

SMALL BUSINESS; When the Boss Is Last in Line for a Paycheck

By EVE TAHMINCIOGLU Published: March 22, 2007

It's been a long time since Michelle Madhok has received a weekly paycheck. In 2004, when she started [SheFinds.com](#), an online shopping publication, she thought she could pay herself a regular salary. But she quickly realized that was not how it worked when you become an entrepreneur.

Ms. Madhok, who is based in New York, had to put in about \$20,000 of her savings, including stock and severance she received from AOL, to finance her venture. And all the money SheFinds generated, which wasn't a lot during those first few months, had to be pumped back into the business, so that meant she had to live on whatever savings she had left.

It took about six months for the business to begin generating income and she was able to pay herself back the \$20,000. In 2005, the company took in \$300,000 in revenue and today Ms. Madhok pays herself about \$10,000 once a quarter, but that's dependent on how the company is doing, she added.

"If I was still a corporate gal I'd be making more than \$150,000 a year in stock and bonus," Ms. Madhok said. "But I really don't feel deprived. This business is my passion."

One of the most difficult questions for entrepreneurs when they take the plunge into their own business is what to pay themselves when they start out, if they pay themselves at all.

Gone are the boom-boom days of the late 1990s and early 2000s when newly minted small-business owners found themselves with hefty paychecks and carte blanche from investors, said Robert Chelle, director for the Crotty Center for Entrepreneurial Leadership at the University of Dayton.

"During the dot-com craze when there was all kinds of money and not a lot of value creation, it was easier to overpay yourself," Mr. Chelle said. "Now, with a more constrained economy, there's a notion we have to prove ourselves before we start to overpay ourselves." Indeed, Mr. Chelle added, people who start small businesses should not expect any money that first year. "So many things could go wrong and capital is dearly critical in the start-up phase," he explained.

Still, it is not all doom and gloom. If a business generates money right out of the gate, or the owner is able to secure venture capital, some specialists say there is nothing wrong with an owner taking a paycheck. But there are limits.

Dennis Miller, general partner of Spark Capital, a Boston-based venture capital firm that focuses on new media and technology, says early-stage business owners can expect to make \$150,000 to \$200,000 during their first year. But he stressed that the salary is predicated on many factors, including the type of product or service the business provides and the past success of the entrepreneur.

E-MAIL

PRINT

PERMISSIONS

SAVE

ARTICLE TOOLS
SPONSORED BY

Coming
On May 2



Because the majority of start-ups do not obtain venture capital to bankroll their businesses, most small-business owners should expect way less when they open their doors, explained Andrew Corbett, professor of entrepreneurship and strategic management at the Lally School of Management and Technology at Rensselaer Polytechnic Institute in Troy, N.Y.

If the business has started to generate some income, the best way to calculate what to pay the owner, Mr. Corbett advised, is to figure out what the job is worth on the open market.

"You want to be true to yourself and to the firm so you don't want to overpay yourself and you don't want to shortchange yourself," he added.

That means looking at what you do day to day and putting your job in one or several categories, for example, sales executive, product developer or general manager. "Calculate how much time you're working and how much time is spent on each role. Your salary should reflect the work you do." Ask what it would cost to hire someone else outside of the business to fill that role, he suggested.

The formula he offered includes paying the owner a 30 percent premium over what the open market would pay to cover health benefits and another 20 percent to 30 percent more for the risk. So if a manager or product developer with comparable skills is making \$100,000 a year in salary, and that's mainly what the entrepreneur will be doing, she can expect to pay herself \$150,000 to \$160,000 a year, Mr. Corbett suggested.

If the entrepreneur errs on the side of taking too much money out, it may end up rattling investors or vendors, said Jerry Mills, founder of **B2B CFO**, a company in Phoenix that provides small and medium-size businesses with chief financial officer services.

Investors and banks, he explained, want to see a certain amount of equity in a company before they take a chance on giving a business owner money. And vendors who give a line of credit or merchandise may also worry about the owner's ability to keep up with bills if a chunk of the firm's capital is drained for salary.

In the last five years, he said, he has seen a significant change in vendors' attitudes. Some are asking to see company financial statements quarterly and many are paying more attention to how much cash is in the coffers.

Mr. Mills said one of his retail clients, for example, started taking too much money out of his business and ended up upsetting a vendor. The vendor, who was giving him \$1 million worth of appliances and was expecting to be paid back within a certain time, asked for a quarterly financial statement and found that the owner's salary had jumped to \$300,000 from \$200,000 in one year. The vendor called the loan and the business owner ended up filing for bankruptcy, he said.

Brian Goss, founder and chief executive of Onsite Videos, a company in Boston that offers a service allowing companies to put a moving image of a person on Web sites, knew he and his partner, Dmitriy Peregudov, would have to bypass a salary for a few months when they started their venture in April 2006.

The goal was to start paying themselves by last summer, especially with Mr. Goss planning a wedding and Mr. Peregudov paying a mortgage.

But the company wasn't generating enough sales so the partners decided to bring in an investor that summer who bought less than 10 percent of the company but gave them enough money to begin paying themselves late last year.

"We got to the point where we needed at least some sort of paycheck," he explained. The company made \$100,000 in sales in 2006 and he expects to bring in over \$2.5 million

this year.

Mr. Goss and Mr. Peregudov now pay themselves \$1,000 to \$5,000 a month each, depending on cash flow, and plan to focus on keeping as much money as possible in the business. "We'll never increase our salary, just increase our bonuses," Mr. Goss said.