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Four Things Every Smart Startup Should Do as It Scales

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Your startup began as “four smart people with laptops and a vision.” Fast-forward a few years and it’s a bona fide business with investors, employees, and a snappy logo. Stay on this path, and signs are good that you’ll continue to grow.

It’s easy and convenient to keep doing what you’ve been doing as you scale. But as your startup matures, you’ll need to increase its level of professionalism. There are two vital reasons to do this: First, you’ll neatly sidestep business-busting distractions like IRS audits, employee unrest, and tax-time nightmares. And second, you’ll lay the critical groundwork for your company’s culture.

You’ve undoubtedly heard horror stories about startup and corporate culture going wildly wrong. Too many businesses have tolerated and even encouraged environments that were toxic for some employees, who flee and file harassment or discrimination lawsuits. Other businesses have confronted financial irregularities that trigger regulators’ scrutiny and even criminal charges.

You may protest that your startup will never face those issues. I hope you’re right. Remember that founders who neglect or ignore the unsexy back-of-house concerns like HR, accounting, and payroll set themselves up for trouble.

If you can put a check by each of the four areas below, you can move on to far sexier matters like innovation, funding rounds, and market dominance:

1. We have a hiring process. When you’re ready to make a job offer, you present your top candidate with a lawyer-approved offer letter that includes her role, pay, and equity compensation. The offer letter must make clear that the employment is at-will, meaning the company or the candidate can terminate the candidate’s employment for any reason or no reason, with or without cause. The candidate will receive and must sign an invention and non-disclosure agreement and a non-solicitation agreement (or in states where it is legal, a non-competition and non-solicitation agreement) before she can start work.

When an employee is fired or leaves, you have a checklist of procedures to follow. These include deactivating her badge and email account, repossessing her company-issued laptop, issuing her final paycheck and accrued vacation pay, and scheduling an exit interview.

2. We have workplace rules and follow the law. A new law in California requires companies with five or more employees to provide sexual harassment prevention training every other year starting Jan. 1, 2020. I wouldn’t expect founders to know that. (And it’s so new that many businesses probably aren’t yet aware of it, either.)

But I would expect founders to realize they know little about employment law and therefore need guidance from someone who does. Before scaling, founders should either contract with an HR consultant or hire a “chief people officer” who will fill the traditional HR role.

Your HR person or consultant can handle anything from vacation requests to complaints to, yes, sexual harassment prevention training, so your team can focus on their work.

3. We outsource payroll to a pro. One of the fastest ways to exasperate and enrage your employees is to mess with their paychecks. So don’t do it. Ever. Contract with a payroll processing company that has a track record of making sure employees are paid on time, every time, and can calculate, withhold, and pay the appropriate state and federal taxes.

Accurate bookkeeping and tax records become increasingly important as your company scales and adds employees beyond your home state. Line up help early on and take questions to your accounting team rather than struggling through on your own. Tax is one area you need to get right.

4. We grant options at fair market value. Founders wear many hats, but “professional appraiser” isn’t one of them. Spend the money to hire a third-party appraiser to prepare your company’s 409A valuation, which sets the fair market value of common stock you grant to employees.

Founders and employees love stock options. Option grants incentivize early employees when you’re strapped for cash and encourage recipients to work hard and stick around for the long haul.

Tax law requires that options be granted at fair market value and allows companies to do this themselves, but why play with fire? The penalty for screwing it up is too significant. Get it wrong and your company may face a costly and distracting IRS audit, and your employees may have to pay sizeable taxes and penalties.

Ideally, your startup would obtain its first 409A valuation when issuing its first batch of stock options. A fresh valuation should follow every 12 months (or earlier if something material happens before then), until you go public or get acquired.

I often hear VCs say that they’d rather invest in a B-grade technology with a grade-A team than an A-level technology with a B-level team. That makes sense to me. So much of a startup’s success is tied to its leadership. Great leaders make thoughtful decisions that take into account long-range plans and possible consequences. Put yourself in their company by doing things right, right from the start.

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