

G|K

Gallagher&Kennedy

Lawyers. When Results Matter.

G|K

Business Law & Transactions
March 2016

The Top Five Issues That Can Tank Your New Business



Stephen R. Boatwright

Shareholder

602-530-8301

steve.boatwright@gknet.com

1. Choosing the Wrong Type of Legal Entity. Except in unusual circumstances, the best entity is the limited liability company. Founders and investors each get better tax treatment. An operating agreement offers maximum flexibility for a diverse and creative way to please all parties. If a future funding source will only invest in the “C” corporation structure, it is relatively easy and inexpensive to convert to this type of entity later.

2. Not Having an Agreement with the Owners.

Whether it is a limited liability company, “C” corporation or Subchapter “S” corporation, each entity needs more than just a set of basic formation documents. An LLC needs an operating agreement, while a “C” corporation and a Subchapter “S” corporation each need a shareholders agreement. Failure to have these critical documents often results in the worst way to start a business: litigation with founders or key employees.

3. Not Protecting Your Intellectual Property.

Most new businesses have valuable intangible assets. Many fail to consider how to protect their intellectual property right away. Obtaining a federal trademark to protect a name, getting a provisional patent to protect an idea, and developing contracts signed by the founders and employees to assign all inventions, know-how and proprietary information to the business are each critical to long-term success.

4. Sharing the Pie with the Wrong People.

Many start-up businesses fail to consider who should own stock. Issuing stock in lieu of cash is a temptation to save money and entice the best talent to join a new company. But, issuing stock up front doesn't motivate employees to stay working for the business, and once unrestricted stock is issued, there is no getting it back! Often, founders forget about the alternatives of profits interests, stock options, restricted stock, and phantom stock. One of these alternatives can often be a better way to motivate performance and keep the best employees long-term.

5. \$\$\$ – How Much Will You Need?

Most businesses are overly optimistic about the amount of money they need to operate and grow. The optimism needed to start a business often hurts the realism needed to determine how much money will actually be enough. A business plan is often the best way to figure out what amount is needed, but at a minimum get a detailed budget of planned expenses reviewed by an outside consultant.

Most businesses need funding to grow, yet failure to handle these 5 issues often results in lack of funding. Good legal counsel can assist in properly addressing these issues in a new business.

If you have questions about this article, please contact the author, Steve Boatwright, at (602) 530-8301 or steve.boatwright@gknet.com, or any other member of Gallagher & Kennedy's Business Law & Transactions Practice Group.