

Creating a three-month checklist

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Section 1. Tutorial tips

Should I take this tutorial?

When I launched my first venture-funded startup, I was surprised at all the administrative setup tasks we had to do before we could get started on the "real" work of the new business. We wasted a month.

So *you* don't waste time, I've created this tutorial to provide you with a list of things you need to do -- mostly administrivia -- but without it, you won't be able to cash that first check. It should help you get the paperwork and organizational details off to a good start without wasting time, or overlooking something that will cause trouble later. Then you can get started on actually creating your product or service.

Our assumptions for this tutorial:

You are about to start your new enterprise.

You have several founders, not just you personally.

You just got, or expect to get, some funding.

This tutorial is organized by "months." If you are ready to set up shop and go full-bore ahead, these would be actual months. But if not, then the time may be stretched out.

Contact

For questions about the content of this tutorial, contact the author, Michael "Mac" McCarthy, at mcwong1@home.com.

Mac McCarthy is a longtime entrepreneur, having founded, cofounded, or been involved in turnaround teams for various businesses over the past twenty years. He was cofounder of IDG Books, where he initiated (and named) *DOS for Dummies*, first in the ground breaking book series. He has also been head of Reviews for *InfoWorld*, and founder and President of the company that produces the Web-only developer magazines *JavaWorld*, *SunWorld*, and *LinuxWorld*. Last year he cofounded the venture-funded BLOSM.com, a site for the book-publishing industry. Currently he is a consultant specializing in assisting startups, and resides in Castro Valley, near San Francisco, California.

Section 2. The first month -- setup

Getting ready to incorporate

Before you can cash that VC check, you need a bank account, which means you need to be incorporated, which means you need to be organized. Let's get started.

* Find a lawyer

You will need a lawyer for many of the things that follow. An ideal lawyer is one who knows venture-funded startups -- as opposed to your family lawyer who has only set up partnerships and one-person corporations before. Most importantly, the venture-experienced lawyer will be able to help you set up a sensible capital structure and guide you in interpreting the VC's investment mumbo-jumbo when you get a term sheet -- vitally important! In high-tech neighborhoods, you have to wait in line for this kind of lawyer, and even pay him in stock as well as (lots of) cash. Elsewhere you may have to settle for a less experienced but willing-to-learn lawyer. But get a lawyer in any event.

* Decide on a capitalization structure

Some experienced advice will help you here -- your venture lawyer, or some other advisor who is current on venture-funded startups.

The "cap structure" is the division of shares of the company among the founders. Rule one: Don't keep it all to yourself. Your cofounders are partners, treat them as such. Rule two: You won't keep majority control if you take money from outside investors; get over it.

Here is an example of one possible division of stock prior to the first investment, just to give you a general idea to start from:

30% of the company is divided among the founders (mostly in the form of "grants")

30% is reserved for future employees (in the form of "options")

The rest is for the VCs. Expect each round of financing to take 30% of the stock, so in the second round the VCs will have majority ownership *and* the founders are diluted down to 20% or less (try not to dilute the reserve for staff). Don't worry about it, it all works out in the end -- your goal is to own value, not percentage points.

(The preceding is a very general guide only.)

* Also create an employee participation system and a vesting schedule

Vesting schedule: Over what period will you allow vesting of stock options and grants? The typical time frame is three or four years -- accelerated vesting schedules are viewed with alarm by investors and during the IPO. Here's a common schedule for a four-year vest: A one-year "cliff" (you get nothing until your first anniversary with the company -- remember, options are a means of employee *retention*, you're not rewarding people for *leaving*), at which point you are vested in 25% of your options; thereafter you vest another 1/12th of 25% each month.

Note: Whatever vesting schedule you come up with, **everyone** should live with it -- that means founders, board of directors, advisory board members, service providers, your mom, everybody.

Now make a list of every kind of job you plan to hire into, and create a schedule (list) of how many options each job type should get, depending on how high up the ladder they are, how important their contribution will be, how hard it is to hire people who are any good at that job, AND at what point in the building of the company they come on board -- as you get each round of financing, the risk goes down and, therefore, so do the number of options later arrivals get. This list will:

1. Tell you how many options you need to give away to build your company, which helps you understand the value of options to the future of the company, and

And, of course, if your options schedule adds up to something dumb like 135% of the company, you'll work with your other founders to revise it.

Now incorporate

* **Incorporate** - preferably in Delaware, which is a corporation-friendly state. But the preceding items (especially the cap table) are required in order to incorporate. Your lawyer will walk you through things like picking corporate officers, and listing your contributions of value to the company -- your time and effort, any hardware or software being donated, any patents and copyrights the company will own. Tip: Keep your corporate structure simple.

Another tip: Make sure the company owns the core technologies and isn't just borrowing them from one of the founders; VCs wouldn't like that. This usually involves the founders and key staff signing over all inventions now and as long as they work for your company. And the VCs will also want at least basic noncompete and nonpoach contracts from each founder and senior staffer.

* When you have incorporated, file for a **business license and tax ID number** in your state.

* Now get a **bank account** -- you'll need the tax ID number and incorporation verification papers to do this. Don't try to run the company out of somebody's personal bank account! And make sure you require TWO signatures to withdraw significant amounts of money -- this is not the area in which trust in your colleagues is a good idea.

Now, with incorporation papers, a tax ID number, and a bank account in hand, you can accept investments, spend money, sign leases, and otherwise dig yourself a big hole and get into a lot of trouble (cool!).

* File for a **business license** with your city or local community, if one is needed.

Organize the operation

* Take a first pass at an org chart

You need a CEO, a president, and a secretary/treasurer. You probably also need somebody in charge of each of several operational areas: technology, sales/marketing, content, maybe IS as separate from tech development, business development (alliances). Have **clear** lines of authority -- who reports to whom, about what, and who approves what at which level. Avoid dotted-line reporting structures as much as possible -- make sure each person in the company - - now and in the future -- knows exactly who has the authority to decide what. This will *change* frequently, especially as you grow and also when you have a business crisis, but at any given point in time the organizational/reporting/decision-making structure of your company must be as clear as you can possibly make it. *Now* is the right time to start this.

The most important item on the org chart at this point is deciding **through whom all the money flows**, and what the system is for making financial commitments and seeing that bills are paid. Ideally the secretary/treasurer (or somebody reporting to him) will have *all* invoices and requests for payment pass through his hands, so he can keep track of things -- otherwise your "actuals" budget won't be complete and you won't be able to control and track spending. Ditto with tracking income and payables.

Crucial! **Don't let anybody bypass the money system!** Nobody, not even the quirky, anti-authority, snap-decision-making founder, can ignore this system and make major spending commitments on his own authority! This is worth going to the mat over, each and every time it is needed. *There is a time to avoid conflict, but this ain't it.*

Tedious details: space, utilities, services

* Start looking for space.

Depending on where you live, this will vary in degree of difficulty, and will introduce you to supply-and-demand in its rawest form. If you brim with confidence in your prospects for future funding, you can take space with room to expand. Most of the rest of us can't afford to risk the company like that, so we do (overpriced) short-term leases for space we will grow out of very quickly if we're successful. That means you'll be moving frequently in the first few years. Get used to it.

A tip: Don't succumb to the temptation to **split your staff** across multiple locations, and don't let any **key people work from home**. A startup has many details to work out, and many strategic and tactical organizational battles to fight out, and split or not-present staffs are a major hindrance to the necessary process of building a company in its first year or two. The only people who can work away from the office are those who have well-defined, settled tasks and who are not Players -- such as salespeople out meeting clients, and programmers creating black-box elements. You shouldn't even have field sales offices until your sales organization is well-organized and the sales strategy is well-defined and tested.

* Shop for utilities...

Somebody has to play point person for shopping for telephones, cell phones, ISP services, network services, near-term equipment purchases. Give that person two weeks, and then have a meeting and decide quickly! No long-term leases! No major purchases on spec! Keep it simple simple simple! This is not brain surgery, don't overthink it, don't tie up senior

brainpower on it.

*** ...And services**

Somebody has to do the same for **HR-type services and decisions:**

What are your employee policies?

How much vacation time do employees receive?

Who can work from home? (Make sure the people doing hiring know this policy lest they use it in hiring negotiations.)

Most important: **Medical/dental plan** - you'll need one! Or, as a stop- gap, you could let employees buy individual/family plans themselves and you reimburse them, for a while at least.

***Hire a bookkeeper** (could be part-time at first)

The bookkeeper will set up your payroll system and make sure withholding taxes are paid, among other vital-but-boring things that will drive you out of business if they're not taken care of from the very beginning.

Section 3. The second month - maintenance

Setting up the budget

In the second month, we assume you have deposited the check from the investor(s) and are now setting up your actual business and starting to work -- which means you're starting to spend money.

* **Set up an operating budget**

An operating budget is the budget that tells you in detail what you plan to spend your money on each month, and what income you hope to generate each month. It's the budget you run your operation on -- as opposed to the three-year-plan- type big-picture budgets you try to confuse VCs with. The operating budget will keep you on-track, help you control your burn rate, warn you early how much trouble you're in, help you convince the rest of the big spenders on your team how much trouble you're in, and assist you in making well-timed strategic decisions.

See [Creating an operating budget](#) here on *developerWorks* for details on setting up and using this crucial tool.

* Figure out how to **compensate board members**. Talk to colleagues and to your investors about what's customary. Outside board members get paid to attend board meetings, varying from peanuts plus lots of options, to thousands of dollars a meeting -- and lots of options anyway, depending on the industry you're going into. But no outside director will do any actual work until this is decided.

* Think of some good **potential board members** moving forward

You will need and benefit from one or more "outside directors," or board members who don't work for the company and aren't investors. These come in two flavors: industry figures, and wise heads. The industry figures are people who, by agreeing to be on your board, add credibility to your company, in the eyes of the industry you're in or in the eyes of potential future investors. Wise heads are people who can give you guidance, ideas, a shot in the arm, or a pep talk, and other forms of adult supervision as needed. Pick a mix if possible. It's hard to find good people, even if you know a lot of people, so spend time on this topic.

* Figure out how to **compensate advisory board members**

Just like board of directors members, advisory board members want a little something for giving out advice. If you are a high-tech startup, they'll purely love to get some options, although not nearly as big a chunk as board of directors members get, of course. Beyond that, minor reimbursement for travel, and a good meal are usually all you need.

* Make a list of potential members for **one or more advisory boards**

Advisory boards can be a good, less-expensive substitute for a larger board of directors, and they can be of more practical help when it comes to operational issues. Possible advisory boards include industry, technical, and customer. They can be large; you can have meetings or poll them by e-mail, and you will find real gems.

So decide what advisory boards you'd benefit from. Then figure out how you will use them --

regular meetings? E-mail consultation? Telephone consultation? Polls? Then assign somebody the task of actually forming them (some will be made up of people you know; others you will recruit through your Web site, for example) -- and *do* use them!

* Still looking for **space**? If you grow rapidly, you'll be looking for space all the doggone time!

Reality checks and milestones

* **Revisit the org chart**

This is the time to double-check how well the org chart is representing the reality. Is it working? Are the people in authority really in control? Are there any crossed lines? Neglected areas? Adjust. You will need to revisit this probably every month for a while, and then every few months for a year or two.

* **Time for a staff meeting**

Have a group staff meeting to review how you're doing and how you're actually spending and *planning* to spend money in the next few months. Get everyone in agreement.

* **Create milestones**, documents, and charts for EACH department in the company.

Now that you have a budget, and some staff, and a month or two of operations under your belt, it's time to create formal milestones for every important thing you want to accomplish over the coming 6 to 12 months. Set up monthly meetings with each department to see how they are doing against the milestones. It will be an early warning system that will test your skills as a manager!

Section 4. The third month - Monitoring

Review budget performance

You've survived this long -- phew! -- and have most of your operation set up and running. Now you just have to keep your hand lightly on the tiller, check all the various checkpoints and monitors you've set up -- the budget, the milestones, the org chart, the advisory boards -- and you will have a real sense that you have things under as much control as can be expected in an unpredictable world.

* First, you need to **review the operating budget "actuals" against "plan."** Schedule this from now on as a monthly meeting, and never miss a month.

Make **adjustments to the budget**, including the appropriate amount of yelling at people. This month, also review the budget *process*, to make sure the system is working and things aren't being spent that aren't on the budget, and people aren't spending or making spending commitments without proper approval. Revise the budget as experience advises -- check with your bookkeeper or accountant before doing anything radical to the budget, however. See [Creating an operating budget](#) here on *developerWorks* for some detailed suggestions here.

* Consult with a bookkeeper or an accountant to **make sure everything is kosher** so far. Make sure the employee withholding taxes are actually being paid, for example.

Check with your advisors

* Have first **advisory board meetings** to make sure you're on track.

* **Review milestones**, argue, settle arguments. *Actually* settle them, don't just paper them over.

* Time to **consider hiring HR services, accounting services, other services** - check the Web-delivered services, which may be more appropriate for small businesses.

* Have a real **board of directors meeting** -- get a feel for what the investors want to know and how much they will be involved (or interfere) with your operation. Schedule regular board meetings -- probably monthly at first, and no less often than quarterly later on. In this first board meeting, approve necessary resolutions (such as adding members to the board, approving paperwork as needed).

Section 5. Wrap-up

What next?

At this point you are established organizationally and you have some processes in place for monitoring your business during this, its most difficult period of starting up and feeling its way through a new marketplace toward eventual success. These organizational structures and processes are at the **heart** of any well-run business, and your establishment of them early and use of them regularly will save your skin on a monthly, if not weekly, basis.

There's a weird little side benefit to this that I almost hesitate to spell out during the glow of the startup period. But it's entirely possible that this startup will fail -- theoretically, at least. I've had a few collapse under me, so I know the feeling. But there are great personal benefits in going through a startup -- you get an accelerated, compressed, high-density education in the practical issues of running a business. You grow up fast. If you have had little actual management experience yet -- very common among high-tech startups, certainly -- the act of setting up an organizational structure and putting in place the tracking processes described in this tutorial will teach you more about how to manage a fast-moving enterprise effectively than a Harvard MBA would.

From this point forward, simply repeat the third month processes each month -- check the "actual" budget for the past month to the "plan" and adjust (including making difficult decisions about your original plan, your business model, the market you face, and the varying contributions of the staff, some of whom may need to be fired); meet with your various advisors regularly; keep an eye on the org chart and adjust as needed (DO NOT let fear or favor interfere with necessary changes); review and revise monthly milestones for each department; and try to have fun with it!

Section 6. Feedback

Feedback

Please send us your feedback on this tutorial. The author will also consider specific [questions](#) from startups and would-be startups on the application of this tutorial or other startup issues you may have. We look forward to hearing from you!

Colophon

This tutorial was written entirely in XML, using the developerWorks Toot-O-Matic tutorial generator. The Toot-O-Matic tool is a short Java program that uses XSLT stylesheets to convert the XML source into a number of HTML pages, a zip file, JPEG heading graphics, and PDF files. Our ability to generate multiple text and binary formats from a single source file illustrates the power and flexibility of XML.