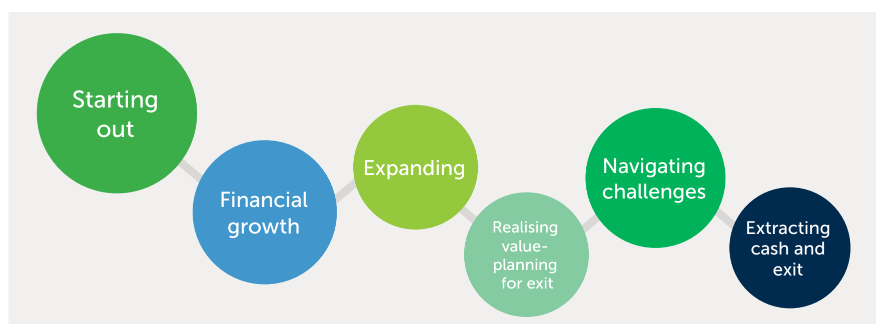
The Entrepreneur Lifecycle – Part I: Starting Out

by Nora Cosgrove and Jonathan Ginnelly

This article is the first in a series of three articles that will examine the entrepreneur lifecycle and the key considerations that entrepreneurs should think through at each stage in the cycle. In this article, we will examine the structure of the typical lifecycle from starting out through to exit, delve into the key structuring, tax and commercial issues entrepreneurs face when establishing their businesses and provide some practical tips on how best to take advantage of opportunities and overcome challenges.



The Entrepreneur Lifecycle

In our experience, the entrepreneur lifecycle typically follows a non-linear path from start-up, financing growth, expansion, navigating challenges through to exit. For most entrepreneurs, this path can be bumpy with opportunities and challenges around every turn. There is usually no set timeline associated with the typical entrepreneur lifecycle with some entrepreneurs spending longer or shorter time periods at each stage. Needless to say, some entrepreneurs cycle through from start-up to exit very swiftly indeed! This cycle tends to be representative of the cycle that is seen across entrepreneurial enterprises of all sizes from very small start-ups by individuals through to novel start-ups within large, multinational groups. The focus of this series of articles will be on indigenous, private company/individual entrepreneurs. We will be exploring the key features, opportunities and challenges associated with each stage in the cycle in this article (focusing on the start-up phase) and in the following two articles in this series.

Starting out – the first stage in the cycle.

All entrepreneurial activity begins with a good idea, but the success or failure of the idea depends on how well the entrepreneur navigates the entrepreneur lifecycle, particularly the initial start-up phase. In our experience, almost every entrepreneur we have worked with is personally involved in developing their business idea and it is not uncommon for entrepreneurs to devote almost all of their time to developing and nurturing that business idea and finding their routes to market. Entrepreneurs are, typically, profoundly invested in their ideas from a personal lifestyle and personal financial perspective. Many (either by choice or through lack of attention to the more administrative side of developing a business) adopt an informal business model in the start-up phases of their business – often beginning their journey as sole traders or in partnership with others. It is only later, as they become more established and begin to reap the financial rewards, do some entrepreneurs step back to assess whether their current business structure is, in fact, the most beneficial and efficient manner in which to operate. By this point, opportunities to protect the business and ensure it is adequately funded for growth may already have been missed. The importance of spending time focusing on getting off on the right footing from an administrative, tax and legal perspective cannot be underestimated.

Business structure

Whilst it is tempting for entrepreneurs to focus all their time on getting their idea off the ground, it is always advisable to identify and establish an efficient business structure and model from the outset. In order for an entrepreneur to be in a position to identify the most efficient and effective business model, the entrepreneur needs to be clear about their vision for the business and its success. Some high-level questions that should be considered include:

[1] Section 626B TCA 1997

- What is the goal and objective of the enterprise?
- How much money will be needed to achieve the goal and when will it be needed?
- What will success look like?
- What level of risk will be tolerated at all stages?

In our experience working with successful entrepreneurs and private businesses, time spent preparing a business strategy, preparing projections and market estimates, undertaking competitive assessments and reviewing available government/other incentives is time well spent at this stage of the entrepreneur lifecycle.

Once the vision and strategy of the enterprise is defined, time should be spent on identifying and implementing a suitable business structure. For many, this will involve the incorporation of a limited liability company. The limited liability company has long been recognised as the cornerstone of our economic system, bringing with it the benefits of separate legal personality, limited liability and lower tax rates on trading profits. The corporate structure both protects the entrepreneur in the event of business failure and allows for unlimited growth and ease of transfer in the event of prosperity.

We would always advise an entrepreneur to consider whether establishing a holding company structure at the outset would be beneficial for their particular circumstances and goals. As many readers will know, the tax benefits of establishing a holding company are many, and include:

- Tax-free disposal of trading subsidiary companies on exit through availability of the Irish Participation Exemption[1],
- Tax deductions for interest on certain borrowings,
- Favourable tax treatment of dividend income; and
- Favourable withholding tax of provisions for interest and royalties.

Establishing a holding company structure from the outset avoids a situation where one would have to interpose a holding company at a stage when the enterprise is more valuable (and thereby potentially incur a tax cost together with more significant advisory/administration fees). Odd as it may seem, considering how one might make a planned exit from the business from an early stage will also provide the greatest opportunity to ensure compliance with beneficial tax reliefs such that whenever one decides to take a step back, this can be done as tax-efficiently as possible. A holding company structure also provides commercial flexibility for entrepreneurs looking to keep distinct business streams separate from one another (for ease of administration, accounting or other reasons) or who wish to have flexibility in terms of future sale (or hive-off) of various business streams.

Protecting the assets of the entrepreneur and the business

In many instances, entrepreneurs enter into business with partners or other seed investors. Formal legal agreements should be in place, from the outset, to govern these relationships and ensure that all parties are adequately protected and have sufficient flexibility to achieve their objectives. Failure of partnership or investor relationships further along the entrepreneur lifecycle can become time consuming and costly (at a minimum) or lead to the ultimate demise of the enterprise (in a worst-case scenario).

Managing intellectual property

If intellectual property ('IP') is being generated by the entrepreneurial activities, consideration should be given to how best to protect it (e.g. copyrights, trademarks, etc.). There are multiple benefits to ensuring IP is adequately protected, including:

- Protecting the IP (and the business) from competitors,
- Adding value to the enterprise which can help attract finance and support for the business; and
- Assisting in expansion and growth of the enterprise (e.g. by way of licence or franchise, etc.) in the future.

Managing tax, accounting and corporate administration

It is true to say that many a good business was forced to end its journey through the entrepreneur lifecycle much too early on receipt of a large and unexpected bill from Revenue.

It is of critical importance that an entrepreneur considers, maps out and manages all tax, accounting and corporate administration deadlines in a timely manner to avoid unnecessary penalties and fines for non-compliance with the relevant rules and obligations.

Financing the start-up stage

How best to finance the business at all stages is a critical consideration. In the start-up phase, many entrepreneurs are burning through their (often, personal) cash reserves and it is useful to consider whether there are any government or tax incentives that should be sought to mitigate this. Whilst the extent of government and other start up grant funding is beyond the scope of this article, we have set out below a high-level summary of some key tax incentives that can assist entrepreneurs in the start-up phase.

- **Corporation tax exemption for start-up companies**

This is a tax relief specifically designed for start-up companies. It applies (subject to certain conditions) in the first three years of trading where the company's corporation tax liability is less than €40,000. Marginal relief applies if the corporation tax is between €40,000 and €60,000. The relief applies to corporation tax and chargeable gains on the disposal of business assets and any excess relief can be carried forward beyond the three-year period.

- **Start-up relief for entrepreneurs ("SURE")**

SURE is a tax relief for entrepreneurs who leave an employment to set up their own company. SURE acts to reduce an entrepreneur's taxable income for any / all of the previous six tax years by the level of their investment in their new company (subject to certain limits and subject to certain restrictions on the activities of the company). This can result in a refund of up to 41% of the value of the investment.

Among the conditions for relief, the investor must have earned primarily PAYE-income for the past four years and hold at least a 15% stake in the company's ordinary share capital. The company must be no more than two years' old, carry out a qualifying trade (as defined in legislation) and not have taken over an existing trade. Therefore, in order to avail of this relief, it is particularly important for entrepreneurs to incorporate a company from the outset and not operate the business as a sole trader first.

- **Start-up capital incentive ("SCI")**

SCI is a tax relief for early stage micro companies to attract equity-based risk finance from family members. Where the company, the investment and the investors meet certain criteria, then the investor can claim relief. The relief is available in two tranches: 30/40 in the year of investment and 10/40 may be available after 4 years. SCI investments cannot be made through designated investment funds. They must be made directly in(to?) the company and the maximum that can be raised under the SCI is €500,000.

Conclusion

In conclusion, most entrepreneur lifecycles follow a similar path from start-up to exit. The most successful entrepreneurs focus their energies not only on their ideas but also on the effective management of the entrepreneur lifecycle at each stage. Engaging as early as possible in the more administrative aspects of developing a business can make the later stages of the cycle more manageable and efficient.

From raising finance to fund expansion, to rewarding key employees or facilitating an eventual exit from the business, having the right systems and structures in place early can allow the entrepreneur focus on the core business as opposed to having to spend time later in the process trying to fit a structure around a somewhat unwieldy enterprise.

Establishing the most appropriate structure for the business from the outset will afford entrepreneurs the greatest opportunity to benefit from that structure and facilitate the most efficient future financing, expansion, growth and ultimate realisation of value in the business.

Protecting the assets of the entrepreneur, managing any IP that is generated, managing ongoing compliance obligations and adequately financing the start-up phase are critical to ensure the enterprise successfully navigates the start-up phase and moves onwards towards financing growth and expansion. We will explore the expansion and growth phases of the entrepreneur lifecycle in the second article of this series in September.

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