



Social Media Law Update

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[Starting Up the Start-Up: When is the Right Time to Incorporate?](#)

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Many social media and social gaming companies have launched products and achieved remarkable viral growth on a relative shoe string, in the process setting a new standard for efficient utilization of capital and human resources. I am frequently approached by new entrepreneurs who are about to launch social media or social gaming ventures and asked to incorporate their startups. In keeping with the mantra of efficiency and economy, I always like to take a step back and ensure that the time is in fact right to begin the incorporation formalities. It is possible to go through the incorporation process too early. It is also possible to be too late. Let's take a quick look at some possible consequences of each mistake:

Downside of incorporating too early:

- Expenses are incurred before they are strictly necessary. Also, if the venture does not have a name yet, further costs will be incurred by starting with a placeholder name that would later need to be changed by amending the company's charter documents.
- Stock may be issued before the founding team has gelled or been finalized, and if one or more "founders" drop out, then it may be difficult to get their stock back, particularly if stock was issued outright and not subject to vesting. On the other hand, if the company has been incorporated but the founders' stock has not been issued, then the founders risk not getting the benefit of limited liability, which is generally one of the reasons to do business in the corporate form.
- Incorporating a company triggers annual corporate and tax filing obligations. Many planned ventures do not make it past the market research or early development stages. If the founders decide to terminate their efforts, but have already incorporated the company, then further expenses will be incurred if statutory obligations are to be followed to properly wind down and dissolve the company.

Downside of incorporating too late:

- In a situation with multiple would be founders, putting off the incorporation and founders' stock issuances can lead to acrimony if there is not absolute clarity among the team as to the venture's initial equity split.
- If multiple founders contribute to the venture's intellectual property (IP) assets, it can be convenient to have an entity to "collect" the IP as it is developed. If this is not done and one of these early founders does not continue with the venture, then (in the absence of other contractual arrangements between the founders), the new company arguably would not own or have any right to use that founder's contributions.
- If, prior to incorporation, a product or service is launched or obligations are incurred, the founders could end up with personal liability for claims asserted by customers or service providers.

The decision of when to incorporate should be made in consultation with an attorney, after giving consideration to factors such as the number of founders and other contributors; the current state of the business planning and product development process; and the likelihood of personal liability being incurred by the founders prior to incorporation. If you decide to proceed with incorporation, then be sure to engage a qualified attorney with significant start-up experience. Often, when founders try to handle the incorporation process themselves, using on-line forms, significant errors are made and the protection sought by incorporation is not always achieved. At the end of the day, it can often cost more to hire an attorney to clean up the situation than it would have to get the company properly incorporated and organized in the first place.

This is the first installment of a series of blog posts addressing start-up matters specifically. The second installment will take a look at "Pre-Incorporation Dos and Don'ts".

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