

OLAIDE A. BANKS, CPA

BUSINESS ADVISORY ATTORNEY



PLAYING FOR KEEPS:

WHAT EVERY BUSINESS OWNER MUST KNOW TO WIN IN TODAY'S MARKETPLACE

Inside You Will Learn:

- ❖ How to avoid signing business-killing lease agreements.
- ❖ Five questions every small business subcontractor must ask.
- ❖ How to protect yourself and your money in a partnership or LLC agreement.
- ❖ What types of business financing to avoid at all cost.
- ❖ The five essential forms of business insurance you absolute must obtain.
- ❖ Cash Is King: How To Raise Capital In A Down Economic Market.

THE ESSENTIAL BUSINESS STARTUP SUCCESS KIT

INTRODUCTION

As a business owner you simply do not have the luxury of learning by trial and error! The business marketplace is more competitive than any time in history and the companies that succeed and thrive are the ones that know the rules of the game and play to win.

Are you playing in the little leagues?

The average little league baseball team spends two hours each week in practice - learning the game of baseball and honing their skills. The time that these teams spend in practice increases with the age of the children and the competitiveness of the league. Little league players and coaches understand the importance of game mastery to the success of their team.

How much time do you spend learning about your business and honing your skills to become competitive and successful in your industry?

The odds are that you do not consistently spend two hours each week studying your business or your industry, and putting new knowledge into action in your business.

The information included in this business success kit would take you several years to learn through trial and error. If you did gain the knowledge available in this document through trial and error, you would most likely be out of business and facing financial ruin.

At some point in the very near future you will need to create a plan to spend at least two hours each week studying the "ins and outs" of your business and the industry you compete in.

You also need to create a winning team.

According to Entrepreneur Magazine, a leading monthly publication for business owners, "hiring a good lawyer is crucial to any successful business."

Our team is committed to helping business owners and entrepreneurs achieve long-term success and profitability in their business. We are business advisory attorneys focused on providing general counsel and business transaction support for our clients.

We provide the information in this document to help you grow your business and avoid the pitfalls that so many other business owners encounter.

The information is divided into two sections. Section I is called, "Seven Deadly Business Sins." This section includes real-life examples and verifiable market data to support each and every piece of advice we give. Section II is entitled, "Cash Is King." This section provides actionable advice from banking and accounting experts to help you make the most of your cash-flow in the current market.

If you have any questions or would like to schedule an appointment, please call our office at (832) 582-8289 and ask to schedule your free consultation. Ask for me, Olaide Banks.

SECTION I: SEVEN DEADLY BUSINESS SINS

Small businesses are critical to the growth and survival of the American economy. There are about 29.6 million small businesses that employ more than half of the total American workforce, and 40% of our country's high tech workers. Although small-business owners are tough and resilient, their businesses are as susceptible to threats as any others. For example, in 2008 there were approximately 627,000 small business starts, and about 637,000 small businesses that either went out of business or filed for bankruptcy.¹

According to a recent research study commissioned by the SBA Office of Advocacy, and conducted by the Klemm Analysis Group, legal disputes can have a devastating impact on small businesses.² The cost of litigation for most small business disputes can range from \$5,000 for smaller disputes to over \$150,000 for larger disputes. As an attorney who represents small businesses, the findings were not surprising to me.

The study found that: litigation is costly to business owners in time and money; litigation modifies the way that small businesses do business; and litigation causes emotional hardship within small businesses.

The Klemm study found that the above outcomes held whether a small business was the plaintiff or defendant in the lawsuit. While not all instances of litigation will cost \$100 thousand dollars, the impact of business disputes can still devastate the bottom line.

SCORE compiled a list of ten reasons why businesses fail, and they can be reduced to one of three general problems: unfocused or distracted management; inadequate financing; or failing to utilize professionals.³

Most small businesses survive on slim profit margins. Additionally, 95% of all businesses never cross the \$1 million threshold for annual revenue. While there is no "average profit margin" for small businesses, for most, a 10% profit margin would be more than acceptable in an average year. For a business with \$1 million in revenue and a profit margin of 10%, the net profit would be \$100 thousand. It is clear then that the cost of one substantial legal dispute can wipe out all of a company's profit margin, and the loss of a major dispute could easily put a company out of business. The seven most dangerous mistakes that I see as part of my legal practice are:

- Entering bad commercial real estate leases,
- Signing one-sided subcontracting agreements,
- Joining partnerships and LLCs without detailed agreements,
- Taking poorly documented loans and investments from friends and family members,
- Maintaining inadequate levels of business insurance,
- Operating in "foreign states" without the proper licenses and expertise, and
- Failing to respond decisively to legal threats.

¹ SCORE – Small Business Trends (http://www.score.org/small_biz_stats.html)

² *Impact of Litigation on Small Business*, Klemm Analysis Group, 2005 (<http://www.sba.gov/advo/research/rs265tot.pdf>)

³ Ten Key Reasons Why Small Businesses Fail (http://www.scorerochester.org/help/documents/Other/why_fail.php)

#1 – ENTERING BAD COMMERCIAL REAL ESTATE LEASES

One of the more common challenges I see in my practice is a small business being stuck in a commercial lease that was created by the landlord's attorney's, for the benefit of the landlord, and which includes terms that are mostly against the tenant's interests.

Many business owners sign personal guarantees for commercial leases, which sometimes have no obligations for the landlords and provide no way of escape for a tenant stuck in bad location, or with a bad landlord. Before beginning negotiations on a commercial real estate lease, the business tenant should have both a good attorney and an experienced commercial tenant's agent on their team. Some business leaders shy away from using professionals because they fear the cost. This approach is often penny wise and pound foolish. Because most business owners are not skilled in these types of negotiations, they often pay significantly more over the course of the lease and get fewer concessions from the landlord for build-out and remodeling. The result is that they end up with unfavorable lease terms.

In business just about every term is negotiable, but if you don't know the power you have in a transaction then you are at a disadvantage in negotiating. Business tenants who do not use a tenant's agent can leave as much as 15% on the table in rental rates and build-out costs.

I asked Joshua Brown⁴, a commercial real estate professional with the firm Jackson Cooksey⁵, who represents one of my business clients to further explain the role of a tenant's agent in a commercial lease.

Q: What is the biggest misconception that people have about the work you do?

A: I think one misconception is that commercial real estate is similar to residential real estate. While there are some similarities between the two, commercial decisions tend to rely less on an individual's emotions and more on business decisions that impact a corporation's bottom line.

Q: Why would someone need to have a commercial broker like you representing them in a commercial real estate lease?

A: Commercial real estate brokers bring tremendous value to corporations during a lease negotiation on both an economic and non-economic basis. Landlords retain representatives whose responsibility is to maximize a landlord's occupancy and rental rates. Therefore, it is imperative that the tenant have an advocate who exclusively represents its interests to ensure maximum value is attained.

Q: How much do your services typically cost the client?

A: Commission is usually a percentage of the gross lease value (e.g. 4%). There is no direct charge to a tenant; however, the commission is factored in the rental rates. The reality is that if a broker does his or her job effectively, the value to the client should far exceed any commissions that have already been built into the lease rates.

⁴ Joshua Brown began his career with Jackson Cooksey in 2006.

⁵ Jackson Cooksey was founded in 1982 and provides a wide range of commercial real estate services.
www.jacksoncooksey.com

#2 – SIGNING ONE-SIDED SUBCONTRACTING AGREEMENTS

Subcontracting is one way that many small businesses are able to grow their business and gain traction with some Government clients and large Corporations. A broad spectrum of goods and services are subcontracted including construction services, professional services and unfinished goods.

The Federal Government has a standard goal of procuring at least 23% of the goods and services it needs from small businesses. Many major corporations also have similar small business utilization goals. The Federal Government and these major corporations sometimes provide incentives for large businesses to include small business subcontractors on their team as they bid for work.

One major mistake, made by many small businesses, is accepting the large business' *standard contract* "as-is". Some of my clients are shocked when I explain that you should rarely, if ever, accept someone's *standard contract*. What they call a *standard contract*, I call a death sentence. In business everything is negotiable.⁶ A contract by definition is "a meeting of the minds." It is an agreement reached not through force or duress, but with each party exercising their free will. However, some businesses employ a tactic of creating artificial time pressure to rush the small business into signing a contract and to prevent thoughtful consideration and negotiation.

If someone will not allow you adequate time to engage a lawyer to review the agreement and provide comments and feedback, then you are better off without the contract.

My client learned this lesson the hard way. He owns a commercial plumbing company and was asked by the prime contractor to submit a bid for some work with a local school district. The kicker was that he needed to review the plans and provide a firm bid by the end of the next day. He was told that his bid needed to come in as low as possible to win the contract. His low bid was accepted the next day and he was asked to begin working immediately, while they worked out the final details of the contract. A week later the firm sent him their standard contract and asked him to sign it and return it by fax. The price he bid was included in the contract, but that was the only term that had been agreed upon. The standard contract included several other provisions all of which benefitted the prime contractor.

My client had agreed orally with the prime contractor, before signing the standard contract that he would be paid half of the price of the job at the commencement of the job and the balance would be paid in six weeks when the work was completed. When the contract finally came in, it did not include any of the previously-agreed payment terms.

One month later, when my client had completed more than 85% of the work and had not received a penny for the work he had completed, the prime contractor kicked my client off the job and replaced him with another subcontractor. At this writing, eight months have passed since my client last worked on the project and he has not been paid anything for his work.

There is a misconception that has become conventional wisdom among small businesses leaders – that lawyers kill deals. I've heard that statement from several small business leaders, but I have never seen large successful businesses exclude lawyers from their transactions. It is

⁶ As you will discover, this is a recurring theme. Almost everything is negotiable so do negotiate.

likely that an experienced lawyer would advise a business leader against entering a one-sided deal to protect the client's interest. But it is unlikely that a reasonable attorney would kill an otherwise good deal.

As someone who has worn the entrepreneur's hat, I have experienced the emotion involved in feeling like a particular transaction is "make or break" or "the big one." As a former CFO I've also experienced the pressure from a business owner to move quickly on the financial analysis and due diligence when the other side has set an aggressive or unreasonable timeline. As an attorney I've had to struggle to convince a client that holding their ground in a negotiation won't cause a deal to go away. Knowing the value that you bring to a particular transaction or relationship is crucial to getting the best results out of a deal.

Many business owners are more optimistic and hopeful, and less strategic and skeptical. It is this optimism that allows business people to sleep at night when things aren't going great, because there is hope that things will get better. Optimism is an important characteristic and quality to possess as you lead people within an organization. That positive energy is essential to keep people motivated and to cast a unifying vision. However, a business leader should never optimistically enter into transactions with people they don't know well, and whose interests may conflict with the business leader's interests and those of their business.

A healthy sense of skepticism is required for most business transactions, as well as a critical legal eye.

My client in the above example entered the deal knowing that he could only hope break even - at best. He did so based on the implicit promise that there would be more business down the line. He viewed the deal as perhaps a "loss leader". An opportunity to make a small amount on this transaction and more than make it up on future deals.

The concept of a "loss leader" is a myth.

Any prime contractor or large business client that would ask you to take a loss on a transaction has no interest in your business' well-being. If there is a guarantee that you will get future work, if you perform as promised, then the agreement is not a loss leader. The reality is that if you are asked to take loss the first time, you'll probably be asked to take a loss or very small margins every other time and you'll be dumped when you become unwilling to work for scraps. If this first low-margin piece of business is part of a larger deal, then get it in writing.

Here are five critical subcontracting questions that business leaders must consider. Answering yes to any of these questions could indicate a dangerous one-sided subcontract agreement:

1. Are you being pressured to submit an unprofitable bid?
2. Does the time that you have been given to consider the contract seem inadequate?
3. Is the prime contractor inflexible on the wording of the "Disputes", "Choice of Law", or "Termination" clauses?
4. Is the prime contractor generally dismissive of your drafting suggestions?
5. Are you being asked to begin work without a final written contract?

#3 – NOT HAVING FORMAL LLC AND PARTNERSHIP AGREEMENTS

It is said that friendships based on business are better than business based on friendship.⁷

There may be no truer words in the life of your business. It is not that friends can't be successful together in business. Yet, the type of frank communication and edgy interactions that are sometimes necessary in business are not always conducive to maintaining previously existing friendships. For example there are some people who "go with the flow" in their non-business lives, but operate mostly in full attack mode when it comes to business. Some friendships may become strained when one party sees the other party as being too abrasive or coarse in their approach to the business relationship.

Many small businesses are formed with a handshake and good intentions. What starts out as a dream can often end up as a terrible nightmare. From my experience, the biggest reason partnerships and LLCs end in disaster is a failure to gain clarity and commitment upfront on some very key issues. The three most common issues that small businesses owners fail to clarify early-on are:

1. Time - the commitment and level of effort from each of the partners or members.
2. Money – who contributes what, and when? Who gets paid and how much?
3. Moving on – when and how to wrap up the business.

No matter how many times I share the nightmare stories that I've personally observed with some small business clients, they are reluctant to address these three basic issues, which typically turn out to be the ruin of their businesses. For most small businesses, coming up with a sizeable initial cash investment can be a challenge, so the sweat equity of the partners is a significant portion of the early business model. Each partner typically is committed early-on to putting in the necessary hours to make the business a success. What often happens is that one or more of the partners has to forego a salary from the business, and take on additional employment to supplement their personal income.

Unless there is a clear agreement as to each partner's level of effort or involvement in the business, even with the best of intentions, there will be conflict and turmoil. This may become even more complicated when one partner invests additional money to keep the business afloat, or loans money to the business to keep the operations going. When one partner spends more time working in the business or is more often the one contributing additional cash to the business, feelings of resentment and mistrust can sometimes arise between the partners.

The risk is that the ill feelings can possibly lead to poor communication within the leadership of the business, which can ultimately lead to poor performance and losses in the business.

Consider the following true story about one of my firm's clients. To protect their anonymity I will call them TRISTAR TREATMENT, LLC.

⁷ Quote attributed to John D. Rockefeller "Friendship founded on business is a good deal better than business founded on friendship."

TRISTAR TREATMENT, LLC

TRISTAR provides physical therapy and treatment to people who have experienced life-changing injuries or illnesses.

Three partners – Susan, Fred and Anna - started the LLC five years ago and each of the members had some form of specialized training. Susan invested \$100,000.00 in cash and each of the other two partners – Fred and Anna – contributed \$50,000.00 each. Susan had an existing complementary business, which provided subcontracting services to TRISTAR. After the first year TRISTAR was profitable. The business sometimes had issues with slow payments from hospital clients, and Susan would provide loans to TRISTAR from her personal funds or from her other business, and would always be repaid by TRISTAR when the cash-flow permitted.

Over time, Fred and Anna became displeased with Susan's management style and claimed that Susan was double dipping because the business she owned was still subcontracting with TRISTAR. Three and a half years into TRISTAR's life Fred and Anna started another business together, which provided the same services that TRISTAR provided, but targeted home health facilities instead of hospitals. Fred and Anna began spending less time at TRISTAR, going from full time to approximately half time. Fred and Anna continued to collect full monthly salaries as officers and managers of TRISTAR. When Susan found out about their new business several months later, she confronted Fred and Anna and questioned their commitment to TRISTAR. Fred and Anna countered that Susan also had another business that she was involved in and that their situation was no different than hers.

Susan, Fred and Anna never signed an operating agreement when they started the business. The operating agreement may have covered existing businesses, competing businesses, time commitments and most importantly how to get out of the business if the partners no longer were happy together.

By the middle of the fourth year in business TRISTAR was still profitable, but laboring under uncollected receivables and one major client who filed for bankruptcy. The Bankruptcy client left TRISTAR holding the bag on over \$200 thousand in uncollectible receivables, the result of four months of unpaid invoices.

The business had a line of credit of its own – approximately \$170 thousand dollars. On December 30, 2009 Fred and Anna informed Susan that they "wanted out" immediately. They wanted a full return of their initial investment, they wanted to be released from all liabilities of the company, and they wanted to be indemnified against any and all liabilities of TRISTAR. They also demanded to receive payments equivalent to their officer and management compensation through June 2010.

Susan ultimately agreed to most of Fred and Anna's demands and now runs TRISTAR alone.

The TRISTAR example is real, and the consequences are real. Susan ultimately paid out all of the cash in the business to her partners as a return of capital, then assumed all of the business' liabilities and is now responsible for running the company on her own. Susan also gave up quite a bit from her personal funds and her business to prevent a potentially acrimonious breakup that could have ended in litigation.

TRISTAR may one day return to profitability, but with the ever changing healthcare business environment there are no guarantees. If the partners had agreed in writing on the time commitments, the contribution requirements, and process for terminating the relationship, they could have avoided this messy situation and quite a bit of hurt feelings.

#4: POORLY DOCUMENTED LOANS AND INVESTMENTS

The ability to raise startup financing and maintain adequate levels of working capital are among the most pressing concerns of any business. Businesses large and small have been affected by banks' tightening lending restrictions, and seasonal or periodic fluctuations often require short-term infusions of cash. How quickly a business is able to raise the cash it needs often determines to what extent the business will survive and become profitable.

Poorly documented loans and investments are typically either from family and friends, or from non-traditional lenders. It is ironic that the financing transactions that represent the highest level of credit risk are the least likely to be properly documented and recorded.

Banks and investment firms require all manner of supporting documents, including financial statements, repayment schedules, interest rate agreements, and they also provide legally required disclosures. Banks will often remind business borrowers of the fact that their loans have legal implications and that it may be in the business' interest to have a lawyer review the documents.

More than 80% of the loans made by family and friends do not have written documentation. That number is alarming because individuals typically approach family members for loans after they have exhausted other conventional methods like banks and credit cards, and are deemed by those institutions as being too risky. The situation is further complicated by the fact that about one quarter of loans made to family members are never fully repaid.

FAMILY LOAN JEOPARDY⁸

Answer: 65%

Question: What percentage of people have made loans of more than \$500 to family or friends?

Answer: 83%

Question: What percentage of loans to family and friends did not have written documentation?

Answer: 25%

Question: What percentage of the loans made to family and friends are never fully repaid?

When family and friends default on loans, relationships are damaged and torn – trust is destroyed. In many situations, as small business owners, the family is our last refuge and support system in a very challenging and competitive business environment. Below are five tips to follow before seeking a business loan from family or friends:

1. Think long and hard before asking for or accepting loans from family or friends.
2. Analyze your own financial position to determine your probability of repaying the loan.
3. Insist on detailed repayment terms and reasonable interest rates and put them in writing.
4. Provide supporting documentation including a business plan prior to receiving the loan.
5. Agree on default provisions for the loan i.e. what happens if you can't pay it back.

⁸ Data source is September 2008 survey by Harris/Decima and reported at www.canada.com in an article attributed to Eric Beauchesne, Canwest News Service entitled *Loans to Family, Friends Risky Business: Survey* - January, 2009

#5: INADEQUATE LEVELS OF BUSINESS INSURANCE

Hurricane Ike provided a tale of two different types of companies in Houston. The first group of companies was the group that had some of the right insurance and dodged a bullet, and the second group was the group that went out of business.

Very few small and medium sized businesses have all of the insurance that they need. To be more accurate, too many small businesses are relying on insurance policies backed by companies that can never payout if they have a catastrophic claim. When a business chooses not to obtain insurance coverage from an insurance company, they are self-insuring – bearing the risk of a loss and wagering on the survival of their business.

Risk is an inevitable part of doing business, but business risk should be analyzed ahead of time and balanced in such a way that the company is not paying excessive premiums, but is also not fully exposed to an unreasonable or catastrophic loss. I advise all of my business clients to get a comprehensive risk assessment from an attorney and have their attorney work closely with their insurance professional to create a risk management plan.

A former client – a telephone equipment reseller – never had a risk assessment done.⁹ When Hurricane Ike struck, damage to the roof in their building caused the ceiling to collapse and destroy most of their inventory. Their office was unusable for more than three months because the landlord made no effort to repair the office, and my client's only recourse was rent abatement. Faced with no inventory, no office, and no claim against their commercial liability policy the client was forced to go out of business.¹⁰

The client had a commercial general liability policy because the landlord required it. The policy protected the landlord, but the client didn't protect their own business with personal property coverage and business interruption coverage. For their size, the coverage may have cost as little as \$1,500 a year.

- **Commercial General Liability:** This covers legal obligations to pay damages caused to others for: bodily injury, personal injury, advertising injury, or property damage.
- **Business Personal Property:** This protects the business assets and inventory including: property the business owns that is used in the business, property of others in the business' care, tenant improvements in a office lease, and leased equipment.
- **Business Interruption:** Pays for the actual loss of business income due to necessary suspension of your operations during the time it takes to restore operations after a covered loss.
- **Errors and Omissions:** Covers defects in the work performed by the business that are not typically covered by the general liability policy.
- **Key Man Life:** These policies are life insurance policies that payout on the death of a key employee or partner. Much of the net financial worth of a small business is tied to the skill of a few employees.

⁹ This client also signed a commercial real estate lease without using an attorney or commercial real estate professional, and failed to respond decisively to a legal threat from their landlord.

¹⁰ To add insult to injury the landlord sued them, trying to collect the balance on the remainder of the lease.

#6: OVERLOOKING STATE LICENSE AND TAX REQUIREMENTS

The rules and requirements to setup and conduct a business vary widely from state to state. The implications of hiring temporary employees and independent contractors also are very different in each state. Some states have a state income tax for business; some like Texas purportedly do not.¹¹

States like New York and other Northeastern states require employers to provide disability insurance for almost all employees, whereas Texas does not. Ignorance of the law, even for very small businesses, is absolutely not accepted as a defense or excuse by these state taxing authorities. In many cases, the penalties and fines imposed for minor infractions far exceed the very minimal taxes that might accrue for doing business in those states.

The United States Constitution places certain restrictions on the extent to which states are able to tax the income of a company which operates in multiple states. In previous years, some states took the approach of attempting to tax all of the earnings of a company no matter where earned. The U.S. Supreme Court in *Complete Auto Transit, Inc. v. Brady* required states to tax companies fairly and not discriminate against interstate commerce.¹² Since the 1977 ruling in *Complete Auto Transit, Inc.* the Court has had to continually clarify the law in this area to keep states in line.

Especially during periods of economic downturns, when tax collections are generally lower, states become more aggressive in going after businesses to make up the shortfall. Strategies that states use to boost their tax collection include:

- **Broadening Nexus Standard:** This is where states attempt to reduce the requirements for a company to be considered as doing business in the state.
- **Disallowing Deductions:** Some states do not allow some business expense deductions that are typical when calculating federal tax liability.
- **Targeting:** Some states target certain industries for increased scrutiny and auditing.

States have broad latitude in collecting what they believe they are owed, including direct garnishment from bank accounts, filing liens against business and the property of the owner, and even garnishing tax refunds.

To protect your business, you should:

1. Consult a CPA and attorney before starting business in any new state,
2. Use a payroll tax agent to handle state and federal payroll taxes,
3. Immediately dispute all demands for additional payment and forward to an attorney, and
4. Pay professionals to file tax returns when due.

¹¹ The Texas Margin Tax, formerly just the Franchise Tax is nothing if not a business income Tax.

¹² The court laid out a four pronged test that required: (1) an adequate nexus between the corporation subjected to the tax and the particular state, (2) the tax is fairly related to the benefits provided the taxpayer by the taxing state, (3) the tax does not discriminate against interstate commerce, and (4) the tax is fairly apportioned.

#7: FAILING TO RESPOND DECISIVELY TO BUSINESS THREATS

“You win battles by knowing the enemy's timing, and using a timing which the enemy does not expect.”¹³

Deciding when to be conciliatory and when to strike is one of the tougher challenges that some businesses face. Some business owners are conditioned to be either brash or passive in dealing with business conflicts. No one approach is right all the time.

I coach and counsel my clients to be as meek as a lamb in some situations, and as ferocious as a mother lion protecting her cubs in other situations. Your adversaries should also be aware that you have the ability to do both.

You should consider the source and the credibility of the threat in determining which response is appropriate. For example, in the midst of representing a former client I determined that his suit against a former university was frivolous and uncovered that he had a pattern of filing suits against people he worked with, or had done business with. Based on ethical considerations I informed him that I would no longer represent him, and as I expected he threatened to sue me and file a false complaint against me with the State Bar.

Prior to his threat, I had begun to gather documentation of all my communications with him and when he made his threat I immediately sent him a certified package that included all of our conversations and a letter containing a warning. My warning stated, in no uncertain terms, that I would not only respond mercilessly to any attacks on my reputation, but I would also push him beyond the point of financial ruin if he made any false statements about me. I received one email from this character since then, but he has thought better of his threat.

The general rule here is that threats to your personal reputation or false statements about your business must be met with overwhelming force. Trying to restore your reputation after lies are spread is much like trying to un-ring a bell. Your response must be swift and decisive.

For legal threats where the dispute is about the meaning of a contract, sometimes the response must be more nuanced. For example where long-standing relationships exist, serious conflicts can be avoided if the leaders of both companies can meet and break down the issues. In these types of negotiations, there is often the ability to enlarge the pot and allow each side to walk away in a better position than before the disagreement arose. The key here is the history of a mutually beneficial relationship.

Small businesses must be on guard for bullies! As I highlighted earlier, sometimes landlords are bullies. Sometimes prime contractors can be bullies. Even former business partners and clients can be bullies. What we learned about bullies in school is absolutely true. If you stand up to a bully they will likely back down and move on to someone else.

To quote Theodore Roosevelt, “speak softly and carry a big stick; you will go far.”¹⁴

¹³ Quote attributed to Miyato Musashi considered by some the world's greatest ever swordsman: 1584 – 1645.

¹⁴ From a letter to Henry L. Sprague dated January 26, 1900. Roosevelt attributes the saying to a West African Proverb.

SECTION II: CASH IS KING

In June 2009, one of my clients needed to increase their line of credit from \$200 thousand to \$300 thousand so they called their banker. They had been in business for more than 25 years and over that time had won all of the meaningful small business and growth awards in Houston. That's why they were shocked when the bank not only turned down their request, but "called" their \$200 thousand line of credit. In the midst of a cash-flow crisis, my clients' situation went from bad to dire. My clients had been customers of the bank for 18 years and in the past had all the treasury management bells and whistles, which netted the bank over \$15,000.00 per year in fees. It just didn't seem right.

My clients survived. Through some creative belt tightening, an infusion of personal cash, and a commitment to increasing revenues, my clients are now a lot wiser and better poised to grow their business.

When it comes to getting the working capital you need for your business, cash-flow is king. So says Laquita Cyprian, a vice president for small business with Capital One Bank. Ms. Cyprian's clients typically average between \$500 thousand and \$10 million in annual revenues.

Many business follow believe that establishing business credit and utilizing services like Dun and Bradstreet will help them to obtain a loan when the time is right, but according to Ms. Cyprian, banks give little or no weight to the Duns Rating. The Duns Rating typically tracks business-to-business transactions and not loans and lines of credits from banks.

Banks focus on three broad factors in establishing their lending criteria:

1. Demonstrated cash-flow of the business,
2. Personal credit scores of the guarantor, and
3. History with the financial institution.

Demonstrated Cash-Flow of the Business

Banks need to see positive cash-flow over an extended period of time before lending to a business. They typically require copies of filed tax returns, and financial statements prepared by a certified public accountant. They generally look at the three most recent years' tax returns and financial statements - so startup businesses are at a decided disadvantage in obtaining loans. Many businesses seek to accelerate expenses and maximize deductions as a way to reduce their tax liability, but there is an obvious down-side when banks look at the tax returns and financial statements of the company as they see higher expenses and lower profits. This underscores the need for sound tax and business advisory services especially for startups and small businesses.

Personal Credit Scores of the Guarantor

Small business loans are usually personally guaranteed by the owner or owners of the business. Ms. Cyprian says that Capital One Bank usually looks for FICO scores of at least 650. For business owners who may be spread thin, and tapping personal credit cards to keep their

businesses running, this can pose a significant challenge. Carrying high credit balances will typically push credit scores down.

History with the Financial Institution

With the tightening of lending standards, banks are now lending primarily to customers who have an existing relationship with their bank. In this way banks can better analyze cash-flow patterns and they feel more comfortable lending to people they know.

For small businesses this means that the need for proactive planning is at an all-time high. The days of walking into a bank just before you actually need the money are over. Banks are no longer lending based on a business plan and a dream. They are looking for a solid history of cash-flow and it has to be backed up with verifiable evidence.

THE TAKEAWAY - For business owners with so-so credit, accessing a line of credit for their business could be harder than ever. Better-than-average credit scores are a must! For those who have experienced a dip in their credit score while having to support their business, the process of improving their credit score can be slow. A solid history with your financial institution is essential, but it may still not be enough to land that line of credit you sorely need for your business. It is thus more important than ever to create a relationship with a qualified and experienced banking professional.

5 STEPS TO BOOST YOUR WORKING CAPITAL

- 1. Improve your short-term working capital forecasting:** A monthly balance sheet and income statement is not enough to plan for your working capital needs as your business grows. A weekly working capital report which includes current cash balances, aged accounts receivable, expected receipts for the next four weeks and payments due for at least next six weeks is essential.

Onome Avbovbo, a Certified Public Accountant and Professional Resource Associate with Siegfried Group, LLP suggests that a forecast looking eight weeks into the future is preferable. Describing her recent work with a small business client, she explained, "Their cash-flow forecast goes out for about 8 weeks and helps the client to see where their cash is going and how much cash they need to deal with their immediate obligations. There are no surprises for the company."

- 2. Identify annual cash-flow patterns:** Review prior financial statements, cash-flow reports and look at upcoming projects to determine patterns of working capital usage. Determine whether there are cyclical patterns of production, purchasing, or sales that factor into your cash-flow pattern. Based on the cash-flow patterns, your business may consider creating an emergency cash reserve for periods of high cash outflows.
- 3. Be mindful of your personal credit:** Be as timely as possible in paying credit cards and loans and create a plan to reduce large outstanding balances. This can be difficult in these tough financial times, but it is important to make a plan and stick with it.

- 4. Develop a relationship with your banker:** Don't wait until you need a loan to know your banker. Keep them informed about what's going on in your business, and make yourself valuable to them through referrals if they are doing a great job. If your current banker is not meeting your needs, get a new one. The key in selecting a banker is the banking professional's availability and interest in your business. Don't overlook credit unions and community banks as you choose your bank.

Five questions to ask yourself when evaluating your current banking relationship are: (1) Can I dial a local number and regularly reach my banker? (2) Do I receive invitations to bank-sponsored events? (3) Do I have merchant services (credit and debit card) processing through my bank? (4) Do I have reasonable access to my branch's conference room facilities? (5) Is my bank a customer, client, or source of referrals for your business? If you can't answer yes to at least four of the above questions it might be time to switch banks.

- 5. Fix your financial equation:** Actively seek ways to generate more revenue and gain control over expenses. A moderate increase in revenue combined with modest decrease in expenses can have a significant impact on your bottom line and boost your business' cash-flow.

With these five steps your business will be well prepared to weather the current financial storm.

Remember that loans and lines of credits are contractual obligations. You have a right to consult with an attorney before signing any loan agreement or modification. You should use a qualified attorney who understands your business and the lending process.

SUMMARY

By reading through this entire business startup success kit, you now have more actionable knowledge about the legal environment in which your business operates than most of your competitors. You also have most of the information you need to hire the right attorney to help you take your business to the next level.

To schedule your free consultation and get answers to your business law questions please call our office at (832) 582-8289. Ask for your free consultation with lead attorney Olaide Banks.