors or even switch from their previ-

ous provider of the product or service.

For example, if you've decided you are going to open a food store and your concept is to provide fresh, organic food items you might want a name that conveys freshness, purity, and a farmers-garden atmosphere. Immediately, you can see that names like "Kathy's Food Store" or "Show Low Foods" would communicate none of these qualities. But consider the name "Mother Nature's Organic Food Store." The items sound natural, fresh, and harvested. Moreover, if you diversified your product line, you could alter the name to "Mother Nature's Organic Deli." This change would enable you to hold onto your suggestive name without totally mystifying your established clientele.

Business Name Brainstorming

List three ideas based on the products or services you plan to provide (e.g., children's clothing, custom menu design, aromatherapy products):

- 1.
- 2.
- 3.

List three ideas based on your special niche (e.g., affordable children's special occasion clothes, exclusive designs for the small restaurateur, aromatherapy for the office environment):

- 1.
- 2.
- 3.

List three ideas combining a favorite theme with your special niche: (e.g., Tea Party children's party clothes, Table For Two menu designs, The Tranquil Desk aromatic office products):

- 1.
- 2.
- 3.

Have you said it aloud to make sure it's easily understood and pronounced? (Has it passed muster with your family? Have you had a friend call to see how it sounds over the phone?)

Name Registration and Protection

Beyond the importance of choosing a good name for marketing purposes you must consider name protection and at what level you want to be assured that no one else can use your name. Choosing a name with an identity that relates to your product or service can have benefits in enhancing image and relating to potential customers. If in hearing your name the customer can envision your product or service, this can be a positive feature.

In Arizona to protect a trade name can be done in more than one way. First, in your County you can file a Fictitious Business Name Statement. For Navajo and Apache Counties this is done with the County Recorders office, and requires a statement be filed in three consecutive issues of a major newspaper. For the state level you must file with the Arizona Secretary of State's Trademark and Trade Name Office. If you are going to be doing business in other states and need name protection, you will need to register your name as a Federal Trademark with the U.S. Commissioner of Patents and Trademarks in Washington, D.C. If you are incorporating in Arizona, the Arizona Corporation Commission will handle name registration for you.

The Secretary of State does not register corporate names (e.g., ABC, Inc). You must remove any designations from your trade name such as INC, LLC, LTD., or LP. If you are filing as a corporation or LLC with the Arizona Corporation Commission, it is not necessary to register your corporate name as a trade name with this office as names are cross-referenced with the Corporation Commission. If you walk your application in notarization is not required. However, a form of United States government issued identification is required to process the application.

In many instances, to open a separate checking account for your business you will need a copy of the Fictitious Business Name Statement or other proof that you own your trade name. Short of registering the name, you can apply for a Taxpayer Identification Number with the IRS. This is as simple as filling out the form and sending it in. There is no cost, and in two to three weeks they will mail back your confirmation letter with your name and number. In most instances the banks will accept this as proof of

your trade name The Taxpayer number can be a good alternative to more formal registration. The worst case is someone else assumes your name and asks you to choose another. If this would be a problem then go ahead and register your name as detailed above.

Legal Structure ~ Ownership Structure

One of the first decisions that you will have to make as a business owner is how the company should be structured. This decision will have long-term implications, so consult with an accountant and attorney to help you select the form of ownership that is right for you. In making a choice, you will want to take into account the following:

- ✓ Your vision regarding the size and nature of your business.
- ✓ The level of control you wish to have.
- ✓ The level of "structure" you are willing to deal with.
- ✓ The business's vulnerability to lawsuits.
- ✓ Tax implications of the different ownership structures.
- ✓ Expected profit (or loss) of the business.
- ✓ Whether or not you need to re-invest earnings into the business.
- ✓ Your need for access to cash out of the business for yourself.

Sole Proprietorship

The vast majority of small businesses start out as a sole proprietorship. These firms are owned by one person, usually the individual who has day-to-day responsibility for running the business. Sole proprietors own all the assets of the business and the profits generated by it. They also assume complete responsibility for any of its liabilities or debts. In the eyes of the law and the public, you are one in the same with the business.

For example, say John Smith starts a shoe business. John would acquire the necessary training (working for Uncle Samuel under an apprenticeship), leather, supplies, and tools, a retail location (preferably a different town than Uncle Samuel for reasons of competition), and would hang out a sign saying "John Smith, Cobbler". This process is not much different today. Nationally, over 95% of all small businesses are structured as Proprietorships. A Proprietorship, even if John were to change the name to "Shoe Emporium" is still just an extension of John Smith personally. John is

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the company. He pays the self-employed tax and files a Schedule C with his annual tax return. He is fully responsible for any and all debts or liabilities of the company, to the full extent of his net worth. If John can't pay his leather vender, he could be sued for repayment and find a judgment on his house. He was also limited by the money he had personally to buy the leather and tools and get started. But to get started, John had to do little more than hang out his sign. And he doesn't have a Board of Directors to report to, asking why his Cost of Sales dropped one-tenth of a percent last month. When John dies or decides to sell the business he will find that the business really ceases to exist once that happens. All he (or his widow) is really selling is the assets of the business; the tools, leather, etc.

Advantages of a Sole Proprietorship

- Easiest and least expensive form of ownership to organize.
- Sole proprietors are in complete control, and within the parameters of the law, may make decisions as they see fit.
- Sole proprietors receive all income generated by the business to keep or reinvest.
- Profits from the business flow-through directly to the owner's personal tax return.
- The business is easy to dissolve, if desired.

Disadvantages of a Sole Proprietorship

- Sole proprietors have unlimited liability and are legally responsible for all debts against the business. Their business *and* personal assets are at risk.
- May be at a disadvantage in raising funds and are often limited to using funds from personal savings or consumer loans.
- May have a hard time attracting high-caliber employees, or those that are motivated by the opportunity to own a part of the business.
- Some employee benefits such as owner's medical insurance premiums are not **directly** deductible from business income (only partially deductible as an adjustment to income).

Federal Tax Forms for Sole Proprietorship

(only a partial list and some may not apply)

- Form 1040: Individual Income Tax Return

- Schedule C: Profit or Loss from Business (or Schedule C-EZ)
- Schedule SE: Self-Employment Tax
- Form 1040-ES: Estimated Tax for Individuals
- Form 4562: Depreciation and Amortization
- Form 8829: Expenses for Business Use of your Home

Partnership

In a Partnership, two or more people share ownership of a single business. Like proprietorships, the law does not distinguish between the business and its owners. The Partners should have a legal agreement that sets forth how decisions will be made, profits will be shared, disputes will be resolved, how future partners will be admitted to the partnership, how partners can be bought out, or what steps will be taken to dissolve the partnership when needed. Yes, its hard to think about a "break-up" when the business is just getting started, but many partnerships split up at crisis times and unless there is a defined process, there will be even greater problems. They also must decide up front how much time and capital each will contribute, etc.

This can be a challenging structure, but does have its uses. Say John (from above) starts his shoe business, making new shoes and repairing soles. He is fairly successful, but suddenly a Wal-Mart moves into town, and his customers are no longer happy waiting for John to make them shoes from their order. They want them on a shelf to pick out. In their size, ready to wear. To compete John decides to stock various sizes and styles of shoes. Maybe even purchase them from China so he can compete price-wise. But he doesn't have the \$50,000 which is necessary to keep all the inventory he needs. His friend, Bert, just sold his Carriage-making business, and received \$50,000 cash, so they decide to join forces and start "Shoe Emporium". This is the classic or General Partnership. They are both equal partners. The advantage to the partnership was to join forces and generate enough cash. Like a Proprietorship it was easy to form, just putting out the new sign. Now for the challenging part. Even though they are equal partners, are they? Bert put in \$50,000 cash and John only put in his existing tools and inventory. John is doing all the work making the

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shoes and stocking and selling the inventory. Bert only comes by twice a month to ask for money. And he's starting to ask a lot of questions of John, like why they don't have enough size 12DD loafers.

In a General Partnership, all partners are personally liable to the extent of the personal worth, like a Proprietorship, but for the debts and liabilities of the entire Partnership. If John gets fed up with doing all the work and decides to empty the safe and skip to Bermuda, Bert is still left to pay all the bills. And say Bert and John decide to go their separate ways. Like the Proprietorship, this involves discontinuing the business. Often, it will also involve having to sell the business to a third party because John doesn't have the cash to pay Bert his share.

What about a marriage? If one spouse decides to start a Proprietorship in the state of Arizona, the other is a full partner (yes, just like a Partnership) whether they're involved in the day-to-day operations or not. (Unless the business is started with legally designated sole and separate assets, not community property.) Your spouse is a partner, and many of the downsides to the Partnership can also apply when a business goes south and your spouse with it (see the Bermuda clause above).

Advantages of a Partnership

- Partnerships are relatively easy to establish; however time should be invested in developing the partnership agreement.
- With more than one owner, the ability to raise funds may be increased.
- The profits from the business flow directly through to the partners' personal tax returns.
- Prospective employees may be attracted to the business if given the incentive to become a partner.
- The business usually will benefit from partners who have complementary skills.

Disadvantages of a Partnership

- Partners are jointly and individually liable for the actions of the other partners.

- Profits must be shared with others.
- Since decisions are shared, disagreements can occur.
- Some employee benefits are not deductible from business income on tax returns.
- The partnership may have a limited life; it may end upon the withdrawal or death of a partner.

Types of Partnerships that should be considered:

General Partnership Partners divide responsibility for management and liability, as well as the shares of profit or loss according to their internal agreement. Equal shares are assumed unless there is a written agreement that states differently.

Limited Partnership and Partnership with limited liability

"Limited" means that most of the partners have limited liability (to the extent of their investment) as well as limited input regarding management decisions, which generally encourages investors for short term projects, or for investing in capital assets. This form of ownership is not often used for operating retail or service businesses. Forming a limited partnership is more complex and formal than that of a general partnership.

Joint Venture Acts like a general partnership, but is clearly for a limited period of time or a single project. If the partners in a joint venture repeat the activity, they will be recognized as an ongoing partnership and will have to file as such, and distribute accumulated partnership assets upon dissolution of the entity.

Federal Tax Forms for Partnerships

(only a partial list and some may not apply)

- Form 1065: Partnership Return of Income
- Form 1065 K-1: Partner's Share of Income, Credit, Deductions
- Form 4562: Depreciation
- Form 1040: Individual Income Tax Return
- Schedule E: Supplemental Income and Loss
- Schedule SE: Self-Employment Tax

- Form 1040-ES: Estimated Tax for Individuals

Corporation

A corporation, chartered by the state in which it is headquartered, is considered by law to be a unique entity, separate and apart from those who own it. A corporation can be taxed; it can be sued; it can enter into contractual agreements. The owners of a corporation are its shareholders. The shareholders elect a board of directors to oversee the major policies and decisions. The corporation has a life of its own and does not dissolve when ownership changes.

The Corporation is the structure for sheltering liabilities. In a Corporation you are a separate legal entity, and sell stock to raise capital and start business. Even with the John Smith example he could incorporate, forming John Smith Shoes, Inc. Here John starts with the same need for cash for leather, supplies and tools. But he puts the cash into the corporation by buying 500 shares of stock for \$10 per share. One advantage to John is his liability is now limited to his investment. If the Corporation is sued they can't attach John's house and other personal assets. Another advantage would apply to the decision to grow into Shoe Emporium. Here John could sell stock to Bert, and could even limit Bert's decision making ability within the Corporation. For instance, Preferred Stock usually contains no voting privileges, but also has a higher rate of return than the basic Common Stock that John owns. Also, when John decides to sell the business he can sell the stock to more than one person, and see that the business continues after he is gone. He can even "gift" shares of stock to his children, who might wish to take over the business in time.

The disadvantage to the Corporation is that it is relatively complex to form. John would have to file with the Arizona Corporation Commission, have an attorney draft Articles of Incorporation and Bylaws, publish the Articles of Incorporation in the newspaper for three consecutive issues, etc. Legal costs will typically run more than \$1,000 to start a corporation in Arizona. And the recordkeeping is more difficult thereafter. More forms to file, records of corporation meetings, etc. More taxes and returns to

file.

Advantages of a Corporation

- Shareholders have limited liability for the corporation's debts or judgments against the corporations.
- Generally, shareholders can only be held accountable for their investment in stock of the company. (Note however, that officers can be held personally liable for their actions, such as the failure to withhold and pay employment taxes.)
- Corporations can raise additional funds through the sale of stock.
- A corporation may deduct the cost of benefits it provides to officers and employees.
- Can elect S corporation status if certain requirements are met. This election enables company to be taxed similar to a partnership.

Disadvantages of a Corporation

- The process of incorporation requires more time and money than other forms of organization.
- Corporations are monitored by federal, state and some local agencies, and as a result may have more paperwork to comply with regulations.
- Incorporating may result in higher overall taxes. Dividends paid to shareholders are not deductible from business income, thus this income can be taxed twice.

Federal Tax Forms for Regular or "C" Corporations

(only a partial list and some may not apply)

- Form 1120 or 1120-A: Corporation Income Tax Return
- Form 1120-W Estimated Tax for Corporation
- Form 8109-B Deposit Coupon
- Form 4625 Depreciation
- Other forms as needed for capital gains, sale of assets, alternative minimum tax, etc.

S Corporation

A tax election only; this election enables the shareholder to treat the earnings and profits as distributions, and have them pass thru directly to their personal tax return. The catch here is that

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the shareholder, if working for the company, and if there is a profit, must pay themselves wages, and it must meet standards of "reasonable compensation". This can vary by geographical region as well as occupation, but the basic rule is to pay yourself what you would have to pay someone to do your job, as long as there is enough profit. If you do not do this, the IRS can reclassify all of the earnings and profit as wages, and you will be liable for all of the payroll taxes on the total amount.

Federal Tax Forms for Subchapter S Corporations

(only a partial list and some may not apply)

- Form 1120S: Income Tax Return for S Corporation
- 1120S K-1: Shareholder's Share of Income, Credit, Deductions
- Form 4625 Depreciation
- Form 1040: Individual Income Tax Return
- Schedule E: Supplemental Income and Loss
- Schedule SE: Self-Employment Tax
- Form 1040-ES: Estimated Tax for Individuals
- Other forms as needed for capital gains, sale of assets, alternative minimum tax, etc.

The S Corporation limits stockholders to 35 individuals, but the tax is paid by the individual stockholders personally. This is important, because in the typical C Corporation the taxes are paid by the Corporation, and any personal funds drawn by the stockholders are also taxed as dividends. Double taxation. There are many other rules for S Corporations, but most domestic small businesses are eligible.

Limited Liability Company (LLC)

The LLC is a type of hybrid business structure that is now permissible in most states. It is designed to provide the limited liability features of a corporation and the tax efficiencies and operational flexibility of a partnership. Formation is more complex and formal than that of a general partnership.

The owners are members, and the duration of the LLC is usually determined when the organization papers are filed. The time limit can be continued if desired by a vote of the members at the time

of expiration. LLC's must not have more than two of the four characteristics that define corporations: Limited liability to the extent of assets; continuity of life; centralization of management; and free transferability of ownership interests.

Federal Tax Forms for LLCs

The federal government does not recognize an LLC as a classification for federal tax purposes, such entities must figure out how they should file their federal returns. For Federal tax purposes, an LLC business entity must file as a corporation, partnership or sole proprietorship tax return.

An LLC that is not automatically classified as a corporation can file Form 8832 to elect their business entity classification. A business with at least 2 members can choose to be classified as an association taxable as a corporation or a partnership, and a business entity with a single member can choose to be classified as either an association taxable as a corporation or disregarded as an entity separate from its owner, a "disregarded entity". The Form 8832 is also filed to change the LLC's classification.

If an LLC does not File Form 8832, it will be classified, for Federal tax purposes under the default rules. The default rules provide that if the LLC has at least two members and is not required to be classified as a corporation, it will automatically default as a partnership, and be required to file a partnership return. An LLC that has only a single member and is not required to be classified as a corporation will automatically default to the classification of disregarded entity. The disregarded entity files as a sole proprietorship and completes the appropriate schedules as part of the single owners Form 1040.

The business structure of the LLC and/or the election the business made dictates which federal tax form the business must file.

If the LLC is a sole proprietor for federal tax purposes, the entity should file either:

- [Form 1040 Schedule C](#), Profit or Loss from Business (Sole Proprietorship)
- [Form 1040 Schedule E](#), Supplemental Income or Loss

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- [Form 1040 Schedule F](#), Profit or Loss from Farming
- [Form 1040 Schedule J](#), Income Averaging for Farmers and Fisherman

If the business has net income over \$400, it may be required to file [Schedule SE](#), Self-Employment Tax.

If the LLC is a partnership, it should file a [Form 1065](#), U.S. Return of Partnership Income. Each owner should show their pro-rata share of partnership income (reduced by any tax the partnership paid on the income), credits and deductions on [Schedule K-1 \(1065\)](#), Partner's Share of Income, Deductions, Credits, etc.

Finally, if the LLC is a corporation, it should file a [Form 1120](#), U.S. Corporation Income Tax Return. The 1120 is the corporate income tax return, and there are no flow-through items to a 1040 from a corporate return. However, if the LLC filed as an S Corporation, it should file a Form 1120S, U.S. Income Tax Return for an S Corporation and each owner reports their pro-rata share of corporate income, credits and deductions on [Schedule K-1 \(Form 1120\)](#), Shareholder's Share of Income, Deductions, Credits, etc

Put Your Thoughts in Writing ~ Start Up Steps

In one sentence, why do you want to start your own business?

What was your score on the entrepreneurial quiz?

What entrepreneurial skills do you need to improve upon?

MARICOPA COMMUNITY COLLEGES SBDC ~ SMALL BUSINESS DEVELOPMENT

What business (service, product, manufacture) are you going to start?

What is the concept of this business, why is it different?

What consumer need will be filled by this business?

How will consumers find/buy your product?

Where would you like to locate/conduct your business?

Will you start from scratch, buy existing, franchise?

What do you estimate it will cost to start up your business?

Where are you going to get the money to start the business?

Contact us at 480-784-0590

What will be the name of the business?

Who are the team of experts you will use to help you?

What is the legal structure you will use for your business?

What questions do you have for your SBDC counselor?

The Maricopa Community Colleges Small Business Development Center works in partnership with small businesses and entrepreneurs to maximize their success.

***When small business owners succeed,
we all succeed.***

Our Goals for Economic Development for Clients:

For clients we work with for five or more hours.....

When surveyed a client will respond:

- *Yes, I am satisfied with the service*
- *Yes, the service has had a positive impact on my business*
- *Yes, I would recommend the service to others*

Your progress in the following areas is progress we want for the entire region:

- *Increased jobs or saved jobs*
- *Increased revenue and tax base*
- *New loans, lines of credit or debt capital*
- *New investment capital*

**Maricopa Community Colleges
Small Business Development Center
2400 N. Central Ave., Ste 104
Phoenix, AZ 85004**

