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Ireland: How to win the ultimate job gamble

Most new firms fail in the first two years but with proper planning and wily budgeting you can survive the tough test, says Kathy Foley

FOR employees slouching in a stuffy office, shuffling papers and keeping an eye on the clock, it's easy to drift off into dreams of life as a jet-setting entrepreneur, ordering minions about, closing enormous deals and enjoying the material fruits of their labour.

Before getting carried away, take a reality check. The average working week of an entrepreneur is 64 hours and one in five does not earn anything in the first 18 months, according to StartingaBusinessinIreland.com. Furthermore, most new companies go belly-up within a year or two, says Krishna De, the managing director of One Ocean Group, which advises entrepreneurs on business planning.

"On average, 40% of start-ups make it to the two-year mark without the business having folded or having to be liquidated," said De. "The main reason is that while the idea behind the business may have been great, the entrepreneur had not put sufficient time and work into making sure there was a market for the product or service and having a robust financial plan behind it."

Those who are determined to go it alone should take their time and plan for their personal and business financial needs as thoroughly as possible. Rushing headfirst into business is a sure-fire route to failure.

Budget for your own needs

Would-be entrepreneurs should calculate how much they and their families will need to live on for the first three to six months after they leave their full-time job. Allow for mortgage and other loan repayments, household bills, food, clothing and a certain amount for miscellaneous costs. Cut all extraneous expenses and consider selling any large assets, such as a new car or a yacht, that are not entirely necessary.

Brian O'Kane, the founder of Oak Tree Press and co-author of Starting a Business in Ireland, says the newly self-employed should have a fund set aside to cover this initial period.

"If you have the money there, you won't be petrified when the mortgage payment is due and there is no money in the business or at home," he said. "Nobody needs that kind of worry. You are engaging in a life of uncertainty but you need to put in certainty where you can. Also, if at the end of three months you realise the business isn't going to happen, at least you can walk away and you haven't lost anything."

O'Kane advises those researching a business idea to do it part time if possible, while retaining their full-time job. "An initial feasibility study can be done over a couple of weeks," he said. "Is there a need for this business? What will it cost? Can I raise the money? You are going to get some kind of answer in the first couple of weeks. Then setting up a company becomes a calculated risk."

Consider how much you will need to earn over the medium to long term and decide if the business really has the potential to deliver that income. This means taking a good look at potential margins as well as turnover, says Desmond Fahey, the chief executive of the Dublin Business Innovation Centre. Even when the business is up and running your margins may be just 4%-5%.

"Say you need €50,000 a year over the next three years," said Fahey. "You might only get 4% or 5% to the bottom line once the business is up and running."

"To take out €50,000, you might need to generate €1m in sales. If you figure out the turnover you will need to get that bottom line, you will start to realise the scale of business you need to achieve."

Servicing existing debts

For most people, the mortgage on the family home will be their primary personal cost and concern while establishing a new business. Sarah Wellband, the associate director of Rea Mortgage Services, a mortgage intermediary, says most lenders will allow mortgage holders to take a payment holiday or go interest-only for a short time. "Once you have had your mortgage up and running for six to 12 months, lenders will be open to that depending on the reasons," she said. "Certainly, if you are setting up a business, they might be a little cautious about it but there is not a lot they can do about it as such."

Lenders will be reluctant to remortgage a family home in order for one or both of the owners to set up a business. "If somebody is going from PAYE to self-employed and they intend to remortgage or refinance, they should do it before they become self-employed," said Ian Thornton, a director of First Ireland, an authorised adviser.

Indirectly financing a business through moving personal-loan and credit-card debt temporarily onto a mortgage can be a sensible move. "That means you will be paying only 3% interest, which will obviously reduce your outgoings in the short term," said Thornton. "When you get your feet on the ground, you can increase the mortgage payments. Alternatively, you can maintain your home mortgage over 20 years but add any term loans that you may have onto it. These do not have to be for the full term but can be for a shorter period at the same rate."

Insurance and pensions

Most group pension schemes have a continuation option, meaning that PAYE workers who switch to being self-employed can transfer their death-in-service and disability benefits to their own name within a month of leaving a company, without having to fill out a medical questionnaire, says Thornton.

Serious illness is one of the biggest challenges an entrepreneur can face and it pays to insure against it, particularly given that those going from full-time to self-employment change from PRSI Class A to Class F, which means they will get no state disability benefits if they fall ill.

Taking out permanent health insurance is one way of protecting income but the premiums could be an unnecessary expense. "Some people who become self-employed pay themselves very little. The problem with PHI is that it pays out 75% of declared earnings over the last year, so in some instances that might not be much," said Thornton.

"Likewise, personal accident benefit will only pay you half your salary and critical illness just provides a lump sum if you get diagnosed with a serious illness but that might not be enough to keep the business going."

New business owners need to decide if they can afford to contribute to a pension in the short term. "Putting a couple of hundred euros a month into a pension does not deliver an immediate benefit and it is taking cash out of the business," said O'Kane. "Think about a pension holiday but put a limit of six months or a year on it as you can make that up later. Anyone in pensions will tell you that losing five years of contributions and accumulation really costs you big time."

Those who were part of a pension scheme need to decide where to move their pension fund. "Where you are going to move your fund will depend on whether you set up as sole trader or a limited company," said Thornton. "Sole traders can move their fund to a PRSA only, which has a maximum contribution of 30% of salary. Company directors can have one-person pension schemes and the company can, on their behalf, put a vast amount of money into that pension, much more than 30%."

Funding initial costs

The next step is to work out your start-up costs. "You need enough money to cover premises, machinery, office equipment, furniture, stationery and the initial marketing spend," said De, who suggests researching virtual offices, working from home and using temporary, contract or "virtual staff" to keep costs low in the early days. Virtual staff work from home to provide office assistance. Find help on Avaireland.com.

Don't forget an emergency fund too; this could help the fledgling enterprise squeak by some tough times.

"Don't buy anything or spend any money unless you have to," said Fahey. "Borrow or beg what you can and don't be shy about asking. How do students survive in university? They eat someone else's sandwich. There is an awful lot of goodwill towards start-ups and people are positively disposed to

helping.”

Some money will have to be spent, however, and the experts say entrepreneurs should use their own or family funds as much as possible. Existing business contacts may also be happy to advance a small loan or investment. Serious investors and the banks will not entertain any inquiries without a detailed business plan.

“You will find it next to impossible to raise money without a business plan,” said De. “Investors and lenders will be faced with many alternative investments and will be unwilling to take unnecessary risks.”

De says one of the best ways to keep tabs on costs and gain access to financing is to find a good accountant. “Hire a qualified accountant who is an expert in supporting people in your industry and size of business. They are invaluable in terms of helping you understand what tax breaks you will qualify for and have smart ideas on how to approach your bank or lender for finance.”

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