The content of the Guide is for information purposes only and should not be taken to be specific legal or accountancy advice. Please seek specific legal and/or accountancy advice from a specialist to ensure that your precise requirements are met. Efforts have been made to ensure that the information is correct at the time of writing but no guarantee is given in this regard and no liability can be accepted for any losses in consequence of errors.

Guide 2 – Starting a Business – Early Considerations

2.1 Before Setting Up a Business

(1) A prospective business owner needs to carry out market research to obtain feedback on the product or service from independent people.

(2) Secondly, competing businesses need to be investigated. How will the business product or service stand out from the crowd? Only a small proportion of products and services will be unique and so it likely that some other businesses will be providing a similar product or service. How are those other businesses (which are the main competitors) performing?

A ready source of information on some of those competitors (if they are either companies or Limited Liability Partnerships (LLPs)) is at Companies House :

https://www.gov.uk/government/organisations/companies-house

Click on “Find Company Information” to go to the search box and insert the name of the company or LLP that is of interest.

Tip: Even though the gov.uk search facility refers to Companies House it can also be used to search for Limited Liability Partnership information, as well as for companies.

There is a lot of other information, aside from accounts, (for companies and LLPs) at the same website; such as who the company directors and shareholders are; (Note that when looking at the business' last Confirmation Statement it will not give absolutely up to the last-minute information. Instead, it will reveal the situation at the time the directors submitted the last Confirmation Statement (formerly called the Annual Return). Having said that, information such as directors' details should be fairly up to date as companies are required to inform Companies House of changes in director details within 14 days of the change occurring).

Information on competitors can also be found by looking at their websites. Other sources of information (such as trade magazines) can also be used to find out about competitors (including, but not limited to, prices/new product developments/feedback from their customers etc.). Learning about how your competitors are performing might give you useful information that will assist you in your business.

Tip: For businesses that are companies or Limited Liability Partnerships you can find accounts and other information by going to https://www.gov.uk/get-information-about-a-company

Tip: The company or LLP of interest may not have filed full business accounts. This is because, depending on the financial size of the company e.g. turnover, number of employees etc. the company might only be required to produce accounts with limited information.

(3) Draft a business plan detailing, amongst other things, the product or service, its Unique Selling Point (USP), what skills the owner will have that will allow them to successfully manage the business, what the start-up costs are likely to be, what the projected profits are likely to be for the first 3 years (or more), details of the main competitors and so on. Business plan precedents are available online. For example, business plan layouts can be found online on the websites of most of the major banks and building societies.

(4) Identify a source of finance to cover start-up costs. That might be from a bank loan, crowdfunding, monies from savings, gifts or private lending from relatives, business angels etc.

2.2 Start-up costs

Start-up costs will vary depending on what the product and service is. Start-up costs will likely include things such as:

(a) **Accountancy fees**. Basic information on business accounts can be found in Guides 7 and 8 but this is not a substitute for an accountant. It is recommended that an accountant is appointed.

(b) **Legal fees**. It is recommended that obtaining the services of a legal expert be, at least, considered.

Other start-up costs include:

(c) **Marketing expenses**. Starting a business will require monies to be spent on advertising the product/service.

(d) **Equipment Costs**. These costs could include anything from a photocopier to a deep fat fryer; depending on the type of business that is being set up.

(e) **Costs associated with Premises**.If a prospective business owner is considering buying a commercial property outright (i.e. becoming the freeholder), then that could cost hundreds of thousands of pounds. Additionally, there will be various costs on top of the purchase price (more of that later at Guide 11). If there is, say, not enough capital, to buy the premises outright, then becoming a tenant is another option; in which case there will be rent and other charges to pay on a regular basis; these other charges can include such things as service charges and insurance (for more of that see Guide 11).

(f) **Intellectual Property Rights (IPRs)** Costs might be incurred in protecting IPRs (see Guide 12 for further information).

Tip: Plan for costs such as registration fees to protect a trade mark or for registering website domain names. IPRs can, in the long term, be a valuable asset and so worth protecting. Consider well-known brand names such as google, nike and similar ones and it can be seen that great value can attach to IPRs.

(g) **Administration costs**. Paper, pens, photocopying costs etc.

(h) **Employee costs**. Guide 13 covers employee matters. Note that some on-going costs of employing people in a business will include tax and National Insurance Contributions and potentially employer pension contributions too (details of which can located in Guide 13).

(i) **Lender costs**. If a loan is obtained from a lender, e.g. bank or building society, there may well be bank/building society account set up costs. Additionally, the lender might only agree to make the loan if the borrower agrees to grant security over the business assets, in favour of the lender. Security is essentially a charge (mortgage) which can, depending on the business vehicle in question, be taken over a whole range of assets from land to stock (stock being a description of the goods that the business sells). In some cases, such as for land, formal documentation has to be registered at HM Land Registry, in order to take a charge over the land.

The reason why a lender will want to take "security" over business assets is to protect itself in the event that the borrower becomes bankrupt (in the case of an individual) or it goes into liquidation (in the case of a company).

An individual may be made bankrupt if that individual has insufficient cash to pay his/her ongoing costs or when the individual's liabilities (amounts owed to third parties) exceed his/her assets. Similarly, for a company that has insufficient cash to pay ongoing costs, or when its liabilities are greater than its assets, the company may find itself forced into liquidation.

In bankruptcy proceedings (or for a company, liquidation) there will not be enough money realised from the sale of assets to pay all of the creditors. So, it is a question of which creditors get what amount from the limited pot of available monies.

A bank or building society will want to ensure that, in the process of bankruptcy or liquidation, it (the lender) is "first in the queue" when it comes to the distribution of any monies. By taking security over the borrower's assets, at the time of making the loan, a bank or building society effectively places itself at Number 1 in the queue, when it comes to the distribution of money.

By way of example, say a company gets into financial difficulty and, consequently, it is forced into liquidation. Imagine that the company has assets that are worth £100,000, but that the company owes various parties £200,000.

The liquidator (an insolvency practitioner) will be required, under insolvency rules, to sell the company's assets and then to distribute any money realised from the sale.

There are legal rules as to which creditors get what amount and in what order. The rules do not say that all creditors are given an equal share of whatever monies is left.

Instead, those with "security" over assets are very much at the "front of the queue" of creditors. Compare that with a creditor who might, say, sell a photocopier to a company on 60-day payment terms, only to find that a week or so later the individual is made bankrupt or, in the case of a company, it has entered into liquidation. In this scenario it is unlikely that, at the time of selling the photocopier, the seller would have required the buyer to grant a charge/mortgage over the buyer's assets in favour of the seller. Consequently, the seller is what is described as an "unsecured" creditor and, as such, will be behind the "secured creditors" when it comes to the distribution of any monies.

So, having considered the various assumptions and start-up costs (See 2.1 and 2.2 above) what next?

2.3 Starting a business "from scratch" or buying a business that is already up and running?

If you are going to set up in business you have 2 main options:

(1) Start a new business "from scratch"; either as a sole trader, partnership, company or Limited Liability Partnership (see Guides 3-6 for details on these business vehicles). From "scratch" means starting from a situation in which there is no business vehicle, no assets, no employees, nothing. i.e. starting a business from nothing. In this situation a prospective business owner will firstly need to decide on which business vehicle is going to be best to meet their needs – i.e. sole trader, partnership, company or Limited Liability Partnership.

Then they will need to consider other matters such as: (a) whether the business needs premises (land and buildings) from which to run the business (not all do) (b) does the business possibly need employees (c) are there any Intellectual Property Rights that need to be protected (d) what contracts (aside from any employee contracts) must be drafted (e) Regulatory matters etc.

All of these matters will need to be dealt with before the business can actually function.

(2) **Buy a business that is already up and running**. It might be that, rather than setting up "from scratch", that it is better to buy an existing business. In this situation a person will be buying a business that is already trading. As such the various assets of the business will need to be transferred across to the business vehicle (which will be to an individual buyer, as a sole trader, a group of individuals in a partnership, to a company (owned by one or more shareholders) or to a Limited Liability Partnership (generally with 2 owners)).

There are also other options that might need to be considered such as buying into a franchise and also licensing but, in these Guides, the focus will be on the most common ones i.e. setting up a new business from scratch or buying a business that already exists. This Guide does, though, also give detail on buying into a franchise (see Guide 9 for details on this option) and licensing (Guide 12.10).

Tip: Consider whether there is sufficient cash (whether that be from a bank loan, your own savings etc.) to: (a) set up a business from scratch or (b) to buy a business that already exists.

Potentially, then, there are 4 main business vehicle options available to a prospective business owner.

The 4 business vehicle options that will be considered are as follows:

(1) Sole trader.

(2) Partnership.

(3) Private company limited by shares (actually there is more than one type of company structure but, in this Guide, the focus is mainly on the most common one which is that of a private company limited by shares). "Private company limited by shares" shall generally be referred to as a "private company".

(4) Limited Liability Partnership.

2.4 Introduction to Guides 3, 4, 5 and 6

Guide 3 considers the business vehicle known as the sole trader. Guides 4, 5 and 6 give details on the business vehicles that are a partnership, private company limited by shares (private companies) and Limited Liability Partnerships (LLP) respectively.

In each of these Guides the processes for setting up each of those individual business vehicles are highlighted, along with a commentary on each of those business vehicles, and how they differ from one another.

Figure 2.1, shown below, is intended to illustrate the interrelationships between the business vehicles of sole trader, partnership, private company and public limited company and of companies that are traded on the Main Market and the Alternative Investment Market.

Major, well-known public limited companies such as Boots plc, Tesco plc, GlaxoSmithKline plc etc. are listed on the "Official List" and their shares are traded on the "Main Market" at the London Stock Exchange (LSE). The total value of these company's shares can range from tens of millions to tens of billions of pounds. Other generally slightly less well-known companies are traded on the Alternative Investment Market which; like the Main Market is also part of the LSE (see Guide 5.1 for details on the Main Market and Official List, Alternative Investment Market and the London Stock Exchange).

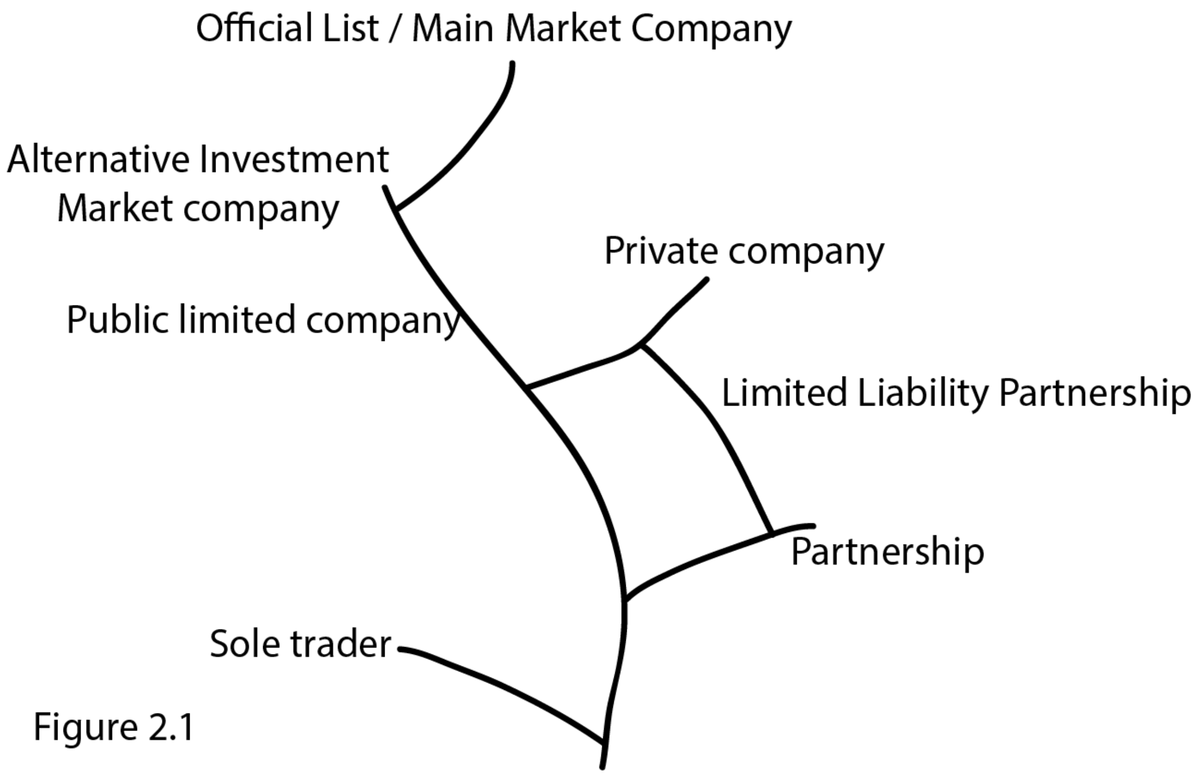

Figure 2.1

A Limited Liability Partnership is shown as a link between a Partnership and a Private Company. That is because an LLP has characteristics of both of those business entities (for more of which see Guide 6).

The government national statistics for the UK put the effective numbers (after removing those in liquidation or course of removal from the register) at approximately 4.7 million (for 2021 to 2022), public limited companies effective numbers at 5,951 and Limited Liability Partnerships effective numbers at 52,394. Other Business, Energy and Industrial Strategy figures put sole traders (proprietorships) at approximately 3.1 million (start of 2022) and ordinary partnerships at approximately 353,000.