

# Setting up a **business**

By now, you should have completed Part A of Appendices 1, 2 and 3.

**This chapter has more detail about setting up a business, including:**

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**The shape or structure of a business**

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**Finding money to start**

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**Where to locate**

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**Practical aspects of setting up a business, such as registration, licences, insurance, equipment and intellectual property.**

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## Business structure and governance

### Putting the business together – shape or structure

A business can be started by an individual, with someone else, or in a group. It is important to choose the best structure to match the money, and to manage the legal responsibilities stemming from operating a business.

#### When choosing the right business structure, consider these issues:

- Who will be involved in the ownership of the business? You? Family members or friends? A community?
- What money and what skills will those involved bring to the business?
- What are the calculations on sales and profit of the business?
- How will profits be shared if there is more than one owner?
- What can be done if the business makes a loss or has a cash flow problem?
- What is the financial risk?
- How much can be lost?
- What are the risks in starting a business?

### Common business structures

#### Sole trader

A sole trader is a person who runs the business on their own. While a sole trader has full control of the business, there are advantages and disadvantages.

#### Advantages include:

- A sole trader business is simple and inexpensive to set up and operate
- It has the least paper work of all business structures
- A sole trader makes all decisions and owns all the business assets and profits
- It is easy to shut the business down if the sole trader chooses to do so.

#### Disadvantages include:

- The business will only generate income if and when the sole trader is working – it won't in the event of illness, or if the person is out of town with family commitments or engaged in community activities

- The sole trader is personally responsible for all business debts and obligations, from paying bills to customer service
- The sole trader must pay personal income tax rates which are higher than company tax rates
- The value of the business (how much it is worth) is linked to the owner, and will therefore be lower if the person is unable to work in the business for whatever reason.

#### Partnership

A partnership is when two or more individuals or companies own a business jointly. They can have equal shares or different proportions of shares in the ownership of the business. The partners each have responsibility for the operation of the business and share the profits. Each partner can bring different knowledge, skills and experience to the business.

#### The advantages of a partnership include:

- Inexpensive to set up and operate
- More capital (funds), experience and knowledge to put into the business and make it successful
- Easier for partners to take a break from the business than for sole traders
- Easier to end a partnership and divide the leftovers.

#### The disadvantages of a partnership include:

- Arguments about the management and operation of the business
- Liability to pay tax at personal income tax rates which are higher than company tax rates
- Each partner is fully responsible for the debts and obligations of the partnership, unless the partners use a limited liability partnership structure (ask a solicitor to explain this)
- It may be hard for partners to separate a personal and business relationship. Before starting a business partnership, make a written agreement which explains exactly how the business is structured and how it should work. This will make the partnership operate smoothly. A solicitor can prepare a partnership agreement.

## A co-operative

A co-operative is an organisation with at least five members who own and control the organisation. A business co-operative would normally aim to make a profit, but its main goal is to meet the needs of its members. It has a board of directors, which is responsible for managing its operation, but all members are expected to actively help run the business.

### The advantages of a co-operative include:

- Each member has an equal say, so it may be suitable for a business run by a community
- Members are only responsible for the debts of the co-operative if they personally cause the debts by being careless or dishonest
- A co-operative can be set up so profits are either put back into the co-operative or handed out to members.

### The disadvantages of a co-operative include:

- With more people involved, it may be difficult to reach agreement on important business decisions
- Some members may not be particularly concerned about the business operating successfully or making a profit, and therefore may not put in their fair share of effort
- While some members may put more time and effort into the business, they still get only one vote in decision-making.

For more information about co-operatives and how to set one up, contact the Registry of Co-operatives and Associations at the Office of Fair Trading on 1800 502 042. The Office of Fair Trading website is [www.fairtrading.nsw.gov.au](http://www.fairtrading.nsw.gov.au)

## Company

A company is a complex and expensive business arrangement. However, it is the most common form of business structure as it lets owners limit their liability to what they invest in the business. *Make sure you understand your legal obligations.*

Once a company is registered under the *Corporations Act 2001*, it is automatically registered as an Australian company. It

can operate throughout Australia without having to be registered in states and territories unless it is trading under different names in various states and territories.

For further information about companies, and how to establish one, contact the Australian Securities and Investments Commission on 1300 300 630. Its website is [www.asic.gov.au](http://www.asic.gov.au)

## Aboriginal corporation

An indigenous group can form a corporation under the *Aboriginal Councils and Associations Act 1976*. A corporation must have at least five adult members. Its rules can be drafted to take indigenous customs and traditions into account. The rules can allow the profits of the corporation to be shared among members.

For further information about Aboriginal corporations and how to form one, contact the Office of the Registrar of Aboriginal Corporations on 1800 622 431. The website is [www.orac.gov.au](http://www.orac.gov.au)

## Incorporated association

An incorporated association is an easier and less expensive way for a small non-profit, community-based group or association to set up a business, rather than forming a co-operative or a company. It is set up under the *NSW Associations Incorporation Act 1984*.

Incorporation creates a body separate from the individual members. Members of unincorporated bodies are liable to be sued as individuals. However, incorporation limits the liability of members as long as proper business and community standards are followed. Incorporation is voluntary.

### Incorporation also means the group or association can:

- Continue regardless of changes in membership
- Enter into and enforce contracts, including having the power to buy, hold, and deal with property
- Sue or be sued – as a whole association – in the courts.

For more information about incorporated associations, contact the Office of Fair Trading on 1800 502 042 or visit their website [www.fairtrading.nsw.gov.au](http://www.fairtrading.nsw.gov.au)

## Legal and financial advice

People should discuss setting up a business with a solicitor to make sure all the aspects are properly covered. There are complicated processes involved when setting up a business, particularly those that include agreements. Be sure to do as much preparation before talking with a solicitor. Remember, meeting a solicitor can be expensive. Discuss a business structure with an accountant. An accountant can help with tax and financial aspects. Do as much preparation as possible before talking with the accountant. This will make things much easier.

The Law Society of NSW can help find a solicitor. The society can be contacted by phone on (02) 9926 0333 and or via the web [www.lawsociety.com.au](http://www.lawsociety.com.au)

Contact CPA Australia on 1300 737 373, [www.cpaaustralia.com.au](http://www.cpaaustralia.com.au), the Institute of Chartered Accountants in Australia 1300 137 322, [www.icaa.com.au](http://www.icaa.com.au) or the National Institute of Accountants 02 8262 6000, [www.nia.com.au](http://www.nia.com.au) for details on hiring an accountant.

## Governance, or keeping to the rules

Businesses must be run according to law, and according to good personal and community standards and practices. This is known as good governance.

In the case of sole traders and partnerships, the business is operated by the person or persons who own it. While they need to ensure they do not break the law, it is also easy for them to follow good behaviour and standards, because they are responsible for their own actions.

On the other hand, a board of directors oversees co-operatives, companies, Aboriginal corporations and incorporated associations. The board appoints a management team, which is responsible for running the business on a day-to-day basis.

The board should appoint a chairperson whose role is to provide leadership, and to ensure the board operates effectively. The chairperson also needs to make sure the members of the board understand their role and responsibilities.

The board of directors is appointed by the members of the organisation or shareholders, and is expected to act in the best interests of the business. The organisation should specify the board's role.

When appointing board associates, members or shareholders of the organisation should take into account the current and future needs of the board. These needs might be the skills the board needs, and the extent to which the board should reflect the characteristics and views of the members or shareholders.

It is important to ensure there is a clear separation between the board of directors and the management of the organisation. One way to do this is by limiting the number of management people who are board members.

### The responsibilities of the board of directors include:

- Recognising the different roles played in the organisation by its members or shareholders, its directors and its management
- Ensuring the organisation operates within the relevant laws and regulations, and according to its own constitution
- Guaranteeing the organisation follows accepted management principles, such as clarifying the different roles of the board and the management of the organisation
- Making sure the board fulfils its legal obligations which include certifying that:
  - the business does not trade if it is insolvent, or not able to pay the people it owes money to
  - employees' rights are protected, and the workplace is safe
  - information belonging to the business such as client lists, supplier arrangements, and the like, is properly protected
  - Advertising is not false or misleading.
- Certifying the board and the organisation behave ethically
- Developing an appropriate strategy for the business, which understands where the business is in its lifecycle and what needs to be done to ensure it is sustainable

- Designing policies for the organisation which management must follow. For example, policies on hiring staff and spending limits, and making sure management implements the policies
- Delegating responsibility to management for making decisions in the day-to-day running of the business
- Monitoring and assessing the performance of the business and the management, including determining the right indicators for measuring performance, and asking questions at board meetings
- Reporting clearly and regularly to regulators, and to members or shareholders of the organisation.

**Good governance practices for a board of directors to use are:**

- A code of conduct which explains how members of the board should act in certain situations. For example, where a member has a possible conflict of interest
- Policies on how the funds and assets (such as motor vehicles) of an organisation can be used by members of the board
- A register of the financial interests of members of the board
- A register of transactions between the business and people related to members of the board
- Making sure all members of the board are kept fully informed of what is happening with the business
- Using proper procedures during board meetings.

Members of the board of directors are legally responsible for the actions, and the failings, of both the board and the organisation as a whole. A chief executive officer usually leads the management of the organisation.

**The responsibilities of management include:**

- Being accountable to the board of directors by explaining its actions to the board
- Supporting the board in governance and advisory roles

- Operating the business in a manner determined by the board
- Making decisions about the day-to-day running of the organisation
- Implementing the business strategy for the organisation developed by the board
- Implementing the policies developed by the board
- Giving advice to the board as it develops the organisation's business strategy and policies
- Making sure the organisation operates within relevant laws and regulations
- Creating an ethical work environment
- Reporting clearly and regularly to the board about the performance of the organisation.

## **Finding the money for your business**

**There are two main sources of funding to establish a business:**

- **Shareholders' equity** – Your money and the money of anyone else including family and friends who are shareholders in the business
- **Borrowed funds** – Money borrowed from banks and other financial institutions, and from other people such as family and friends.

### **Shareholders' equity**

This can be a complicated process. Consult an accountant first before considering this option (see Useful contacts on page 35).

### **Borrowing from banks and other financial organisations**

If borrowed money is needed to start a business, consider how it will be spent before choosing the type of finance that best meets these needs.

Remember – Banks and other financial organisations require a record of accomplishment or proof, from a bank or similar organisation, that you can save and manage money properly. The first step is to develop a savings routine. Do this for at least six months.

This shows a bank what you can do, not what you might do.

**The three types of finance for business borrowing are:**

### **Short-term finance, or working capital**

This is money borrowed for a short length of time, generally for less than a year. It is used to cover some of the smaller start-up costs and running costs of a business. These working capital loans are usually more expensive than loans taken out for a longer period, as interest rates are normally higher.

**Working capital typically comes in the following forms:**

- **Bank overdraft** – Where you can take out more than you have in your business bank account, up to an agreed amount. Banks normally want some form of security (guarantee) for this service, often in the form of a mortgage on property or equipment. An overdraft can be particularly useful if a business has irregular cash flow. Interest is charged and additional charges may be imposed.
- **Commercial bill** – A short-term loan, often for periods of between 30 to 180 days. At the end of the period, the borrower must pay back the full amount of the loan. With larger amounts, a borrower can extend repayment for the same length of time.
- **Debtor financing (factoring)** – While not suitable for all businesses, factoring can provide a ‘revolving line of credit’. This means selling outstanding (unpaid) invoices to a factoring firm at a discount (up to 70-90 per cent of the total value). The business gets the discounted amount in cash, and the factoring firm is responsible for getting the full invoice amounts from the customers.
- **Credit card** – A simple way to finance a business providing there are no large start-up costs, and only a small amount of money is needed for stock, equipment and materials. Be very careful. Non-payment of a credit card account by the due date attracts high interest rates. Non-payment can make it hard to get finance in the future.

### – **Micro-enterprise Loan Programs** –

Provides access to affordable business loans to people on low incomes. Loans may range from \$500 to \$20,000 and are available to help start up or support an existing business. Micro-enterprise loans are available from some major banks and not-for-profit organisations.

### **Medium-term finance**

Money borrowed for one to 10 years, and used by a business to purchase equipment, expand, or develop new products.

**Medium-term finance comes in the following forms:**

- **Term loan** – A loan paid back in monthly instalments over a set period.
- **Personal loan** – A loan made by the owner of the business, to the business, or by a bank to the business using personal assets, such as a house or a car as security. High interest rates may be charged.
- **Leasing** – A form of hiring rather than borrowing. A financier buys the business premises and equipment, and allows you to use them. In return, you pay an agreed amount during the leasing period. At the end of the lease, there may be an opportunity to buy the asset or be forced to buy it (depending on the agreement).
- **Micro credit** – Provides access to affordable business loans to people on low incomes. Loans range from \$500 to \$20,000 and are available to help start up or support an existing business. Micro credit loans may also include access to business skills training and mentoring.

### **Long-term finance**

Money borrowed over a longer period, often 25 years, to purchase major assets such as buildings, plant and machinery.

### **Applying for a loan**

Applying for a loan requires careful planning, and collecting a lot of personal information to convince a bank or other lending institution to lend money for a business or a business idea. A well-prepared business plan can support a loan application, because it shows a large amount of work and preparation about the business.

**The following information is useful for a loan application:**

- The amount and purpose of the loan
- A description of the business, including products, services, location, equipment and other valuable assets
- Personal history, including qualifications, skills, experience and achievements.
- Financial statements:
  - Cash flow, sales and profit projections over the term of the loan
  - The last three years' annual accounts (if available)
  - A monthly cash flow budget for the next 12 months, which includes loan repayments
  - A current list of creditors and debtors
  - A valuation of the stock on hand, and
  - A list of personal assets.

**Be prepared for the lender to want some form of security to protect the loan. Some generally accepted forms of security are:**

- Real estate (property)
- Shares (in other companies)
- A bill of sale over assets other than real estate
- The cash-out value of an insurance policy: and
- A personal guarantee (from a family member or someone close).

Financial institutions are also likely to carry out credit checks to determine a credit record or rating (the history of borrowing money and if it was paid back on time).

### **Other possible sources of finance**

**While most business borrowing is from banks and other financial institutions, there are other possible sources of finance. These include:**

- **Venture capital** – This is when investment companies or fund managers seek to invest (usually more than \$1 million) in businesses which might make a lot of money. Venture capital is often difficult to obtain, so a business idea and the ability to make it happen must be solid. Contact the Australian Venture Capital Association Limited (AVCAL) on (02) 8243 7000.

Alternatively, visit the website [www.avcal.com.au](http://www.avcal.com.au)

- **Business angels** – Individuals who invest amounts ranging from \$100,000 to \$3 million directly in a small number of private companies (those not listed on a stock exchange). There are a number of business angel matching services, such as Australian Business Angels, operated by Strategon. Check out the website [www.strategon.com.au](http://www.strategon.com.au) or phone (02) 9660 6641.

- **Vendor finance** – This is when a business is sold to another person or persons, and the owner selling it lends some funds to the purchaser.

Both angel investors and venture capital firms generally become part-owners of the business they invest in, and therefore have some say over how the business operates.

When starting up, do not assume you have to buy everything for your business or that everything has to be bought new. Sometimes it can be better to lease or rent equipment rather than spending time finding the money to buy it. Leasing can also be tax effective, and thus free up cash for other purposes.

- Consider getting help through NSW and Federal Government programs. (See Chapter 5, Assistance and Support)

## **Premises**

**When choosing the business premises, consider the following issues:**

- Can customers find the business easily?
- Is there public transport or parking?
- Will the location attract employees?
- Are there too many or too few competitors nearby? More than one type of a particular business located close by can increase the amount of custom each business gets, as long as customers can distinguish one business from another.
- Is it a good area?
- How close is it to your home?

- Are there any other businesses or residential developments in the area, which might be good, or bad, for the business?
- Are the premises large enough? If the business is growing, is there enough room for more staff and extra stock?
- If not, what sort of alterations might be needed?

Contact the local council for rules or regulations which may affect the business. Do not rely solely on information provided by real estate agents or proprietors. A solicitor might be able to help with these issues.

## Commercial leases

Most businesses start in leased premises. A lease provides the legal right to occupy and rent the premises. It sets out all the agreed terms and conditions of occupancy. Before signing a lease, get a solicitor to check the details. Sign only when you understand the details, and when the solicitor expresses confidence in the lease.

## Working from home

The attractions of running a home-based business include low costs, independence and the convenience of not commuting.

It is also much easier than working away from home especially if you have family members to care for, and if customers are nearby.

**Examples of home-based businesses operated by indigenous Australians include:**

- Fashion designers
- Didgeridoo makers
- Internet service providers
- Trades such as building, plumbing and electrical.

Before setting up a business at home, check with the local council to make sure it is acceptable, and if there are any regulations which might affect the type of work that will be carried out. This might include space limits, noise levels, customer parking and rules on selling or advertising.

## Shared premises for start-up businesses

If it's not suitable to run a business from home, a good alternative is renting space in a special location called a business incubator.

Small business incubators help new and growing businesses become established. They provide office space, advice and support services and are often cheaper than commercial rental spaces.

Generally, offices and workspaces are rented out on a monthly basis. The basic fee covers rent. Additional services such as telephone answering, secretarial support, photocopying, fax and the use of meeting rooms are all charged if used. Generally, business tenants can stay between one and three years.

Incubators are often operated by community-based organisations, including Business Enterprise Centres, which can provide business advice and support. They are mainly for office-based businesses, but some can also accommodate light industrial and manufacturing businesses.

For further information about business incubators, call the nearest Business Advisory Service on 1300 650 058.

## Practical issues for setting up a business

This section provides detailed information on registering the name of a business, licences and permits, purchasing equipment and proper insurance cover.

### Registering a business name

A business name should be distinctive and easy to remember. Make sure it is not already registered, or is too similar to a name already in use.

If the trading name is different from your name, or if you have added words to your name, then the business name needs to be registered with the NSW Office of Fair Trading. For example, if you are using your own name, 'Julie Smith', as the business name, there is no need to register it. But if you chose to use the name 'Julie Smith's Arts and Crafts Gallery', it must be registered.

Contact the Office of Fair Trading on 13 32 20 to find out if a name is registered.

If the business trades only in NSW, the name needs to be registered just in NSW. However, if the business operates in other states or territories it must be registered in those states and territories. There is no need to register the name outside NSW if you are offering products or services in other states and territories via the internet.

Business name registration is valid for three years, and must be renewed after this period.

To register a business name you must complete a business name application form, and lodge it with the Office of Fair Trading. Call 13 32 20 for an application form, or download one from the Office of Fair Trading website [www.fairtrading.nsw.gov.au](http://www.fairtrading.nsw.gov.au)

## **Business licences and permits**

Licences and permits might be required before starting a business. To find out if a business needs to be licensed, visit the Business Licence Information Service (BLIS) website at [www.blis.fairtrading.nsw.gov.au](http://www.blis.fairtrading.nsw.gov.au) or call the Office of Fair Trading on 13 32 20.

## **Equipment**

Business equipment is an important investment. Think carefully before buying or leasing anything.

Communication is vital to a business. It includes the phone and fax number and the lines, and how to connect to the internet. The Small Business Website [www.smallbiz.nsw.gov.au](http://www.smallbiz.nsw.gov.au) contains useful information about selecting computer and other equipment when starting up a small business.

Work out the need for other types of equipment such as a fax or a photocopier, plus items such as filing cabinets, desks, chairs and the like.

Consider second-hand or leased equipment.

## **Risk management**

Risk is a part of everyday life. There are many types of risk especially for a business. Risk ranges from burglary to fire, to competitors stealing customers. Risk management is the way in which events or circumstances may have a good or bad effect on a business, and how the risk is managed. The Department of State and Regional Development's *Risk Management Guide for Small Business* is available at the Small Business website [www.smallbiz.nsw.gov.au](http://www.smallbiz.nsw.gov.au) or by phoning 1300 134 359.

## **Insurance**

Insurance is one way of managing certain types of risk.

It is wise to take out insurance for a business, especially to cover emergencies. A serious event like fire will probably put a business out of action. Get advice on managing risks. It's the smart thing to do and might help reduce insurance premium costs.

Next, decide the most appropriate type and level of insurance. The Department of State and Regional Development's Small Business website [www.smallbiz.nsw.gov.au](http://www.smallbiz.nsw.gov.au) includes a small business insurance 'finder' under the 'Insurance and Your Industry' link. This finder can help with business insurance needs.

There are many different types of general and specialised insurance policies available for small businesses. It is worthwhile contacting more than one insurance company.

Insurance brokers can help choose the right type of insurance for a business and provide information on different insurance companies.

### **Look up the Yellow Pages directory or contact:**

- Insurance Brokers Network Australia (IBNA) on (02) 8913 1640 or [www.ibna.com.au](http://www.ibna.com.au) or
- National Insurance Brokers Association (NIBA) on (02) 9964 9400 or [www.niba.com.au](http://www.niba.com.au) to find an insurer.

## Intellectual property

Intellectual property (IP) is the product of creativity. It can be an invention, an original design, a work of art, or the practical application of a good idea. Intellectual property can be secured by insuring exclusive rights so competitors cannot copy a business idea or an invention. This increases the chances of business success.

### Elements of IP worth protecting include:

- Unique product(s) or service(s), which can include their packaging
- Designs – the visual appearance of a manufactured product or a business logo
- Confidential information such as trade secrets, how something is made, product manufacturing specifications, business and marketing plans, and client lists
- Know-how – how proven techniques or processes are applied to new situations, and
- Results from research and development.

### Establish your rights to IP by taking out:

- Patents – the exclusive right to stop others from manufacturing, using and/or selling an invention
- Trade marks and trade names – which are used to identify goods and services; for example, a letter, number, word, phrase, sound, smell, shape, logo, picture, feature of packaging, or any of these together

- Copyright – this includes protection from unauthorised copying of original works of art, literature, music, films, broadcasts and computer programs.

IP Australia is the best place to look for information about intellectual property ownership and protection. In addition to its main website [www.ipaustralia.gov.au](http://www.ipaustralia.gov.au) IP Australia also has a general IP information website [www.ipaccess.gov.au](http://www.ipaccess.gov.au) or call 1300 651 010.

Alternatively, call the Innovation Advisory Centre nearest you.

- **Hunter Innovation Advisory Centre**  
Phone: 1800 995 299, (02) 4962 0999  
Fax: (02) 4960 1137  
Email: [mail@innovation.org.au](mailto:mail@innovation.org.au)
  - **Illawarra Innovation Advisory Centre**  
Phone: (02) 4223 3100  
Fax: (02) 4223 3199  
Email: [innovations@illawarraitec.com.au](mailto:innovations@illawarraitec.com.au)
  - **Sydney Innovation Advisory Centre**  
Phone: (02) 9415 2630  
Fax: (02) 9415 2624  
Email: [becn@bigpond.net.au](mailto:becn@bigpond.net.au)
  - **Western Sydney Innovation Advisory Centre**  
Phone: (02) 4731 5711  
Fax: (02) 4731 5799  
Email: [innovations@pvedc.com.au](mailto:innovations@pvedc.com.au)
- See checklist in Appendix 2, Part B, and complete Appendix 3, Part B.**