Module 5 - Start-Up Costs

By definition, start-up costs are those incurred by a business prior to opening doors to the public. According to the IRS, "Start-up costs are amounts the business paid or incurred for creating an active trade or business or investigating the creation or acquisition of an active trade or business." (Internal Revenue Service, 2021) In other words, costs to prepare for entry into business are considered start-up costs, but not ongoing costs of doing business. Typically, depreciable assets will not be considered start-up costs since these will be depreciated over a period of time based on their useful life. But qualifying expenses that are typically not depreciable can be lumped together as start-up costs.

For Tax and Income Statement purposes these costs are often capitalized and amortized over an extended period of time, usually 15 years. By capitalized, we mean that these costs are treated as an asset, and 1/15th of the total asset amount is charged against income each year. The asset balance is typically reduced by this same amount until depleted. These costs are handled in this manner so that the expense, which can be significant at times, is not all charged in the first year but instead is spread over a period of time.

When planning a rural grocery store, start-up costs incurred will be dependent on the situation inherited by the owners. Some examples of start-up costs a grocery store may incur would be employee wages during training or store preparation, travel, licenses and permits, advertising, rent, telephone, utilities, and repairs. As you can imagine, these costs can add up, again depending on the situation.

If an existing store is available for purchase, that is the simplest transition, and start-up costs may be minimal. If the new owners are reopening a store that was previously closed, or are leasing or purchasing an empty building, or are building new, start-up costs will increase.

Leasing a building rather than buying will require less cash to start, but the operator does not build equity and only controls the property for the period of the lease. Purchasing a store or building, or building new, will require more up-front cash, but the owner will build equity and will not have to worry about potential lease issues. When purchasing or building new, most business owners will find it advantageous to set up a separate company to own the real estate. The owner of the property then will essentially rent the building from themselves. A qualified attorney and accountant should be involved throughout the process.

If considering building a store, owners will need to determine the cost of doing so. An internet search for current (2023) construction costs returned a range of $200 to $400 per square foot. This is in comparison to a 2018 feasibility study from Autaugaville, Alabama (referenced below) where construction costs came in at $132.01 per square foot. (Southeast Research, 2018) The more current numbers reflect the price increases we have seen in recent years, and the wide range of costs are at least partially due to regional differences. Potential owners will need to research current costs in their own area prior to beginning construction.

Fixtures, equipment, and refrigeration are also integral when planning a grocery store and analyzing costs. While these are not "start-up costs" as defined by the IRS, they are necessary expenditures that must occur prior to opening of the store. Customer desires, store layout decisions, and current technologies will all impact the decisions around these items. We include more detailed information on store layout in the section entitled Departments and Layout.

Overall sales volume and the inventory needed to support that volume will dictate space needs and equipment capacities. To reduce the initial cash outlay some companies will lease equipment when possible. In addition, in many instances it is possible to buy used fixtures, equipment, and refrigeration. There are numerous internet auction sites that specifically sell these items used. The used fixtures, equipment, and refrigeration can often be purchased at substantial cost savings, even after factoring in delivery charges. One thing to consider however is that in most cases used equipment will not be warrantied.

The cost of real estate, construction, fixtures, equipment, and refrigeration can all vary considerably based on size, features, and geographic location. It is therefore not possible to reasonably estimate costs for specific locations around the country. The list below includes many of the items to be considered when opening a new rural store. Owners should estimate costs associated with these and other start-up costs as they calculate initial working capital needs.

- Land Acquisition
- Construction Costs
- Parking Lot
- Heating/Cooling System
- Equipment and Refrigeration
    - Shelving, displays, pallet jack(s), shopping carts, scales, etc.
    - Walk-in coolers, freezers, display coolers
- Lighting/signage
- Point-of-sale system
- Office FF&E
- Security System
- Initial Inventory
- Phone/computer system
- Licenses, Permits
- Insurance
- Website/Social Media Setup
- Professional Fees (Accountant, Attorney, etc.)
- Packaging Supplies
- Upfront cash – to pay salaries/vendors until revenue generation is sufficient

The categories above consider the construction of a new building. If one is buying an existing building, or leasing a building from a separate entity, certain of these costs would be reduced or eliminated. Beyond that, this listing should prove helpful in laying out the expense associated with preparing to open a rural grocery store.

References

Internal Revenue Service. (2021, November 9). *Here's how businesses can deduct startup costs from their federal taxes*. Retrieved from IRS: https://www.irs.gov/newsroom/heres-how-businesses-can-deduct-startup-costs-from-their-federal-taxes

Southeast Research. (2018). *Feasibility Study and Business Plan for a Grocery Store in Autaugaville, Alabama.* Retrieved from Central Alabama Regional Planning and Development Commission: https://carpdc.com/wp-content/uploads/2019/08/Grocery-Store-Feasibility-Study-Finall-7-24-2018.pdf