

User Guide

Setting up and running a business. Frequently asked questions.

Pearson Hinchliffe Commercial Law has developed this User Guide for ease of use. The document follows the development of a business from its concept to attaining stability through to expansion and ultimately its sale, or in some cases decline. The format is based upon frequently asked questions (“FAQs”) and follows the stages in the development of a business.

Making the Dream Come True

Q1. What do I need to Start?

A. The essential element is to have the commitment to develop your product or service and bring it to the market place. Once the concept has been crystallised the business can be established.

Q. 2. What will I need?

A. Starting a new business and developing it successfully imposes considerable demands and pressures on the budding entrepreneur. He must have the basic skills in all areas of the proposed business together with sufficient initial capital, an open mind and a readiness to look for and follow professional advice.

Q. 3. I have heard that many businesses collapse during their first year. How can I best avoid this?

A. To reduce the risk of failure, carry out as much research as possible to establish that your customers will chose your new business product or service rather than others which already may be established. Prepare a thorough and realistic business plan.

Q. 4. What basic skills do I need?

A. The relevant areas of expertise are finance, marketing, production and personnel. It is not necessary to be an expert in any of these items but you should have a basic working knowledge of what is required. Basic courses on each of these items is readily available in your area.

www.businesslink.gov.uk,

www.britishchambers.org.uk and local colleges of further education should be able to assist you with finding such courses.

Q. 5. When do I start seeking advice and where do I get it from?

A. This website will provide some of the assistance that you need but you may also obtain it from various online sources including www.businesslink.gov.uk

Q. 6. I have identified a good product and a niche in the market place. What personal qualities do I need to succeed as an entrepreneur?

A. 1. You must be willing to commit yourself totally to your business.
2. You must be a determined self-starter.
3. You must be self-sufficient.
4. You must be able to overcome set-backs.
5. You must have a lot of energy and be in good health.

If you are not able to give a positive answer

to any of the foregoing then you may have great difficulty in succeeding.

Q. 7. I believe that I have the necessary personal qualities and I really want to succeed. How can I best achieve this?

A. It helps to do the following:

1. Identify why your business will have a competitive edge.
2. Make a detailed assessment of the risks of starting the business and work out how to reduce those risks.
3. Prepare a comprehensive business plan.
4. Have a thorough understanding of your market and no where you can achieve sales.

Setting up in business.

Having made the decision to start in business you need to consider whether you wanted to do it alone as a sole trader or in partnership or as a company. Whether you are starting in partnership or as a sole trader may depend upon what other individuals are involved in the project and their level of involvement.

Q. 1. What are the advantages of setting up as a sole trader and/or partnership?

A. There are no formalities necessarily involved prior to establishment of a sole trader or partnership business (although a partnership agreement is highly recommended). The commencement of a business activity is sufficient to establish the existence of a partnership without the need for actual trading. Both types of business will need to comply with various legal requirements of the Inland Revenue and other government

authorities. Such obligations are in no way a pre-requisite to the legal establishment of the business.

Q. 2. What are the main advantages of a partnership over a sole trader?

- A.**
1. At least two people will provide capital.
 2. The liabilities are shared.
 3. You probably will have twice as many contacts.
 4. You have support in the event of illness or absence on holiday.

Q. 3. What are the disadvantages of being a sole trader or in partnership?

- A.**
1. You have personal liability on all business contracts whether trading alone or in partnership.
 2. It can be exceedingly lonely.
 3. All contracts are entered into in your own name.

Q. 4. What is a limited liability partnership (“LLP”)?

A. The Limited Liability Partnership Act 2000 has made it possible for two or more persons carrying on any trade or profession to register as a Limited Liability Partnership by filing an incorporation document. This creates a separate legal identity (still taxed as a partnership) and offers limited liability protection for all its members whilst allowing them to take an active part in management. It can provide an incentive for key employees of the business to take on partnership status without incurring liability for the faults of their fellow partners, over which they have no control.

Q. 5. What are the advantages of trading as a Company?

- A.**
1. The owners are not generally liable for the debts or other commitments of the Company. Generally their liability on the failure of the Company will extend only to the investment they have made “in fully paid” shares.
 2. It is likely initially that the Company will only pay tax at the rate of 21% on its profits.
 3. It is easier to raise equity finance as a Company than as a sole trader or partnership.
 4. It is easier to grant security over a Company’s assets particularly its trading stock.
 5. The death of a shareholder will



not bring the business to an end as it may on the death of a sole trader.

Q. 6. What are the disadvantages in operating as a limited company?

- A.**
1. It may be difficult to obtain credit without the Directors giving personal guarantees.
 2. The Company will need to appoint an accountant to prepare its final accounts.
 3. The cost of management of a Company is generally more than as a sole trader.
 4. The accounts are public in that they have to be filed at Companies House although in the case of small and medium companies the

accounts are in an abbreviated form.

5. It costs more to register a company than to form a business as a sole trader but, today, it need cost no more than around £150.00 to form a Company which can be done within days.

Q. 7. Can I trade under any name that I wish?

A. Sole Trader.

You may trade under your surname or your surname and forenames or initials without any restrictions. Where the name of your business does not consist of your sole name then approval may be required if the name implies a connection with the government or local authority or includes a restricted name, such as a bank.

Partnerships.

1. If the trading name of the partnership consists of the surnames of all the partners then no restrictions apply.

Company.

1. Under the Companies Act 1985 there is a prohibition on the registration of a company name:-
 - a. Which includes the words “limited”, “unlimited” or “plc” (or their Welsh equivalents) otherwise than at the end of the name.
 - b. Where the name is the same as that of an existing company.
 - c. Where in the opinion of the Registrar it will be offensive or constitute a criminal offence.

Certain other names such as those suggesting a link with a local or

national government or containing certain words or expressions are restricted.

To check the availability of a name access the index at Companies House www.companieshouse.gov.uk.

Q. 8. How do I check whether my proposed name has been registered as a trade mark?

A. You cannot use a name if it is the same as or similar to a name already registered as a trade mark or service mark and you are using in the sector in which the mark is registered. To avoid trade mark infringement you can conduct a full search at the Trade Marks Registry held at the Patent Office (Pearson Hinchliffe could organise this for you). Or alternatively you can carry out a quick search at the Patent Office website. www.patent.gov.uk. To be absolutely sure that there is no potential infringement a full search is advised.

Q. 9. I have heard that the Business Names Act 1985 may apply to my business?

A. The Act applies to sole traders, partnerships and companies.

It requires the following to be stated, in legible characters, on all business letters, written orders for goods or services to be supplied to the business, invoices and receipts issued in the course of the business and written demands for payments arising in the course of the business:-

- a. in the case of a partnership the name of each partner
- b. in the case of an individual his name
- c. in the name of a company its

corporate name and

- d. in relation to each person so named an address in Great Britain at which service of any document related in any way to the business will be effective
- e. in any premises where the business is carried on and to which the customers of the business or suppliers of any goods or services to the business have access, display in a prominent position, so that it may easily be read by such customers or suppliers, a notice containing such names and addresses.

Q. 10. Are there any special requirements for publicising the company's name?

A. The name of the company must be painted or affixed in a conspicuous position and in easily legible lettering outside every

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office or other place in which the company's business is carried on.

Where a business name is used by a company then its corporate name and the address for service of documents within Great Britain must be displayed in any premises where the business is carried on and to which customers or suppliers of the business have access.

Q.11. Does a V.A.T. registration number have to be stated on business letters?

A. It is not a legal requirement for the V.A.T. registration number to be stated upon business letters and other documents although it is good practice to do so but it must be noted on the business' website.

Q.12. Are their penalties for breach of the various publicity requirements of business names outlined above?

A. Yes.

Any breach of the various publicity requirements gives rise to a liability to penalties on the part of a company or any officer or other person on behalf who is using business stationery or other documents not complying with the statutory requirements.

Section 349 of the Companies Act 1985 makes any officer or other person signing, on behalf of the company, any bill of exchange, promissory note, endorsement, cheque or order for goods or money, upon which the companies name is not mentioned, liable to a fine and also personally liable to the holder of the bill of exchange etc. for the amount of it unless it is duly paid by the company.

There are also civil remedies for breach of the Business Names Act 1985.

Q.13. I have heard that there are two principal documents required in the formation of a company, the memorandum of association and the articles of association. What is the significance of these two documents?

Memorandum of Association.

A. Section 2 of the Companies Act 1985 requires the memorandum to state:-

The company's name;
The registered office;
Its objects;
What the liability of its members is; and
The amount and division of share capital.

The Articles of Association.

A. These are the internal regulations for the management of the company. Table A (created by the Companies [Tables A to F]



Regulations 1985) sets out the default regulations for the management of a company limited by shares. The members are free to amend the Articles of Association if they wish but Table A will apply to the extent that it is not amended. Frequently, those companies specialising in selling "off the shelf" companies make minor alterations to Table A which often do not reflect the requirements of the shareholders. In order to change the Articles it is necessary to call a general meeting of members.

FINANCING A NEW BUSINESS

Types of Capital.

Funding is provided in two basic ways, being either loans to the company or the provision of equity capital:-

Loans.

Long term loans can be secured upon the assets of the company including its goodwill, debtors and plant and machinery. Long term loan stock is usually secured by a debenture in favour of the lender. Any interest charges paid to the lender are deductible in computing the company's trading profits.

Equity Capital.

This can be in the form of ordinary shares, preference shares, convertible preference shares and redeemable preference shares. Owner managers will usually receive ordinary shares in return for their investment in the company. When an investor is not involved in the management of the company he may well take a preference share carrying a fixed right to a dividend if declared by the Directors. Preference shares do not normally carry any votes. It is not unusual for redeemable fresh preference shares to be granted to employees on the basis that they are redeemed by the company upon termination of employment.

THE DEVELOPING BUSINESS

Once the business has been established management usually focuses on expansion. Procedures and policies are developed laying the foundation for the infrastructure. Rapid growth ensues and entrepreneurs tend to get involved in a flurry of activity. This is a stage

where the personality of the company is developed along with the essential elements of trade including the introduction of standard terms and conditions of sale and purchase, contracts and detailed contracts of employment, service contracts, distribution agreements, the acquisition or the lease of property and in some cases the acquisition of other businesses.

Terms of Trading.

Business people will often be confronted with suppliers insisting that all contracts for the purchase of their goods will be based upon their

Focus

own standard terms and conditions of sale. Such terms are typically very one-sided. Whilst the Unfair Contract Terms Act 1977 gives some comfort it is better for traders to have their own Terms and Conditions. Commercial Contracts are the route of all business deals between suppliers, distributors, agents and customers. It is in the best interests of all business people to have up to date commercial agreements upon which their business relationships are founded.

Q.1. I have heard of the “Battle of the Forms” what does it mean?

A. Buyers and sellers will frequently

have Standard Terms and Conditions of Sale and Purchase which frequently state that the buyer or seller will only offer to supply or purchase goods incorporating the buyer or seller’s own terms. The effect of this “last shot” rule is that whichever of the seller or buyer is last to get their conditions into the pre-contract negotiations, without objection, should succeed in establishing that his conditions are applicable. With care this can be avoided.

Q.2. We are not worried about our Terms and Conditions we have copied them from a National Company. Why should we pay to have our own prepared?

A. Lawyers prepare Terms and Conditions specifically to the requirements of their clients. It is unlikely that the conditions that you have copied will fit precisely into your business requirements. In any event have you thought about breach of copyright?

Q.3. We put our Terms and Conditions on all invoices. Is this sufficient?

A. If you only have them on your invoices you have wasted the cost of preparation of the Terms and Conditions and the printing of them. If you want to enforce your terms and conditions the terms must be incorporated into the contract and therefore they must be brought to the notice of the contracting parties before the contract is entered into. This usually means that they are printed on the back of a purchase order form and that the contract will be completed when the order has been acknowledged or the goods delivered.

Q.4. Are there any standard terms which I should take account of?

A. The most common terms are the following:-

Those relating to the title to the goods i.e. when does this pass on to the buyer.
Matters of insurance.
When payment is due.
When delivery is due.
How the price is calculated.
How to deal with complaints.
Restrictions on liability.
Warranties.

Q.5. We get on very well with our customers and suppliers do we really need to worry about having written terms?

A. Thankfully most business transactions run very smoothly without reference to terms and conditions. It is only when something goes wrong, that can’t be sorted by negotiation, may become very important. Treat them as an insurance policy against a rainy day. Frequently well drafted terms and conditions will bring an issue to a speedy conclusion. Otherwise court proceedings could, and frequently do, have a damaging effect upon a business’s profitability. The cost of reviewing and drafting Terms and Conditions is very little compared with the value of the business using them. The costs are also negligible when compared with legal and expert fees in resolving a dispute in court or by way of arbitration.

Q.6. I have been told to protect my Intellectual Property Rights. What are these?

A. Intellectual Property Rights is a legal term for the rights in patents,

trade marks, copyright, design rights etc. They can be

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exceedingly valuable and can be mortgaged and transferred. Whilst in some instances they may be acquired without any formal documentation it is better to register them if you wish to enforce them.

THE MATURE BUSINESS

At this stage in its development the business has overcome its initial problems and is ready to take advantage of all the groundwork and effort expended by its owners or owner managers. The decisions to be taken at this stage of its development are just as serious, if not more so than in setting up the original business and developing the concept. The business will have moved into a different league from that in which it originally started. It will be in competition with similar organisations that may have more skills or capital available with which to compete. The entrepreneur will need to consolidate prior to considering launching into further growth which may be organic or may involve the acquisition of other businesses.

Consolidation.

FAQs.

Q.1. I have built up a successful business as a sole trader. I have been advised by my accountant that I should incorporate it – What does this mean and what do I need to consider?

A. Incorporation means transferring the business to a Company formed specially or purchased “off the shelf”. The transfer will be the consideration or the issue of shares in the new Company or debentures in the new company (sometimes known as “Loan Notes”). Alternatively the business could be taken over by an existing company in return for shares or debentures or for cash or a combination of all three. Consideration should be given to income tax, capital gains tax, stamp duty and v.a.t. There are other considerations which you may have to take into account concerning employment and company law matters.

Your approach to this subject depends largely upon the type of business and the reason for the sale. You may be operating a small retail business based upon the tenancy of a shop which you wish to sell or perhaps you are transferring a partnership business from a Company set up for the purpose or perhaps you are thinking of retirement and want to know how must to dispose of your business. The answers to the following frequently asked questions may be of assistance to you.

Q.2. What is the importance of goodwill in the sale of a business?

A. Goodwill is a combination of a company’s reputation in the

market place and the location of its business, its market share and the range of goods and services in which it is involved. It is represented by the difference between the value of the net tangible assets and the purchase price of the business. You should note that stamp duty is not paid on the value of goodwill.

Q.3. I am thinking of selling my business. What do I need to consider?

A. The first question frequently asked is whether you are selling business assets and goodwill as a sole trader or partnership or whether you are selling the shares in a company or the company’s assets.

Q.4. I have heard that I may have to give warranties to a prospective purchaser; what do these mean?

A. On the transfer of a business most liabilities, including those relating to tax will remain with you in respect of the affairs of the business up to the transfer date. A warranty is a form of guarantee. It is defined in the Sale of Goods Act 1979 s. 61(1) as “*an agreement with reference to goods which are the subject of a contract of sale, but collateral to the main purpose of such contract, the breach of which gives rise to a claim for damages, but not to a right to reject the goods and treat the contract as repudiated.*” On the sale of a company the purchaser of the shares in the company will take immediate responsibility for all liability to the company including those incurred before the acquisition of the shares and therefore the purchaser will require warranties from the vendors of the shares and possibly the managers of the business with

regard to certain aspects particularly matters of the assets, employees, litigation and taxation.

Q.5. I have heard that on the transfer of my business TUPE will be relevant – What is this?

A. TUPE is an acronym for the Transfer of Undertakings (Protection of Employment) Regulations 2006. These regulations, together with the decisions of the European Court and the Domestic Courts can have far reaching effects on responsibility of a purchaser of a business who will generally assume responsibility for the outstanding claims of employees on the Transfer of an Undertaking. For this reason warranties will be asked for by a prospective purchaser relating to the terms of employment, the existence of disputes and whether the employer has established “Employee Representatives” for the purpose of collective redundancies or transfers.

Q.6. I am in negotiation with a prospective purchaser of my business who wants some detailed confidential information. How can I protect my interests if the purchaser withdraws?

A. It is common, once serious negotiations have commenced, for the seller of a business to require the prospective purchaser to enter into a Confidentiality Undertaking, the effect of which is that information if received as the result of enquiries by the purchaser or his professional advisers will be used only for the purpose of evaluating the business and will be kept confidential and will not be passed to a third party without express permission.

Q.7. I am in negotiation for the purchase of a business how can I stop the Seller negotiating with any other parties.

A. You can require the Seller to enter into a “Lock-out” Agreement whereby the seller agrees not to enter negotiations with another party for a specific period of time to enable you to carry out your investigations of his business.

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roger.hinchliffe@pearson-hinchliffe.co.uk