ENTREPRENEURSHIP AND SMALL BUSINESS MANAGEMENT COLLECTION
Scott Shane, *Editor*

Starting Your Business

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To Shanth, Yash, and Anand
Find your own special star and reach for it. Follow your hearts and true passions.

To My Fellow Entrepreneurs:
"Do not go where the path may lead, go instead where there is no path and leave a trail."
—Ralph Waldo Emerson

Abstract

In the hard-fought business world, only one new business in 20 lives to see its fifth anniversary. Typical management books do not address the unique nuances of early stage companies. Most entrepreneurial books often profile successful entrepreneurs or companies who are better known, which usually includes only the small percentage that achieve stratospheric success. *Starting Your Own Business* shares the secrets of long-term survival and success, detailing practical guidelines, and relevant "Tales From the Trenches" to help entrepreneurs tackle common concerns and obstacles. A welcome combination of first-person how-to advice and peer mentoring support, this comprehensive, essential resource book provides sound, battle-proven advice for determining early structural decisions, uncovering innovative funding resources, and developing a business plan and budget. This resource is designed to work as an independent resource or integrate into business curriculums.

Keywords

Entrepreneurship, starting a business, raising venture capital, funding a business

Contents

Acknowledgments

Books like *Starting Your Business* come from years of collective experiences and discussions. There are many, many people whose wise counsel and insight I have benefited from and who have directly and indirectly contributed to this book. I am grateful to all of these people who have through the years touched my life and my businesses.

I also want to express my sincere gratitude to the people who worked for, with, advised, or invested in my companies. The concept for this book came as I navigated entrepreneurial opportunities, bumps, and challenges. Over the years, many of you also experienced the same entrepreneurial cycles with me and generously shared your insight, wisdom, enthusiasm, professionalism, and above all, friendship. Thank you.

This book would not have emerged in its current form if it weren't for the inspiration and input of some wonderful fellow entrepreneurs and friends. Their stories bring to life much of the lessons of *Starting Your Business* and follow in the pages hereafter. All of their personal experiences, attitudes, passions, and enthusiasm highlight what attracts so many to the intriguing world of entrepreneurship. All of you have been instrumental as I navigated the gray, fuzzy space between professional and personal worlds that each of us must come to terms with at various junctures in our lives.

To my wonderful boys, Shanth, Yash, and Anand, thank you for your patience in letting me spend the weekends needed to finish this book. Your contagious giggles, hugs, and antics provided inspiration and clarity at just the right times. To my parents, a most heartfelt thank you for always being there when it was needed most and embodying the lifelong values of hard work, passion, kindness, integrity, discipline, and generosity of heart and spirit. For many decades, you have both lived exemplary lives and you continue to do so.

Author's Note

There are a lot of experiences, stories, facts, and opinions in this book. I'd like to clearly state that the opinions in this book, if not directly attributed to a fellow entrepreneur, are mine or as a direct result of research I've conducted. I bear full responsibility for any inaccuracies and/or omissions of all that follows in the pages ahead.

I hope that this book provides you with insight and essential information on your own entrepreneurial journey. I'd love to hear from fellow entrepreneurs and those who work in the worlds of entrepreneurship, including employees, VCs, investors, advisors, and customers. If you'd like to submit a potential "Tales From the Trenches" for the next edition or just have an interesting or really great personal story, please send it to me at spdunung@msn.com. Please note that while I can't acknowledge receipt for all stories, no experiences will be used without the sender's final permission.

Thank you for making this book part of your entrepreneurial journey! I hope it provides you with the necessary insight as you commence or continue to navigate the entrepreneurial peaks, valleys, and bumps.

Introduction

Like many entrepreneurs, when I started my first company, I didn't know any other entrepreneurs. My frame of reference was the corporate world, in which I had cut my professional teeth, so to speak. As I progressed, I found myself facing all sorts of opportunities and challenges that I would have been able to navigate much more smoothly had I had the knowledge I do now. It was not until I was well into operating my second company before I began to meet fellow entrepreneurs whose companies were at similar stages of growth. Once we began to share experiences, I realized that I was not alone and that my experiences were not unique.

One of the most difficult challenges entrepreneurs encounter is the feeling of aloneness when facing all the business issues of starting, growing, and running their own company. The reality is that while many of the challenges that entrepreneurs face are unique to entrepreneurship, individual entrepreneurs are certainly not alone. Many entrepreneurs feel as though no one else has made a certain mistake or faced a particular challenge, when in truth, many have.

After many coffees and cocktails with fellow entrepreneurs, I realized that there were no sources any of us could turn to to read about "real-life" experiences. All the books on entrepreneurship were written by journalists or consultants and lacked a real understanding of what it was like to be "in the trenches."

Also, most entrepreneurial books profile only enormously successful entrepreneurs or companies, thereby bypassing much of the common entrepreneurial experiences. Not every company can be a Dell or Microsoft, yet thousands of entrepreneurs happily achieve a high level of success far beyond the sole proprietorship stage. My focus is on the millions of entrepreneurs looking to find success in this range.

As entertaining and inspiring as the rags-to-riches stories may be, it is important to focus on the opportunities, challenges, mistakes, and bumps in the road. It's important to know what the start-up and early years of highly successful companies were really like on a day-to-day basis. There's a prevalence of PR-generated images of young entrepreneurs in garages or dorm rooms, which then fast-forward to a very successful post-initial public offering (IPO) world. The decade or more in between is a vague blur and rarely referenced, yet every company and entrepreneur faces many of the same challenges during those growth years. Even the most successful entrepreneur experiences bumps in the road, and may need to fold several companies before finding the right "recipe" for success.

Further, the reality is that most entrepreneurs have no guarantee of success. Clearly, you feel optimistic about your possibilities or you wouldn't be engaged in your current project. However, you can't know for sure. You just believe and hope that you're right. Michael Dell and Bill Gates didn't wake up one morning in their early years and know for sure that they would create multibillion dollar companies within one or two decades. Few focus on the fact that it's passion, not a clairvoyant guarantee of success, that fuels the entrepreneur on a daily basis.

This is the handbook I wish I'd had when I began my first business. In it, I've tried to incorporate all the knowledge I gleaned from having had several businesses. Often, the most frustrating quandary for entrepreneurs, and for people in general, is that they don't know what questions to ask early on, because they don't know what they don't know.

In this book, I've tried to highlight the range of key issues that you need to consider every step of the way. Of course, we have all had a little entrepreneurial optimistic arrogance at one point or another and thought we could handle everything just fine. As we get more seasoned, we realize that while that may be true in some situations, it would be much less stressful to be able to anticipate and be prepared for opportunities, challenges, and bumps in the road.

Entrepreneurship is a spiritual journey where you learn as much about yourself as you do about your business, products, and customers. What I hope will make this book useful is that it provides relevant facts while nourishing the entrepreneur's spiritual journey.

Those who think entrepreneurship is just hard facts, business, and dollars and cents have probably never met a real entrepreneur. I am not just talking about the human side of a company and the problems it can cause—something all organizations encounter. I am referring to the intense soul-searching an entrepreneur goes through when asking himself or herself a slew of questions every day while encountering opportunities and obstacles. It's about the passion and believing all the way deep into your gut and soul. For that reason, you'll find that I'll talk at times about the things you'll need to reflect on at different stages of the start-up phase.

I was moved to write this book because of my personal experiences. I'm on my third company as a career entrepreneur. Through all three I've made a good number of mistakes and many smart moves, some as a result of careful planning and strategy and others from luck and timing. Entrepreneurship encompasses all of it—the successes, challenges, mistakes, and comebacks. I wanted to write a book for novices as well as for seasoned career entrepreneurs, for companies with revenues of six figures as well as companies of nine figures. I've also written this book for potential entrepreneurs, for people thinking of starting their own companies, to help them understand what they may encounter along the way. I have personally ridden the entrepreneurial roller coaster, and it's a great ride for those who are ready for it.

My entrepreneurial experience started quite early in my life. Even as a child, I was always starting a business of some sort. As I was not content to have just another lemonade stand, my "business" was a successful little Sunday morning camp for neighborhood kids. I charged a mere 50 cents per child for 2 hours—quite a bargain in today's terms—and I soon realized I had much to learn about pricing. It was the first of many ideas, and I gradually learned, as many entrepreneurs do, that it's a long way from a great idea to tangible success.

My first company sort of fell into my lap, which is how many entrepreneurs find their first firm. In my case, my first company was offered to me by a friend who wanted to move to the new Czech Republic and needed to "sell" her business, which was in essence one client. I jumped at the opportunity. I bought the "business" and her fax machine for $500. The client didn't make much money, and sales were very low by my heady expectations. I knew I needed to expand and again, "the entrepreneurial opportunity" found me. It was the early 1990s and Asia was starting to boom. Sensing the opportunity, I expanded into providing companies with cultural training services and products to enter and operate in the Asian market. At the same time, we helped Asian companies learn about and enter the American market.

We grew quickly until the Asian economic crisis of 1997 started to unravel our key overseas partners and our sales plateaued. I then realized, along with some key customers, that taking our training methodology, materials, and know-how to a technology platform would be highly beneficial for them and profitable for us. It was the beginning of the dot-com period, and although we weren't a dot-com, we certainly rode the early wave.

By this point, after a decade plus in the "culture" business, I was deeply passionate about the need for great products to help people of all ages learn about different cultures. I had always wanted to run my own firm, and I wanted to grow one from a unique idea or vision that I knew was germinating deep within. This was an approach that worked well for me. I had discovered a market need, developed ideas, and my life's passion was born.

Despite my enthusiasm and the advantage of external funding, my second company was a bit ahead of its time and fell victim to the post-9/11 economic collapse and a disincentivizing capital structure, which I'll talk more about in Chapter 3. It's taken me until my third company to get the right formula and timing to create a growing and profitable education company. Through it all, my vision has stayed fairly consistent, only evolving with market opportunity and demand. This has enabled me to continue building my knowledge, network, and experience.

Many people are surprised to learn that successful entrepreneurs do not always have a perfect business plan and marketing and sales strategy in place before launching their businesses. In fact, many often deviate so significantly from the original plan that the business is unrecognizable. Instead, what seems to be the mark of a successful entrepreneur is the ability to adeptly navigate the daily, weekly, and monthly bumps, twists, and turns in the life of a young or small company.

We live in a world of instant gratification. People want instant success along with everything else. There are no prepackaged sure paths to successful entrepreneurship. You'll notice from the title that this book does not promise a get-rich-quick scheme. This book is about building growing, sustainable businesses and the experiences that most entrepreneurs go through.

I'll relay one of the more sound pieces of advice I have received—start a business for what you can get out of it this year, not 3 to 5 years down the road—because you're not likely to make it to that future point if you can't take care of today. Pay yourself a salary and strive for profitability.

If you're looking for a how-to book with a step-by-step outline for guaranteed success, don't look here. You won't find that in this book. In fact, you won't find it anywhere, and you should be wary of those who promise such formulaic approaches. There is no guaranteed formula for success. The path to successful entrepreneurship is unique in every circumstance. The product, the market, and the timing are all unique. Something that works in one mix may not work in another. What's similar is the *spirit* that bonds entrepreneurs.

I'm not going to suggest that I have all the answers and have figured out this entrepreneurship thing to a science. What makes a successful entrepreneur is 50% ingenuity, 50% luck and timing, and 100% hard work. If you're quickly doing the math and ready to write to my editors about a typo, it's intentional. Entrepreneurship is not an exact science, it's an art. I've often heard that luck is defined as preparedness meets opportunity.

Launching a successful business requires vision and passion. Some have tried to make it a science, hence the preponderance of venture capital (VC) incubators, which are insulated breeding labs for taking an idea and hiring a management team to take the idea and make it an enduring and growing company. The reality is that these incubators have produced limited success. They're missing the key ingredient, the zealous entrepreneur, who's convinced that his or her idea IS the next best thing to sliced bread and is ready to go for broke—in some cases literally. Cherry picking a bunch of successful professionals and asking them to launch a new venture is like a soda without the fizz. It's missing the key ingredient—the entrepreneur's passion. It's the passion that helps the entrepreneur keep the faith during the start-up phase and the difficult times and eventually successfully navigate the entrepreneurial opportunities and bumps along the way.

When I decided to write this book, I had some initial qualms. To be of value, this book needed to be honest, which meant the necessity of admitting and publicly analyzing both my successes and my failures. The

Japanese have a cultural concept called *honne tatemae*, which means *real* truth as opposed to the "public" truth. I realized that as entrepreneurs we needed a *honne* book; in other words, a real truth book. We want to know what it's really like to experience the stages of starting a young company, from conceptualizing to dealing with venture capitalists to managing early employees and customers.

When I speak on entrepreneurship, I often find that audiences are more interested in the challenges, pitfalls, problems, and failures. The successes are of course very important, but everyone is willing to share those. What's lacking is a candid discussion of entrepreneurship by entrepreneurs. We often learn more about business not through the successes, but through the analysis and soul-searching of failures.

Seasoned entrepreneurs will also find great value in this book. The presented situations and experiences are real and most people can relate to the challenges and opportunities. First time entrepreneurs will certainly find value as well, but the experiences presented in this book will ring a bit truer after you've started down the entrepreneurial road. In this book you'll find real-life experiences from entrepreneurs and myself. These "Tales From the Trenches" help to illustrate a point in the relevant chapter.

I can't, despite my best intentions, reduce entrepreneurship to 10 easy steps as if there were some mechanical formula. Life should be so easy. We'd have a heck of a lot more successful entrepreneurs. This is more about what to look for along the way. No one can predict his or her path with any surety; all you can do is prepare for the range of "wild animals" and "weather conditions." Pursuing entrepreneurship needn't be difficult, but you need to understand that it's also not formulaic. There is no perfect business plan, no perfect amount of start-up funding, no perfect organizational structure, and so on. Rather, it's a combination of what works for you. As you navigate the world of entrepreneurship, this handbook will provide you with a range of options, experiences, and strategies to help you start a very successful company.

CHAPTER 1

Are You Ready for Entrepreneurship?

OK, so you think you want to be an entrepreneur. Up until the 1990s, most people equated the word "entrepreneurship" with people who were risk-takers or nonconformists, usually unable to work in a corporate environment. It was a small segment of the population who were willing to take what most perceive as very high risks.

Most people believe that entrepreneurs are risk-takers. In truth, that is far from the reality. Entrepreneurs are certainly an adventurous group, but most would not describe themselves as aggressive risk-takers. More often they are passionate about an idea and carefully plan how to put it into effect. Most entrepreneurs are more comfortable with managed risk than with dangerous get-rich-quick schemes.

Entrepreneurship came into recent high profile in the 1990s with the dot-com era, which created a whole new breed of wannabe entrepreneurs. Entrepreneurship was in vogue, and everyone wanted to be one. However, initially most of these newcomers were more intrigued by the prospect of instant riches than with creating new products or services or uncovering new ideas and markets. That period shaped the expectations and perceptions of an entire generation of potential entrepreneurs. It also made the world of venture capital more commonplace and accessible. Eventually, as with most business cycles, the Internet bubble burst and the shift reversed and people sought the surety of corporate life again. Nevertheless, the allure of entrepreneurship continues to tempt many people, although often for varying reasons.

Personal Philosophy and Goals

First, What Makes You Tick?

When you start a business or assess how to grow it, you first need to think about your personal priorities and values—these will influence every aspect of your business whether you like it or not. Your business is an extension of you and will need to complement your personal goals and values, not challenge them.

You need to think carefully about what motivates you. What makes you happy and fulfilled? In essence, what makes you get up in the morning? What would you like to be doing in a year? In 5 years? What does a fulfilling day look like?

Having a personal philosophy to guide you is essential. Most of us have core values that have been shaped since childhood. Our values have helped shape our personal philosophy, which may evolve over time as we face opportunities and challenges.

Our personal philosophy helps us, among other things, to determine how we define success. For some it's material gain, for others it's artistic expression, and for others it might mean making a difference. The key is to determine your own unique philosophy. If you try to adopt others' philosophies, you'll find yourself bending whichever way the wind blows. It may sound a bit like a self-help guide, but it should come as no surprise when you look at the range of successful business books that many are looking for the professional spiritual guide. Entrepreneurship is a spiritual journey. Not only is it a path for reaching your vision and potential, but for many people it brings a sense of purpose to their professional existence.

If you're objective and honest with yourself, entrepreneurship can help you better understand your own character, as well as give you greater insight into others' characters and human nature in general. You may find that people relate to you or respond to situations differently than you anticipated. More importantly, you'll likely discover new sides of your own professional personality, for better and worse, more often the former. As you experience the successes and the challenges, you'll hone your skills and goals and find that you're able to attack issues with laser focus.

As you consider becoming an entrepreneur, you'll need to ask yourself a host of questions, starting with the following:

1 Why would you like to have your own business?
2. What resources do you have access to?
3. What personal resources are you willing to commit?
4. What kinds of operating and management experience do you have?
5. Are you a product or service business kind of person?
6. What existing relationships do you have that you can leverage to get customers, capital, advice, and so on?
7. What's your end goal?
8. How do you define success? How do key people in your life define success? If their definition differs from yours, can they accept your definition?

The key is that there are no right or wrong answers to questions like these. Each of us has to choose our own path. Be sure that you understand what motivates you and why you want to pursue entrepreneurship.

Some of you may also be career entrepreneurs, people whose chosen profession is to start new ventures. You may have both successes and nonsuccesses under your belt. Everyone can benefit from refreshers and new insight. That's why I relish the opportunity to meet with fellow entrepreneurs, formally and informally. I challenge you, whether you're a first time or a career entrepreneur, to always keep asking yourself why you're an entrepreneur. Review your personal philosophy and goals every so often. It's OK if they change and evolve, and quite frankly, they should, as we all pass through the various stages of life. The answers are actually less important than the self-discovery process. The process will help keep your personal goals and objectives clear and enable you to make decisions that are consistent with those goals.

Why Do People Want to Become Entrepreneurs?

There's certainly no one-size-fits-all answer to this question. People's motivations range from money to flexibility to vision and all combinations of these.

The Vision Thing

Candidly, most entrepreneurs I know would say that while money certainly motivates them, it's not the primary goal. For most, it's pursuing a vision for a new or better product or service. Many entrepreneurs are competitive, and once they have started on their venture, it's about the win as well. Developing a new way of doing things or a new product and selling it to its fullest potential is what makes the sun rise in their world.

Most people decide to start a business because they have a great idea for a product or service. This is usually the best place to start, as it usually invokes the level of passion needed to sustain you through the ups and downs.

If you think you have a great idea and it has been nagging at you for a while, I urge you to at least go through the planning process exercise of Chapter 2 and put together a plan. Even if you can't commence your venture right away, you'll have the information you need to make an informed decision as to when and how you can start your venture.

In Your Blood

For some people, being an entrepreneur is simply following in the family footsteps. If your family consists of a few entrepreneurs, you may feel inspired early on to follow their lead. Many people join family businesses and find themselves in a position to expand and grow them beyond the original scope and plan.

For many career entrepreneur people, being an entrepreneur is in their blood. I knew since I was very little that I wanted to have my own company, although I had no idea in what industry. As I noted in the introduction, entrepreneurship was in my blood, even though both my parents preferred the professional route of working for a company.

Some entrepreneurs develop their first company and stick with it, whether or not it grows. Others of us are career entrepreneurs who create multiple companies, some successful, some not. Over time, most of us accumulate wealth by either successfully earning money through our companies or through the process of selling them and starting again. It's the thrill of success that motivates. Don't assume that your first company will be your only company. It might be or it might be one of several building blocks toward lifelong success.

Money, Money, Money

A good number of people say that they're most focused on money and making lots of it. That's a fine enough goal and, of course, very important, but having that as your sole goal can get you into trouble. You need to combine it with another personal goal tied to the business. Does having the best product or service in the market jazz you? Most entrepreneurs will tell you that your business needs to stir more in you than just the money passion to be successful.

Having said that, there's probably a good number of successful entrepreneurs for whom money was the sole goal. Just assess how you'll feel if you don't make "enough" money. More importantly, how do you define "enough"? For many people, the definition of "enough" changes over time as they confront other issues like control and fulfillment. I will talk more about that as I discuss lifestyle businesses.

Part of understanding your definition of "enough" is determining how long you will keep going in a venture that's profitable but isn't bringing you oodles and oodles of money. You'll need some other passion to sustain you at that point. In all three of my companies, I loved what I was doing so much that I probably would have done the same thing even if I wasn't paid, and in my second company, there were a few years of that. However, money was always an important driver, and when there wasn't enough of it in terms of my personal definition, I faced the music and moved on.

Making a Difference

Many people decide to pursue their idea or vision on a full-time basis because they want to create something lasting. People grow tired of dead-end jobs and want to make a difference. By that I am not only referring to life-saving products and services but also to those that allow people to enhance their lives in the broadest sense of the word.

Many businesses have a social mission, from beauty product companies that do not test on animals to uniquely inspired childcare facilities. There's even a social venture group (http://www.svn.org) dedicated to facilitating interaction among socially conscious companies, entrepreneurs, and investors.

Be Your Own Boss

Some people just want to work for themselves. That's a good motivation, but again, like money, it won't generate the innovative ideas and creativity required to get a business off the ground. Recognize that success in one industry or function does not ensure that you'll be successful in another. If you want to work for yourself, decide if you only want to deal with yourself or if you want to be the final authority and have people work for you. Buying an existing business or franchise is often a great option for those who are looking to run their own show but aren't sure they have a unique or marketable product or service idea.

Life Transition

Some people choose entrepreneurship to make a change in their lifestyle. This is not necessarily the creation of a lifestyle business, which I'll discuss later. If you're looking to adjust your schedule so you can take care of children or other family members, starting your own business can provide more flexibility than the corporate world, although you may find that you end up working more hours, just not always during the traditional nine-to-five workday.

The reality is that most entrepreneurs are motivated by a combination of priorities. Collectively, these motivations fuel the entrepreneurial passion. Now, some will tell you that businesses should be kept sterile and you shouldn't get too attached to your business so that you'll know when to exit. I disagree. I think the passion is what makes entrepreneurs successful, especially considering that *every* business will experience successes *and* failures and only passion and vision can sustain you through the challenges. Talk to any successful entrepreneur and you'll see their eyes light up at the mention of their product or service. Listen to the passion in their voice. You can better believe that their customers are seeing and hearing that passion too.

I'd like to clarify a point here. Passion and vision should not be confused with blindness. Many early entrepreneurs often don't know when it's time to exit a business or cut their losses. Make sure your passion and vision, as well as internal or external factors like capital structure, don't prevent you from making the right business decisions. I have been one of those entrepreneurs whose capital structure made it difficult to transition a business at the right time, although I eventually did. Those who minimize passion and vision focus on these sorts of issues, but most successful entrepreneurs are able to eventually have both the vision and passion as well as the ability to make the right business decisions at the right time.

Forms of Entrepreneurship

Before we continue to talk about entrepreneurs, let's review commonly accepted perspectives of small businesses, early stage companies, and growth companies. These aren't so much actual definitions as they vary widely from economic to social definitions. The Small Business Administration (SBA) defines small businesses often by the number of employees—for example, less than 500 people. Banks may add a financial definition, including revenues and net worth. The finance world and the government also like to differentiate businesses by revenues. This works for finance-related purposes, but the definition goes much deeper. There's a difference in the way the founder and management perceive the company's resources, options, and outlook. The truth is that there is no clear definition that's accepted by everyone—vendors, suppliers, financiers, and entrepreneurs.

For some, the difference between an early stage or growth company and a small business depends on the stage of the business and perhaps the attitude of the entrepreneur. For this group, a small business is one that's likely to have been around for a number of years and has been at the same size in terms of revenues, numbers of employees, and so on. It's not likely to have steep growth projections. An early stage company is one that is relatively young in terms of the number of years it's been established and operating, usually under 5 years. It often has very strong growth projections. And, perhaps most relevant, its entrepreneur still expects the company to grow aggressively.

The challenge is that the differences in the common perception including government resources such as the SBA make it difficult to lump these into one simple category and efforts to address "small business" needs with one-size fits all program usually falls far short.

Early stage companies are generally considered engines of growth. Some people adhere to the traditional definitions of small, medium, and large enterprises but that doesn't quite work in today's service-oriented economy. Do you differentiate based on sales, market capitalization, number of employees? Compared to other small businesses, at what stage of growth is the company?

Regardless of the type of entrepreneur you choose to be, realize that the entrepreneurial lifestyle is not likely to provide you with a standard nine-to-five professional existence. Most entrepreneurs are constantly and consistently thinking about sales, products ideas, and market opportunities. Random events can trigger thoughts and ideas. This is just part of the entrepreneurial spirit. There are three basic ways to be an entrepreneur: sole proprietorship, lifestyle business, and growth company.

Sole Proprietorship

A sole proprietorship is just what it sounds like. You're running the company on your own and are often the only key employee. Consultants, artists, and others fit this category as they are the company's product or service. This structure works well for people who may want to work from home for family or personal considerations.

Lifestyle Business

This category can be very misleading. Most people are quick to assume that these are very small companies, almost like sole proprietorships, and are not likely to have employees, structures, and so on.

"Lifestyle businesses" really refers to moderate growth, not always the size of the company. The entrepreneur has decided to opt against aggressive expansion or more rapid growth, usually for personal reasons, even if market conditions warrant it. Alternatively, some businesses may not have prospects for rapid growth as a result of a smaller market, even though the venture is profitable.

A lifestyle business can generate annual revenues of $100,000 or $30 million or even more. It's not the size of the company, but the approach of the entrepreneur and owner that distinguishes a lifestyle business. Many entrepreneurs start by assuming they will grow aggressively, but somewhere along the way they realize that reaching a certain revenue level affords them ample financial flexibility to meet their personal goals and objectives. Some may make the decision to accept more moderate growth for control reasons. They decide against expanding because they prefer to own everything and are content to be relatively debt free. Revenues may be $10 million and if they are bringing in $1 to $2 million net to themselves, some may decide that it's the perfect operating level for them. Lifestyle businesses are still very focused on revenues and profitability, but they may not have the same exponential expectations as a fast-growth company.

Whether a lifestyle business is right or wrong for you really depends on your personal philosophy and goals, and how they evolve over time. There are hundreds of thousands of lifestyle businesses in existence, many below our radar as we don't focus on them. Think about successful businesses in your community that may have been founded by their owners 10 or 20 years ago and you're likely to discover a handful of lifestyle businesses.

One colleague represents this market well to me. She started an ad agency in California. In the first 5 years they experienced rapid growth and had two offices in San Francisco and Los Angeles. At that point, she and her husband, who assisted with parts of the business, had achieved their lofty financial goals. They had also started a family. She could have grown through acquisition, which would have required outside capital and investors to deal with, but opted against it. She had several homes, had a private jet to commute between the offices, and was living a very comfortable lifestyle. She enjoyed her clients and her team and could achieve a happy balance between home and work. She opted at that point to grow moderately and pursue her venture as a lifestyle business. Being a $50 million agency was acceptable to her. She was no longer seduced by rapid expansion and all the opportunities and headaches it might bring. She loved getting up every morning and going to work and, even more, she relished the lack of outside investor involvement, which she felt might be a distraction. I'll talk more about investors and control issues in Chapter 3.

In my opinion and observation, lifestyle businesses are an underrated category filled with successful companies run by entrepreneurs fulfilling both their professional and personal goals. It's hard to anticipate what you will want in 3, 5, or 10 years after you start your venture. You need to be open to the options and not create rigid expectations that can't be modified as you progress.

The key is determining how big is big enough. The answer to this question is very personal and individual. You need to be sure that you allow yourself the personal flexibility to change your mind along the way just as the California ad entrepreneur did.

Most of us start our ventures with huge dollar signs in our eyes and, let's face it, it sounds much more ambitious and professional to aim for high financial heights. But along the way, many of us realize that it's much more enjoyable to be able to reap the benefits of your venture and not worry prematurely about control or exit strategies. Most of us just want to keep doing what we do because we love it.

Growth Company

What sets a growth company apart from being a sole proprietor or lifestyle business is severalfold. First is the scope of the product or service. Some businesses just can't grow beyond the original founder and maybe one or two employees. Growth companies, as the category suggests, are poised for significant expansion. Second is the personal philosophy and goals of the entrepreneurs. Third is how the entrepreneur manages the company's financial strategies. I am not just referring to whether or not they raise venture capital or utilize angel investors' money, but at some point you need cash to grow, whether it's to get larger space, hire more employees, or invest in some research and development (R&D) or marketing and advertising. It requires more creative negotiations with customers, suppliers, lenders, and maybe even investors.

Expansion is a key component of growth. It's very challenging to go from being a small concern to a midsize business. Various issues impact every aspect of the business, but the decision to expand or not to expand and the timing for any resulting expansion is critical for an entrepreneur. Becoming a $30 million company over 10 years is moderately paced growth. Achieving sales of $30 million in 3 to 5 years is aggressive growth and not achievable by most companies unless they have a unique product, outside investor support, or both.

Should You Become an Entrepreneur?

Whatever your reasons for becoming an entrepreneur, understand and be clear about your personal motivations. This will help you enormously as you need to make decisions and choices along the way.

As you go through the personal decision-making process, try to talk to as many people as you possibly can. Seek out others who have tried entrepreneurship, both those who have been successful and those who have not. Talk to people in your industry, including colleagues, friends, and potential advisors. You'd be surprised how open people can be about their experiences, good and bad. Of course, read lots of books and get a variety of opinions. You're not trying to get people's "permission" to be an entrepreneur, nor are you looking to give yourself permission. What you should strive for is to understand the factors critical to success and see if you're comfortable with them. There are no right or wrong answers. As I noted earlier, that's one of the reasons I decided to write this book and include "Tales From the Trenches," profiling real entrepreneurial experiences. Only another entrepreneur can tell you what it's like to lie awake at night stressing about whether you'll make payroll that month—we all have. But at the same time, it's the same entrepreneur who can tell you what successful strategy worked to make payroll that month as well as overcome the other challenges that creep up time and time again. It's not the issues that define you as an entrepreneur, but how you respond to those issues.

As you consider entrepreneurship, you need to assess whether it will provide you with the ability to support yourself and your family, both in the beginning and later on, when you eventually achieve your personal financial goals. Are you comfortable with the time it may take to grow and sustain your business? Many people start companies expecting them to grow aggressively in financial terms and then find that they are actually quite content with a profitable lifestyle business that allows them the ability to pursue other personal goals.

Think about what kind of growth you're comfortable with. Do you want a lifestyle business or an aggressive growth business? Both are commendable choices and only you can make that decision.

As you decide to become an entrepreneur, take a look at your professional and personal support systems, particularly the latter. Are they supporting you or thinking you're off your rocker? Even if you are comfortable with the risks, uncertainties, and challenges, a spouse or other key family member may not be. Negative whisperings can cascade into thunder and rock the very confidence that's required for entrepreneurship. Be wary not only of your own demons, but also those of others around you.

Attitude is a key factor. If, deep down, you're happiest as a sole proprietor, but talk about growing a company because it sounds so much better, then guess what? You're likely to stay a sole proprietor and defeat yourself subconsciously. Not only will you not grow your company, but also you'll be unhappy and unfulfilled, even if your company is successful by financial and market definition. Get in touch with what you really want and how you define success. Be comfortable and confident with the answers you arrive at for yourself. Confidence is a key component, as it will draw success to you by way of customers, investors, and supporters.

You also need to assess how you handle stress. How determined are you to succeed? Starting a business isn't always easy and with the wrong support system, you may have more naysayers than coaches around you. Many businesses fold in the second year despite the fact that the next year might have been the turning point. Most entrepreneurs will tell you that they hit a key milestone of sustainability around year 3. If you can make it to that point, you can keep going, barring any unforeseen problems inside or outside the company. For example, you could be doing great and then in year 5 your largest customer stumbles badly, creating a ripple effect in your company. If you've been astute enough to diversify, it should be no problem, but if not, you'll drown, too. Diversification in terms of your customer base is essential.

If you're choosing entrepreneurship as a response to a personal or professional transition, think through your motivations thoroughly. If you're starting a company because you were laid off from your last job, do you see it as a life-turning opportunity or are you treading water until a suitable full-time position becomes available? If a personal situation or crisis is motivating you to consider entrepreneurship as a way to balance your obligations, you may want to focus on being a sole proprietor for a while, as growing a company, of any size, is a very time- and energy-consuming endeavor.

Leaping From the Corporate World

As corporate life continues to offer less and less security and upside, more people are considering entrepreneurship. Some leave, taking their former corporate employer as their first customer. For others, it's an opportunity to enter an entirely new industry. For most of us, we're hoping to capitalize on our experience and know-how or on a new idea or market to fill a gap in our own industry.

Many entrepreneurs have actually discovered their vision and opportunity through a former employer. If you've spent your professional life in the corporate world, recognize that the early year or years of an entrepreneurial venture demand your very hands on involvement. It's not a joke when I say that you should be ready to take out the garbage. Most of us have in the early days.

When you make the leap from corporate life to entrepreneurship, there are clearly some things to keep in mind.

The biggest difference between being inside a large corporation and entrepreneurship is that entrepreneurs don't have a buffer between a mistake and total failure. When a large company makes a bad bet on a product or market, the damage gets absorbed, perhaps with a hit to earnings or the stock price at most. In an early stage or growing company, a bad bet can destroy everything. There are no shock absorbers. This is one reason I don't buy into the concept of "intrapreneurship" that many large companies attempt to create inside their organizations. Sure, these internal groups may spur more innovation, but they're still far from the realities of entrepreneurship. They have far more resources than most new ventures. They are protected from feeling the immediate impact of failures and mistakes and there's no immediate risk of losing a paycheck.

I'll talk much more about planning, budgeting, and funding in later chapters, but it's useful to note that large companies can often get away with making bad bets because the risk is less tangible to the person making the decision. An executive isn't going to lose his or her paycheck because of a bad deal and spending too much is somewhat irrelevant because it isn't the professional's money to start with. The loss isn't personal. I had a controller whose wise response to me on every budget question was "It's your money." The entrepreneur has much more at stake with every step. If you're coming from a large institution, you need to be comfortable with this new reality.

In your own company, especially when it is in the early stages, a bad decision will probably result in a personal loss of money, whether it was paying an employee who didn't deliver or investing in a marketing or technology strategy that derailed. Even if you have outside investors, whom we'll talk more about in Chapter 3, the loss of the company's money directly affects you. For example, you may have to raise more money, thereby diluting your equity stake.

I'm not pointing this out to scare people—just the opposite. Entrepreneurship is one of most rewarding professional courses a person can take. I am not just referring to monetary gain, although that's certainly important for all of us. Entrepreneurship fulfills many of our unspoken dreams to create something lasting and real, to make a difference. Entrepreneurs who leave the corporate world are aware that entrepreneurship can offer an alternative to the corporate feeling that the company is going to keep plodding along no matter who is in each job. Further, entrepreneurship can remove the frustration of unspoken "corporate ceilings" and the difficulties of pursuing new ideas or taking on new challenges and opportunities.

By all means, I encourage all who are dissatisfied with corporate life and are considering entrepreneurship to make the leap. But do so with research, knowledge, and planning. It's essential to manage expectations and be prepared for new worlds.

Partnerships

As you think about what kind of entrepreneur you want to be, you may need to consider whether you want or need partners, either in terms of financing (which we'll talk about in Chapter 3) or strategy.

Family and Friends as Partners and Employees

You may be deciding whether you should be in business with your spouse, sibling, family member, or friend. If you are considering being in business with someone you know, you need to think about your compatibility and how the personal relationship will impact the business and vice versa.

My husband and I ended up working together in my second company, not by design but by circumstance. Because we hadn't anticipated his involvement, we didn't think about critical issues surrounding our working styles until much later, which is common for many entrepreneurs.

The following are some questions to ask yourselves up front. The answers are less relevant than going through the thought process and being comfortable with each of your answers.

1. Do you have similar work ethics? Do you both keep similar hours or does one expect to put in substantially more or less, and is that acceptable to both of you?
2. Do you have similar approaches to quality and vision? Are you both committed in a complementary way to providing things like customer service or quality management?
3. What are your management styles, and are they complementary and suited to your industry? Is one of you a yeller? In some worlds, this is not only acceptable but also required for effective management. In others, it's a huge taboo. Management and communication styles are particularly relevant if you come from varying industries that operate differently. Can that partner from the different industry make the transition?
4. How do you each handle challenges, stresses, and crises? Does one of you avoid challenges in the hopes that they will just go away? What's your mutual commitment level? Does one person expect others to take care of everything?

5. Is your personal relationship compatible with your professional roles? For example, if you are a parent and child, going into business together may mean that the relationship dynamics will continue. Is this suitable for your new venture?

There's no doubt more questions will arise as you begin to think about this. Spend time thinking about how the partnership or working relationship will function. Again, there are no right or wrong answers to the above questions. It's more important to be aware of some of the areas for both compatibility and incompatibility. Ideally, you're complementary in your approaches and if you allocate roles and responsibilities early on, you're likely to go down the road to success. I'll discuss how partnerships impact new and growing ventures in relevant chapters.

As you consider entrepreneurship, don't let a fear of failure intimidate you. Believe in yourself and your idea. Of course, do your research and develop a thorough business plan. Be in touch with your personal philosophy, goals, and expectations. Many entrepreneurs are big on energy and enthusiasm, although not all have credentials in the exact industry they may be considering. Successful entrepreneurs follow a vision and pursue it with enthusiasm—believing in themselves the entire way.

CHAPTER 2

Getting Started

When you decide to pursue your own company, getting started can seem either overwhelming or like an easy-to-manage, linear process depending on your idea, your customer base, and your experience. From choosing a name and determining the right corporate structure to developing detailed business plans, all entrepreneurs have to take certain key steps.

What most entrepreneurs don't realize is that planning is a process, not just a checklist. It's the gradual and sometimes not-so-gradual evolution of your ideas and inspirations. Building a business into a sustainable organization takes time and planning.

As you start your venture, there are a number of issues you'll need to focus on. Planning is a catchall word that really encompasses many components, including the following:

- Choosing a company name
- Developing business plans
- Addressing personal and structural issues
- Managing legal and accounting issues
- Developing marketing and sales plans
- Developing contingency plans

The latter two topics fall under growing your business and are the scope of a related book, *Growing Your Business*. Having said that, you'll probably want to include components of a sales and marketing plan in your first draft, even though you may not be able to attend to them with the level of detail you will eventually give to them once you're up and running.

Choosing a Company Name

One of the first things you'll need to do is think of a name for your company. There are so many varying philosophies on naming companies that it's clear there is no right or wrong. Some people will tell you to make sure your name is clear and customers know what they are getting. Well, thank goodness Jeff Bezos didn't follow that lining of thinking—Amazon turned out to be a great flexible name for a business that continues to evolve. Bezos's focus on finding a name that was at the beginning of the alphabet no longer matters in an Internet environment where listings are now "purchased" and are no longer just based on the alphabet.

Some people actually start the planning process before they finalize a name. Some change the name early in the life of their new venture when they have more information and market input. The name of your company should inspire you. If you like to get right to the point and clarity is very important to you, then make sure your name reflects that. If you prefer a vaguer name because you believe that you too will evolve over time, then go with that. Remember that good marketing can ensure your customers know who you are and what you can do for them. You don't have to rely on a name to communicate your mission to your customers.

Once you pick a name, do conduct a trademark search—you can do it for free yourself at http://www.pto.gov—and also see if the Web site is available. If you intend to get a lot of your business through the Web, you'll want to be sure that the Web site is easy to find and search for—in other words, it contains common search words found through the search engines; otherwise, you'll have to plan to spend both time and money optimizing it. Just remember that the Web is still evolving, and today's marketing and optimization strategies will not always be valid in just 1 year. It can become costly. On other hand, if your Web site simply supports your brick-and-mortar business, people will come directly to your site because other promotions and Web searches may not be as relevant or as critical. The real message here is that marketing strategies can change, but hopefully your very successful venture will be around for a long time—the name should be able to stand the test of time. Any changes in the name will require a budget for branding and marketing.

Do not bother spending any money on extensive market research. Informal research with advisors, potential customers, and colleagues is usually all you need. You can hire someone to design a logo and marketing materials but only after you have the basics of your marketing and sales strategy in place. More likely than not, you'll know your customer and market much better than a design firm.

Planning Process

Whether you're a first-time entrepreneur or a seasoned veteran, planning is something all entrepreneurs do; we just all do it differently. Think of it as a process and not as a checklist. All levels of planning require a sustained effort that evolves over time.

A business plan is an accumulation of the information and decisions made during the planning process, and it helps you articulate how you are going to seize and execute your great idea. There's great value in the exercise of going through the entire planning process and developing a business plan even if you never intend to use it for external purposes like fund-raising. It helps you organize your thoughts and strategies. It's important to include key management members in the planning process if you have them in place, as that will enable them to get a sense of ownership for their functional portion of the plan, budget, and areas of execution.

The process can help the entrepreneurial team ask key questions and challenge assumptions. It can help you identify potential risks and obstacles, many of which can be managed and overcome with advance planning. A plan is also a formal document that can be used to establish accounts and credit lines with your bank as well as pursue investment options. It also provides a mechanism for you to monitor your progress and make modifications as needed.

Having said that, many great businesses were started by people who took a seat-of-their-pants approach. People like this will tell you that there was no formal plan at the start-up stage, although many probably created a plan later in the process. In most cases, however, the entrepreneurs were actively engaged in a planning process, even if a formal written plan was not prepared during the beginning stages.

People make many arguments against planning. It's out of date so quickly. You can't predict everything. It's time consuming. It's tedious.

The truth is that planning is something all entrepreneurs do—it's the level of the plan's formality that differs. A business plan is a written tool that helps increase the odds for success.

Developing a Business Plan

Let me start by clearly stating that I am not going to give you an overly theoretical overview of planning in this chapter. Rather, I have found it more useful to understand how different entrepreneurs have utilized the planning process. It's possible both to plan too much and to plan too little. The correct amount of planning really depends on your business and industry. Even the best business plan is not a guarantor of success. You need to pursue a combination of planning and actually operating in your market to guide your new venture to success.

Most successful entrepreneurs will tell you that they had distinct plans in their head, and many actually put those to paper. They may have not had a full plan before start-up, but somewhere in the early years they spent extensive time thinking about their goals and their time frame, which is in essence what useful planning is. Each business is likely to require a different level of planning. I have prepared business plans for all three of my companies, although the degree of polish and depth differed. You'll find that you'll need to modify your plan regularly as well to incorporate new information. A plan can actually be most helpful a year into your venture when you have tangible results and customer experiences.

The planning process really helps you avoid "talking to yourself" and hearing only what you want to hear. As you progress, you should share your plan with trusted and knowledgeable advisors and colleagues to get their input and suggestions. Advisors can help point out flaws in your logic, hopefully before it's too late. If you're using your plan for fund-raising, have your lawyer review the plan to be sure that the representations are appropriate and that there are no misleading statements.

There's usually a section in plans intended for prospective external investors that highlights the risk factors. To make your plan useful, you need to be honest with yourself at each stage of plan development in terms of what the risks and problems might be. Every business has some risks, although their severity differs significantly.

It's always helpful to find a successful entrepreneur to review your plan as well. He or she is more likely to identify operating challenges. A trusted industry expert can help review the marketing plan components. Don't hire a general reviewer or writer, unless he or she is functioning as a business consultant or investment banker in a broader capacity. A general reviewer or writer is likely to be a waste of your resources, as he or she is unlikely to know your business well enough.

You may not need a formal, colorful, and glossy plan, unless you expect to raise outside venture or strategic capital or to bring some angels on board. The most elaborate plans and budgets will not guarantee business success. As an entrepreneur, I know that it's what's in the plan that matters to you, not how good it looks. However, for the investment community, looks do matter, and a professional, glossy presentation will get you noticed faster, although substance will count far more after the initial glance.

If you're looking to raise capital, your plan will need to convince investors that you have a high-growth and leverageable opportunity, that you and your management team have identified a viable and realistic plan for success, and that you and your team are the right ones to execute the plan.

Going through the research, planning process, and actual writing of the plan can be incredibly time consuming, taking even 100 to 200 or more hours over several months. As a result, some people consider hiring an outside consultant. Think and plan carefully before taking this step.

Going through the planning process allows you to carefully think through each aspect of your business. You need to intimately understand your market, customer, and opportunity. "Outsourcing" that planning work ensures that you miss critical information at key junctures. You may find that research challenges your original assumptions about your market, customers, or pricing model and presents you with different and better options. If you haven't done the research yourself, you may be wary of "trusting" any new strategies as a result of the information.

However, many entrepreneurs don't have the skills or experience to create a thorough business plan and financial projections. Most people actually lack the background to do the latter with enough understanding of how to build credible financial projections. Many entrepreneurs fail because they haven't focused enough on where the revenues will actually come from and when. Entrepreneurs often underestimate the costs required to get to certain revenue levels.

If you really need help, consider having an outside consultant prepare select sections of the business plan. Do not think that you can simply assign the full plan preparation to someone else and wait for that person to produce a useful business plan. You must be involved in the logic and reasoning. You still need to drive the research and talk to potential customers directly. If you are going to raise investment capital, a consultant or investment banker can enhance your draft, but you should prepare the first one. Determine where your strengths are and look for a consultant to supplement your weak areas. If, like most entrepreneurs, you need more help on the actual financial projections and assumptions, then look for a consultant who truly understands the numbers side of young ventures. Nevertheless, be sure you understand how the projections are developed and all the logic and assumptions that are used to create them. After all, in a presentation or meeting, you'll be the one most likely "defending" your numbers, and you need to truly understand the building blocks of your business.

The best way to find qualified business consultants is to ask other entrepreneurs. Use referrals and ask to see what the consultant did and how he or she assisted with the company's planning process. You want someone who works alongside you and your team and strives to truly understand your market, your company, and its unique opportunity. Ideally, the consultant should have seasoned experience as an entrepreneur or with running a company as well as some industry experience.

A key part of the planning process is information gathering. Get out and talk to your likely customers and potential suppliers, as well as to other entrepreneurs and industry experts.

During the planning process, you'll need to consider a number of things, which at the macro level might include determining the best structure for your company (taking industry norms and personal preference into consideration), defining your market and customers, and determining the kind of staff you'll need and at which points.

Planning can seem somewhat insular as you try to anticipate everything, even with the best of contingency plans. For example, thousands of young and small businesses, as well as companies of all sizes, were deeply impacted by the 9/11 tragedy. Prior to 2001, it's unlikely that anyone could have anticipated or planned for such an event. Now, many of us think about how our businesses would be impacted in such a national tragedy, whether in terms of our employees' well-being, our customers and sales, or our backup systems. We also spend time thinking about how our customers might be impacted in various scenarios. As we'll cover later, diversifying your customer base as early as possible is essential for long-term survival.

Your projections about marketing and sales should try to account for fluctuations in the general economy. How is your product or service impacted during recessions?

For companies at all different stages, business plans provide the broadest and most encompassing overview and roadmap. Business plans include sections on marketing and sales, but many companies also have a separate and more detailed marketing plan. Contingency plans allow you to anticipate some of the obstacles and your reaction.

When you begin to put together a plan, know who your audience will be. Will you be using your plan primarily for yourself and for key employees or for external audiences, such as lenders and investors?

Initially, don't worry about how well your plan reads in terms of writing. You're not after a literary award; you're seeking to organize your goals and vision. Many people write a plan for outsiders only. While it's certainly likely that you may need to present your plan to a banker or to the investment community, you won't get much out of the exercise of developing a plan unless you write it primarily for yourself. These days, business plans often sound like they were written from the same "business plan factory." Forget about complex sentences, impressive words, or extravagant financials. Write to organize your vision and to create a tangible and realistic road map for yourself. Perhaps the most useful outcome of the planning process is the break-even set of projections and the milestones that need to be reached to get there.

Also, don't worry about writing too much. It's better to err on the side of including too much information in your draft, as this often helps you see your own logic and reasoning. You can always have a colleague or business copy editor edit your draft into a size and shape appropriate for external audiences.

A good plan is to create a document that you will refer to over the course of the year. You should expect to refresh it, update it, and revise it based on results and new information. If it simply sits on your shelf gathering dust, it was a wasted exercise.

There are some very good industry resources already available on the technical aspects of writing good business plans, so I am not going to go through a detailed analysis of this exercise. Instead, I'll offer practical suggestions and advice to evaluate what kind of plan you need and the level of depth it should have based on the type of funding and involvement you anticipate.

As you develop your plan, you're likely to have gaps in information, which is perfectly fine, but be sure to take note of the areas you would like to research more thoroughly in the future. For example, you may believe that there are global markets for your product or service, but in the beginning you lack the resources to assess and enter these markets. Your plan may simply state which countries you believe to be possible markets and then target a date when additional research will be conducted on these markets. You may even need to plan a budget to conduct that research, whether it's to travel or to hire a market consultant.

When you develop your plan, realize that it's the marketing and sales that are really critical. Most of us get enamored with our product and service and focus on them heavily. While understanding your product is essential, it's your unique selling proposition with regards to the product or service that's going to ensure you revenues, profitability, and viability.

Core Components of a Good Plan

So what really makes a good plan? There are of course standard ways of evaluating plans, but it's really the planning process that is most invaluable to the entrepreneur. The planning process allows you to test your assumptions about the business, industry, and market as well as the possible profitability scenarios. Most plans have the following sections.

Executive Summary

Executive summaries are really not intended for internal purposes, although you should be able to communicate the mission and purpose of your company in a few simple sentences.

In most cases, an executive summary is between one and three pages long and summarizes all the key areas below. Companies that offer highly technical or complex products and services may find it difficult to keep their executive summaries brief. The goal of an executive summary is to hook your reader, who in many cases is a potential investor. In your first paragraph, you should highlight the possible size of your market, especially if it is significant. A multibillion market will always catch a venture capitalist's (VC) eye, but your claim must be substantiated using the real data and research. Seasoned investors will quickly and easily challenge you if your facts and data are not in order.

A good executive summary is also a great way to hone your "elevator pitch"—that is, a convincing summary of your plan and opportunity that could be given in the 1 or 2 minutes it takes to ride an elevator. Even if you're not pursuing the investment community, it's an effective way to communicate your company's mission and focus to bankers, suppliers, and others.

Company and Product or Service Description

What are you selling? Describe your product. You don't need to have pages of technical detail, but clearly outline your product's or service's features and benefits. Use this section to highlight how your product or service will meet a critical market opportunity. Use photos or other visual representations if you can.

Indicate if your product has a unique methodology or patentable technology or architecture. You should not disclose any sensitive information in this section. Business plans are usually submitted to investors before a presentation. If an investor continues to express interest, you can provide confidential information at a later date, after having him or her sign a confidentiality agreement or provide similar protection.

This is the section where you can let your passion and vision shine through. You can discuss your growth strategy and the reason your company is best poised to leverage the perceived market opportunity.

Market and Industry Research

In this section, you'll need to describe the market or industry or industries that your products and services fit into. If there are multiple markets, that is even better. Size is usually a key factor for this section. How big is your potential market? When you define the size of your market, substantiate it with research.

You may want to look at the low-hanging fruit first, the markets you'll easily enter in the first 1 or 2 years. Make a note about potential markets that you will look at in years 2 to 4 after you've reached financial and other milestones. For example, there may be good markets in different countries. You might be able to repackage your product and sell into different channels. Get creative. Understanding the various market opportunities also ties directly into determining how you sell.

A point of caution: While you may see multiple markets or envision several product lines from the outset, realize that you can't pursue them all at the same time without spreading yourself too thin. Focus on the low-hanging fruit first, wait until your company breaks even, and then think about expansion opportunities.

Identify how much of the market you intend to capture and in what period of time. No one is expecting instant results or success, so substantiate this part by referencing the financials.

Competition

Do plenty of research as you develop this section, as it's one of the most critical factors. Who else does what you do? Why will people buy your product versus someone else's? What will be your unique selling proposition (USP)? How are you differentiating your product or service—by price, quality, features, service, and so on? And, quite importantly, does your customer care? That is, if you plan to compete on price, are your customers price sensitive or are they brand conscious and willing to pay for a perceived benefit?

Sales and Marketing

How will you sell to your likely customers? Will you go direct? What would be the costs of that? Would you sell through an intermediary? What would be the costs of that? How do your competitors sell?

As part of your sales and marketing efforts, you'll find that a detailed marketing plan is very useful. A good marketing plan includes not only the strategy and vision for taking your products or services to market but also the required staffing, detailed pricing strategies, advertising, promotions, sales events, and other details, as well as the costs associated with each. You'll develop a marketing budget that is part of your overall planning budget. If your plan is for internal purposes only, you may merge all of it in one document. If you intend to use the plan for external purposes, then the detailed marketing plan does not need to be included, but it should be summarized here. What you need in the plan is an overview of the marketing strategy, key factors you need to get to market, and your selling strategy.

Management Team

You're the most critical person on your management team. Instead of listing people involved in your company, first note positions that are required to start and operate your company. Identify the positions that are already filled. For those positions that are still vacant, list the skills that are needed to fill them. Biographies of existing team members are essential. If you're raising investment capital, it's important to note if your investors will contribute key management members and, if so, which ones and when.

If you have a board of directors, an advisory board, or both in place or in formation, list them in the plan. This part of the plan is most relevant to potential investors and if your board has impressive industry credentials, you may consider listing this portion at the end of or directly after the executive summary. There's some flexibility in the order of the sections; while your summary ought to be logical in flow, you can manipulate the order to cast the best possible light on your project. Just be clear in the table of contents as to where each section is—don't make an investor or reader search. In general, each section should lead naturally into the next one.

Opportunities and Risks

This section is often intended for external investors, but you can consider summarizing the opportunities and risks for yourself, particularly if you're still deciding whether or not to pursue your idea.

Financial Offering

This section is only necessary if you are pursuing the investment community. Some may actually include a term sheet here or directly after the executive summary. If you use a term sheet, be sure to include the range of financing you're looking for, the investment that's being offered, and related terms. Plan to get external legal counsel on developing the term sheet. Many VCs will actually send you their own, but it can be an advantage to start with your "wished for" version, especially if you anticipate multiple investors.

Financial Projections

Putting together realistic projections is the most critical part of your plan. Your sales and marketing efforts may be sound, but if you're not sure what it will take to break even or become profitable, you're likely to run into challenges. Financial projections can be either straightforward or complex depending on your audience. There are plenty of resources on developing step-by-step projections.

For example, you can find sample projections in formats suitable for VCs online or in books. One useful resource is *Business Plans That Work: A Guide for Small Business* by Jeffry A. Timmons, Andrew Zacharakis, and Stephen Spinelli. Projections are always presented in a spreadsheet format, usually Excel, but you'll also need supporting detailed text, not just a few footnotes. The supporting notes should detail your assumptions for all the numbers. The core statements in the projections should include the basics:

- Income statement
- Cash flow
- Balance sheet

There are also additional supporting spreadsheets that will provide the basis for key numbers on these statements. The sales numbers will likely come from a customer-driven spreadsheet indicating how the number of customers and price points will result in various sales levels.

Your projected cash flow is critical, as it will really show when the venture will provide cash and what its uses will be and any projected shortfalls. It will help identify how much outside capital you'll need and when you will need it or when you will need to adjust expenses to reduce any shortfalls. You should include an additional statement that indicates the sources and uses of funds.

The balance sheet shows how a business is capitalized. You'll find that you need a balance sheet for your regular banker. To a potential investor, your balance sheet also indicates the strength of a company and who else is involved and through what kinds of structures.

Developing projections can be a tough exercise if you plan to raise external investment capital. You may be told that it's important to have impressive projections and indeed for many VCs a huge market combined with aggressive projections are important. However, I would caution against starting with potential external readers as the basis for creating your projections.

Draft your first set of projections for internal use with your team. Don't worry about impressing others. In fact, more conservative and internally generated projections can help you determine whether investment capital is necessary and right for you. Even if you need capital to start, well-thought-out projections can indicate what you really need and when. You can then survey the range of options that is highlighted in Chapter 3.

When you're doing financial projections, develop two or three scenarios. Your optimistic scenario should reflect your hopes, while your base case assumes that sales will be lower and slower than hoped for and expenses higher by 25% to 30%. Plan for things to go awry. If your plan necessitates that everything go exactly as planned, you're likely to face some challenges early on. Focus on cash flow and not booked revenues. Assume the timetable will be one and a half to two times longer than expected. The biggest mistake many first time entrepreneurs make is assuming that a sale means cash. It can take customers weeks or months to pay and some contracts may call for payments over the course of a year. If you can, try to get as much cash upfront from customers as possible. It's in essence a source of funding, as I'll talk about in Chapter 3. Some companies have to give customers incentives to pay early by giving discounts. Make sure your projections account for this as well. Plan on having your likely customers enter into purchase orders or letters of commitment. Letters of intent are much more vague and really don't have repercussions to customers by way of penalties or fees if they refuse to purchase later on. Incentivize the order. There are ways to finance a purchase order or invoice, but not a letter of intent.

Also, when you do your financial plans, keep the accounting simple. Large companies can fool themselves with creative accounting, but early stage companies have no margin for error. The most important financial document for early stage companies is the cash flow statement. For all of my companies, we have also used daily cash reconciliation so we always know exactly how much cash is in the bank at any given time. Plan for this process.

If you are not taking a paycheck or someone else is performing a function but not yet receiving compensation for it, put it in your plan. Expect to start paying the compensation somewhere in the first or second years. You can't go on indefinitely without a paycheck, so you need to plan for it early on. It should also be a part of any break-even projections.

We all hear that most early stage companies fail because they don't have enough working capital. Honest assessments are critical here.

As part of your planning process, it's also useful to spend a bit of time developing milestones and benchmarks for you to achieve, by which you can judge your success. For example, "The company has to break even by X date, or I will need to reconsider my full-time involvement." Be clear with yourself about how much you're putting in and at what benchmark you'll stop putting in funds. It may not be a financial benchmark, but a customer one. Your planning process may require a certain number of customers averaging X revenues each. Your benchmark may focus on the schedule for securing customers with another set of benchmarks on the revenues and cash flows from those customers.

Structural and Personal Issues

Staffing

As you work on determining how best to staff your company and what kinds of people and skill sets you'll need and at which stages, you'll need to determine what kind of role you want and are happy with. Are you happiest running everything operationally and strategically, or is your time best spent staying close to the heart of the business, such as being the head of a creative team or research and development? If you decide to take on a more functional role, you may need someone to function as a chief operating officer (COO) at some point in the growth stages.

Avoid hiring the "crack team." Don't hire big guns early on. You don't need them to sell your products or service. Most are rarely worth their big salaries and often come at a loss to young companies. Further, many lack the temperament to make it in an early stage or growing company, which usually have less support staff and other resources.

Better yet, look for diamonds in the rough—people who have the right basic skills and experience and who can be trained. This group is likely to want to build their résumés and may eventually leave your firm, but not before providing significant value.

When it comes to creating an organizational structure, think again about your own style and philosophy. What environments are you most comfortable in and where would you prefer to work?

Roles, Responsibilities, and Other Issues in a Partnership

Most entrepreneurs who have a partner make the mistake of not delineating formally and in writing who has responsibility for what. While it's easy to generalize that one is sales or external and the other is internal, it's the day-to-day details that need to be clearly defined. It can also be confusing to employees who may not be clear as to which partner has final authority and over which matters. Vagueness may work in the very beginning when there are too few employees and far more work, so everyone does a little of everything. Clarity of roles is helpful to partners, employees, and outsiders—even if those roles evolve.

If you expect to co-run the company, ask yourself whether you have discussed roles and responsibilities, which, if not clearly defined, can present bumps along the way. Are you both absolutely comfortable with the give-and-take that will be required? Or does one of you expect to be the "driver"? Often, the person with the idea or vision will naturally be the driver as employees, customers, and even investors will turn to that person for direction. Both partners need to be comfortable with this reality.

As you set up the company, you'll also need to consider the contribution of key players or partners. Is each of you putting in equal dollars or is one bringing a tangible contribution and the other(s) an intangible? Also, just because you have joint ownership interests does not mean that you need to work together or that you both need to contribute the same amount of capital. Just because you plan to work together, you don't need to automatically have an equal ownership interest. In fact, most start-ups with family members or spouses involved do not always have equal ownership unless there is equal and required involvement. For example, as often happens in the early stages, if one spouse or family member is just going to manage the books and administrative and operational issues, then equal ownership is probably not needed. It can be misleading if you have not clearly identified roles and responsibilities.

In a situation in which you are dealing with friends and family, ownership issues are key. Always keep in mind the worst case scenario. For example, if a marriage fails, you don't want to jeopardize your company because of a 50/50 stake. Over the years, I have heard of a good number of companies whose futures became hostage to a divorce process. If you retain all or a significant majority of your company's shares, your spouse cannot elect to close a business. At best, he or she can get a financial settlement, but your company continues to operate, much less affected.

It may sound harsh, but you don't need to show your commitment to someone by giving him or her 50% of your company. Actual ownership of equity percentages differs from control factors. One person or entity can own less than 50% of the shares and still have certain control capabilities. This is important, whether you're structuring a partnership, getting outside investors or determining the right mix with family and friends. It's also relevant if you intend to apply to the SBA for minority- or woman-owned classification for both public- and private-sector opportunities. See which definitions and classifications work best for your company and market.

Another factor that's key with partnerships is exit strategies. After a few years, one of you may want out. How do you achieve getting out or exiting the business if the other partner doesn't want to sell or buy you out? Can you sell your share to someone else? While it won't address every scenario, put together a partnership agreement in the first year when you're both more likely to be rational about some of these issues. Good agreements won't establish a price for a buyout, but will establish a procedure to address these issues and formulas for determining the price. For example, the agreement may say that if one partner wants out, the other partner has 1 to 3 years to decide to sell or buy out the partner. The formula to determine the buyout price may be in the agreement or the agreement may be to hire an investment bank to do a valuation and the buyout price is 80% of that valuation to be paid over X years. Since, in the first year, neither partner is likely to know which one of them might exercise such a provision, the agreement is likely to be moderate and acceptable to both. You should plan to use a good lawyer to help with this type of agreement. Even if you are just starting your venture, it's worth spending a little time thinking about these types of issues.

Tales From the Trenches

In 1978, Gail Koff became the third partner in the legal business that became Jacoby & Meyers. She was based on the East Coast and offered the two California partners a chance to take their mission nationally, providing quality legal services to the general public, an unusual concept at the time. While the three had a basic partnership agreement from the early days, there was no provision for exit strategies or a buyout provision, a shortcoming that would come to haunt the partners 15 years later. In the early 1990s, because of strategic and operating differences as well as the changing nature of the business, Gail Koff and Stephen Meyers sought to buy out Leonard Jacoby.

The ensuing haggling consumed their attention and resources as they negotiated for several years. Finally, a buyout was achieved through mediation under the threat of expensive and messy litigation. The terms agreed to under the mediation were not in the best long-term interest of the firm and included a divided ownership of the name. It took Jacoby and Koff close to 10 years to redefine their relationship. In the interim, the firm lost valuable opportunities because of the split use of the name. Originally, to meet the needs of their investors, the three had not included a buyout formula or mechanism in the partnership agreement. In hindsight, Gail strongly recommends that entrepreneurs stipulate a mechanism for legal and financial issues in any partnership agreement.

Shortly after the agreement on a buyout, Gail's remaining partner, Meyers, was tragically killed in a car crash. Their partnership agreement had a provision on buying out a surviving spouse by maintaining life insurance on each partner, paid for by the company. Unfortunately, because of normal operating challenges and cash flow demands, the company had elected not to pay the key man insurance. This key man insurance would have been extremely useful in addressing outstanding financial obligations. Gail eventually worked out the financial situation, but not without liquidating her personal assets. Key man insurance is important for any venture. Most people involved with entrepreneurial firms just don't anticipate the premature death of a partner, entrepreneur, or key team member and the resulting financial obligations, many of which can be addressed with insurance.

Gail's personal commitment for social change and to the company's founding mission of growing a national law firm for the general public has remained high throughout the decades, and her experiences have helped her find creative solutions to meet the needs of the company's clients and employees. Her experiences highlight how essential partnership agreements are and how critical simple policies and procedures can be to the long-term viability of your company. Many entrepreneurs try to go without insurance or without fully clarifying partner issues. It's possible that they will never need to enter negotiations, but in many cases it takes extensive and disruptive litigation to resolve issues that planning and partnership agreements can help avoid.

As many people do, Gail sees partnerships like marriages, with stresses, issues, and resentments that can build over time. The critical issue is how to address and resolve these evolving challenges. It's hard to anticipate the wide range of things that can happen over the course of time, inside the company as well as in the market and industry. Carefully thought-out partnership agreements that provide mechanisms not only for financial and legal issues but also for resolving management differences through such things as mediators or consultants can go a long way toward ensuring the company's viability.

Accounting and Legal

Choosing the right type of person to oversee the books and make financial decisions is critical. When you're in the very early stages, you can probably use QuickBooks software and manage the books yourself. As you grow, you'll eventually need a bookkeeper to enter bills, as well as file and cut checks. If you need to set up an accounting system, you may opt for a more senior bookkeeper, finance manager, or accountant. Often, seasoned professionals are available on a part-time basis. At the early stages, make sure you're the only one with check-signing authority.

As you get larger, you may need to transition to a controller or chief financial officer (CFO) with experience in larger companies. If you're planning to seek investment funding, you'll find that a CFO with experience in dealing with the outside investment community can be very valuable.

A good CFO should be able to craft a financial vision for the company that complements your strategic plan and vision. He or she should be able to advise on how best to finance growth and expansion. The CFO should be able to offer insight on how to craft deals with customers and vendors. In many cases, he or she may have to deal and negotiate directly with the purchasing departments of your larger customers. The best CFOs are then those with business and finance backgrounds.

Now the reality—depending on the size of your company, you may be looking for champagne on a beer budget. If you can't afford a seasoned

CFO with VC experience, but need to interact with the investment community, one option is to assemble a team of senior managers who will lend their names and résumés for the business plan stage for an agreed upon compensation that includes equity and cash as well as other benefits. These agreements are important in your discussions with potential investors as they want to know what their "investment" will buy—that is, what the uses of their investment will be. However, you should note that some VCs will actually expect to place their CFO in the company and will not want to hire yours. So be prepared to be flexible. An alternative option is to find the diamond in the rough: someone who is both presentable and knowledgeable on finance, and who may be willing to be the controller in the event the VC installs his or her own CFO.

Among the various controllers and bookkeepers I've hired, one stood out. He was not quite a CFO, since he lacked the business and VC experience to meet effectively with investors, as some were quick to inform me. But he was sharp in daily financial management and personable, which was important, since a controller or finance manager is likely to be your daily financial liaison with clients and vendors. Whomever you hire for this position needs to be able to encourage clients to pay faster and sometimes even convince vendors to wait longer for their payments. Further, he was also able to provide seasoned and useful advice in establishing processes and procedures, a critical factor when developing your senior team.

Finding the Right Advisors

You'll need to have different lawyers for different advisory functions. During your start-up and growth stages, you'll need advice on areas including corporate law, contracts, human resources (HR), and even collections. Law firms will tell you that they can do it all, but be very aware of how they bill and make sure you avoid overpaying. Over time, you'll see how much certain tasks cost, and you'll find out if you can get fixed rates. At the risk of annoying a few colleagues in the legal profession, I'll note that the larger firms tend to add extra items to their bills, even billing clients for coffee and snacks served at meetings. Large law firms are often used to working with large companies who are less likely to scrutinize bills.

For example, they commonly bill you for internal conferences between lawyers who need to discuss matters relating to your business. You need to determine if this is valid and what is an acceptable time period. Look for consistencies and raise discrepancies early on. Most firms will make adjustments.

Like many entrepreneurs, I've used a large law firm and seen six-figure annual bills. I've also used small contract lawyers who charged flat fees by the agreement. It's important to remember that money doesn't always buy you the attention that your business needs. The best legal work came when I had a personal friendship as well as a professional relationship with the partner managing our business. We didn't get billed for every 5-minute phone call. You need a lawyer for whom your business is relevant and important.

You need to be clear about what issue you need assistance with. If you have a more complex legal matter, you're better off paying more for a seasoned and knowledgeable lawyer. A good junior associate should be able to easily complete simple contracts, set up HR policies, or process basic trademark applications. Negotiate the rates for all work, especially these simpler matters. Don't assume that you need to give all of your legal work to one firm. Shop around.

If you're filing a patent, there are firms that specialize in patents and that often charge flat rates for the bulk of the work. Even though it can take years to be approved, your patent is protected from the day of filing, assuming it is eventually approved. Use the trademark and copyright symbols on all materials and packaging even if you have not received final approval. Copyrights are the easiest to file, and you can usually do so yourself, although having a good lawyer to perform these services is usually worth the time and money as you ought to be focused on running and growing your business.

Many lawyers are active in the VC industry as well and actively seek early stage and growth companies in the hopes of increasing their business as you grow. If you access the investment market, your VC may be able to make suggestions on law firms. Just be sure that the VC does not give them other business: otherwise, your lawyers may have a conflict of interest, even if it is not directly related to your business. In challenging situations, they are less likely to get tough with the VC if the law firm generates significant revenues from the same VC.

Accountants are a bit more straightforward to find. There are many who focus on the early stage and growth companies. For the first year or two, you'll really only need tax-related work. Once you have outside investors or when you get ready to sell your company, you'll need to consider having audited financials prepared at year-end. It is best to find both lawyers and accountants through referrals.

Choosing a Structure

Choosing a structure is important up front. Start with the most basic notion that a corporate structure will protect you. Unless you choose a corporate form of structure, the law assumes that you are your business—you're a sole proprietor. Even though you're taxed at the personal tax rates, you're personally liable for all business debts. If someone sues the business, that person can, in essence, go after your assets.

Each type of structure then provides different types of protections and benefits—at a cost since the tax basis is different for each. Deciding to incorporate is a decision that you'll need to make based on legal and accounting advice. Your company will be governed under the laws of the state in which you incorporate. If you are doing business primarily in a state other than the state of incorporation, you'll need a certificate for doing business in that state. There may also be tax ramifications.

Many U.S.-based companies choose Delaware for its straightforward legal code and low tax basis. Appendix A has a summary of the common forms of structure in Delaware. There are seven basic forms of structures, although four of them are the most popular. Some are more suited for certain industries and financial arrangements, so use this only as a guide and first resource. Get proper legal and tax advice before you make your final selection.

You should note that if you try to change the corporate structure later on, you may incur taxes or find that some options are not available for you. For example, you can choose to be an S corporation and later elect to be a C corporation, but you can't go the other way around. Choosing to be a corporation and then trying to elect a limited liability corporation

(LLC) or partnership status later may incur taxes as the first entity will usually "need" to be sold to the new entity.

Also, if you are considering multiple shareholders, it's to their benefit to have founder's shares as their cost basis will be higher if they "purchase" in later on, since, technically, the company will be deemed to have a value.

Structure is also important if you are not sure whether you are raising outside capital. Most VCs prefer to fund a C corporation, which gives them the most flexibility on exit strategies, including the public markets. They also want to be sure that there's a plan for developing a board and possibly a team of advisors and that the structure will accommodate compensating and incentivizing them.

As you go through the planning process, keep in mind that everyone makes mistakes, even very serious ones. It's really how you deal with and manage these mistakes that defines you and your business. Plan to make frequent changes along the way and have a fluid process as your company grows.

CHAPTER 3

Funding

Deciding how to capitalize your company is one of the most critical decisions you can make in the early stage. Funding can be one of the biggest challenges for a start-up company as well as a growing company. Product companies typically require more start-up resources than companies in the service sector, although that can depend on the stage of development, customer requirements, and barriers to entry.

Deciding how to best fund your company can not only mean the difference between success and failure, but it can also significantly impact your personal situation if for any reason the company doesn't succeed as you planned or in the timetable originally envisioned—both very real possibilities for many entrepreneurs.

At the core of the funding issue is the fact that you need to fund your business with as much money as you are comfortable using and from the sources with which you're most at ease. I've started three companies, all of which varied significantly in their amount of start-up funding, from three figures to seven figures. There is no "right amount." You need to determine where your comfort level is and what your particular business really needs to either get your first few customers or get to cash flow positive. You can have too much money as well as too little. Feeling a bit like Goldilocks, I must say that there's a perfect range in the middle that will enable you to execute your business plan without forgetting that you're in the early growth stages.

You also need to be mindful of not only how much you need but also when you need it. Raising capital in any form and from any group is time consuming. Obviously, some groups require more time than others. A lot of people waste time in the early years raising money rather than focusing on the business. Determine how far you can get your business with minimal external resources and then focus on achieving that level of success. For some companies, achieving success is proof of concept; for most, it's proof of market with tangible sales results. Obviously, if you need capital for initial R&D, you should choose from the options outlined in this chapter. But as a rule, try to get as far as you can before raising capital. Not only will your time be well spent, but also when you do need to raise capital, it will likely be cheaper, as your valuation will be higher.

In this chapter, I'll cover funding for both start-ups and expansion. Many options are similar for both, although the cost will obviously differ depending on the stage of your company. In each of the sections in this chapter, I try to highlight the risks associated with each type of capital and fund-raising. Far from being a pessimist, I believe it's all too easy to minimize risks, particularly when you're focused on the upside. It's managing risks and expectations as well as understanding the capital options that is critical for start-up and growth companies. Remember, start-ups are high risk. Even sales contracts are not guarantees, as your customers' financial conditions can change.

Yours

As you decide how to finance your company, you'll have to determine whether you'll use *your* personal access to capital, debt, or equity or *theirs*—outside sources, lenders, or investors—to meet your company's funding needs. It can deeply impact how you run your company.

Personal Assets

How much of your own assets are you willing to lose? Some people are willing to sell their homes, investments, and any other personal assets to help fund a business. I did. However, more often, people don't start by selling the bulk of their assets or some such grandiose but usually foolish gesture. Usually there is a sum of money, obtained from a home equity line of credit, personal loan, savings, or loans against insurance or retirement assets. The challenge for entrepreneurs is to know when to say "enough" in terms of putting in their own money. It's a bit like being in Las Vegas and saying, "My maximum pot to gamble from is X dollars. When I hit that, I'll stop no matter what." It's usually easier said than done, as most casual gamblers can attest to.

Like most entrepreneurs, I've misjudged how much of my capital my company will require and found myself putting in more and more over time. Businesses almost always require more money and time than anticipated to reach profitability and sustainability. Typically, the golden rule is that sales take twice as long to materialize and expenses are usually double what entrepreneurs anticipate. Using your own assets, while freeing of some of the pressures associated with outside funding (see below), can be a deceptively slow IV drip into your company. Before you know it, you've used far more than you had ever anticipated.

The lesson here is that it's perfectly fine to use your own assets if you've put some thought into the planning and budgeting phase, but expect to put in more than twice what your plan calls for. You should also be prepared to lose some or all of it and be able to support yourself until your company is revenue-generating, breakeven and eventually, profitable.

Credit Cards

Credit cards have funded many businesses, some successful and some not. Again, think through the repayment strategy. Make sure that you can make payments for at least the first year or two without sales. Many have high interest rates, and falling behind on payments will affect your credit rating, which will in turn impact your ability to get more credit, rent an apartment, or buy a home and other basic assets.

If you decide to use credit cards to either fund your business or to pay for expenses, look for ones with the best marketing programs, especially for frequent flyer miles. These added benefits can help you save cash for other critical expenses.

Credit cards typically provide only a small amount of funding that is usually inadequate for most growing companies. However, if you decide that's all you need, then credit cards may work for you as they did for Liz Elting of Transperfect Translations, who started her business with $5,000 on a credit card and managed to grow in 15 years to become a $250 million global translation company.

Loans

Plan ahead and get some type of loan in place. Lines of credit are usually the most flexible types of loans, and you should set one up as early as possible, even if you never intend to use it. These are, in essence, loans you can borrow from, repay, and then borrow again from time to time. With a line of credit, you do not need to take the money upfront, and there are usually no conditions on how and when you can access the funds as long as you make the minimum monthly payment, which is usually interest and a small principal payment. You may pay a small annual fee for having the line available to you. It's worth it, even if you don't use it. It's peace of mind, which will allow you on a second's notice to respond to a capital need.

With a term loan, you get all the money upfront and start to pay interest on day one. Term loans may be cheaper than revolving loans if you need the money immediately or if it's for a capital purchase like equipment. Lines of credit are good ways to finance your receivables, as you may need to make payroll and other operational payments while waiting for a receivable to come in. A line is usually better than a term loan, unless you expect to use all the cash upfront for buying product or equipment.

Both types of loans can be secured and unsecured. A loan is "secured" when something or someone (usually you) is guaranteeing payment. It can also be secured by an asset like your house or an investment account. Be very wary of securing a business loan with personal accounts. No one likes to think of the downside in life, possibly even bankruptcy, but it happens to thousands of businesses, and it could happen to yours.

Many banks and commercial finance companies, like General Electric or American Express, offer lines of credit of $20,000 to $50,000 that are personally guaranteed. There are commercial finance companies that can offer lines up to $1.5 million and sometimes even more, but the terms can be expensive. The size of the loan usually depends on the credit-worthiness of the entrepreneur or signer. While these may not be secured by an asset, you'll need to personally guarantee them, so be sure you can make the monthly payments and can handle the personal obligation. Pay attention to fees and be sure to compare interest rates. While those that offer lower-interest-only payments for the first 2 years or so are appealing from a cash flow perspective, remember that you're paying more for the loan over its entire life. Also, make sure that there are no prepayment penalties. Once sales kick in, these are the types of expenses you'll want to repay quickly, especially if you have personally guaranteed them.

Some people will take out a home equity loan to finance a venture or expansion. While you won't have to give up any equity to an outside investor, remember that this is your home and you need to be able to make sure the payments will be made in a timely manner every month or you may risk a default and problems on the home front.

Theirs

Debt or Equity

When you're first setting up your company and even as you grow, you'll often have to decide between funding your company with debt or equity. Very simply, debt is money that's borrowed and must be repaid. Equity is money that is invested in return for a percentage of ownership, but is not guaranteed in terms of repayment.

As such, debt requires repayment with a fixed return in the form of interest, although certain types of debt allow the lender to benefit if all goes well. The previous section discussed basic loans and lines of credit, which are the simplest forms of debt. Investment funds and VCs can also provide funding in the form of debt or convertible debt, which simply gives them the right to convert their debt to equity through a predetermined formula or price.

Equity as an investment does not guarantee repayment, but it provides for a higher upside. Equity equals ownership, and understand that if you choose this route, you'll share ownership of your company with one or more investors. All types of funding sources can provide you with capital in the form of debt or equity or sometimes a combination. However, there are some basic principles to keep in mind.

Debt can be *senior*, *senior secured*, or *subordinated*, depending on its priority in the capital structure. Priority is most relevant in the event that a company is liquidated. Debt that is senior or senior secured enables those lenders to get their money out first, with the latter usually having the highest preferred position. Subordinated debt takes lower priority but is higher than equity. As a result, most lenders prefer their debt to be senior and usually secured by the assets of the company, if possible. Many lenders may seek to secure the debt with your personal guaranty. Again, think very carefully before you take this step.

Some investors look to invest as convertible debt, which allows them the best of both features. In the negative scenario, the convertible debt gets out first, especially if it's senior and secured. In a sale or merger, the convertible debt can benefit from the upside by converting to equity. It's easy to negotiate good scenarios. It's the negative cases that are harder. Lenders and investors like to have liquidation preference. The higher the preference, the better for many.

A key factor of equity is a concept called *valuation*, which refers, in essence, to how much your company is worth. Most start-ups have very little value. Early stage companies that have a proven product or market, as indicated by a customer commitment, have a higher value, although the exact number is often debated and an assortment of complex formulas and approaches considered. There is no golden number. Entrepreneurs love to jack up the value of their companies, and as I'll note later in this chapter, investors and VCs will make relentless efforts to bring down the valuation as much as possible before their investment. Accordingly, the approach for determining valuation differs for each.

The following sections cover some of the sources for your capital, whether it's debt or equity or a combination. The first two sources of early capital are from family and friends and angels.

Friends and Family

Friends and family are often the toughest category. In some instances, friends and family may function like angels and are included in the same round of financing as early angels.

Every entrepreneur will most likely warn you about the dangers of taking money from friends and family. Every VC will tell you to get your first money there. The reality is that it may be your only option early on.

It's important to recognize that while investors invest in a deal, family and friends are likely to invest in you. This means that they are likely to see their contribution as a "loan" (regardless of the technical structure) and not as an at-risk investment, unless of course all goes fabulously well, and then the higher returns of an investment are expected. Putting aside any legalities for a moment, should things not work out as expected, you'll probably feel the need to make good on any investments that go south somehow in the long run; otherwise, you'll suffer through many awkward family holidays.

Treat your friends and family much as you would an angel investor. Make a formal presentation and give them a business plan. Make sure they understand that their investment is at risk, although keep in mind the reality noted previously. You're not their stockbroker, and they aren't investing in Coca-Cola. This is not a sure thing, and it is far from secure. You certainly expect it to do well. Point out how you have invested your money, time, or skills and are deeply committed to the success of the venture. The reality is that most friends and family, as do many angels and VCs, invest in you, the entrepreneur. Their confidence in you may make them blind to the realities of the risk level. Hopefully, you'll spend more holidays toasting to your mutual success together, but you need to be mindful of the relationship risks if things do not go as planned.

Angels

Angels are typically people who invest in the very early stages of companies, including start-ups. The more supportive and valuable angels tend to be those with extensive senior experience in your industry. They can bring not only early financing but also access to customers, partners, and possibly venture capital or secondary financing.

Finding Angels

You can find angels in several ways. The first is by networking in your own industry. Look for those who have been successful. Consider former colleagues, customers, industry experts, and even unrelated service professionals who have personal wealth like doctors and dentists.

There are individuals who help early stage companies find capital either from angels or VCs. The more successful and experienced intermediaries require a success fee and may actually prescreen you and your firm and only take candidates they are confident of finding funding for.

Some may ask for a retainer. Be wary. A retainer or fee is only warranted if they are doing significant work like writing or fine-tuning the business plan and presentation. Opening their Rolodex, while valuable, warrants a success fee, not a retainer. You can, however, agree to reimburse all mutually agreed-upon expenses incurred on behalf of your fund-raising efforts.

Another way is through the many angel groups. This can be a bit trickier. Some angel groups are organized by industry, others are geographic, and still others are more random. There are online sites, but you're better off networking with other entrepreneurs and advisors in your area or industry to find credible angel forums.

Some Web sites advertise angel lists, and even the SBA has tried to facilitate the process, but the reality is that these produce few results. Remember, unlike an institution, bank, or VC, as we'll cover later, this is the angel's money. The angel is likely to be very protective about who and what he or she will give it to—as would any of us. People really only give money to people they know, so don't waste your time on generic and public databases or Web sites. Angel forums give angels slightly more comfort in that the entrepreneur has been vetted by another angel in the group and also, in many cases, by a steering committee.

Some angel groups require entrepreneurs to pay a fee in order to obtain access to their forum. Be wary of paying fees to participate in any forum, angel or VC. Small fees to cover administrative costs are reasonable, but anything over $500 is too high and likely to be unnecessary and not produce results. The forum is making money from you rather than helping you access capital. Some enterprising individuals have made it a business to "help" entrepreneurs find angels. Functioning somewhat like investment bankers, these intermediaries may ask for up-front fees, success fees, or both.

Angel groups that organize entrepreneur forums require companies to submit an application including an executive summary in order to be considered to present to the angel group. Angel groups tend to have already prescreened the angels as accredited investors as defined by securities law. Also, you often have to be recommended by other angels to be eligible for angel membership. However, don't assume that someone is credible just because he or she is in an angel group. While some groups require at least one investment over a certain period of time, not all groups are as diligent about enforcing guidelines and rules for their angels.

The more established angel groups ask the angels to pay a small annual fee to have access to company mailings and to attend monthly or periodic meetings, where select companies make a 15- to 20-minute pitch. They're usually managed by a steering committee, which decides, among other things, which companies can present at the monthly meeting. The group also helps set investment parameters, with $25,000 as the typical minimum investment. On occasion, some angel groups will try to invest as a group for a series A funding. This usually enables them to secure more rights as a group. Understand that there are no hard-and-fast rules. Much of this is always up for negotiation.

Contacting Angels

When approaching angels, you'll usually need to submit a business plan. Angel groups often have committees to review plans and meet with prospective entrepreneurs. These steering committees prefer executive summaries profiling the company, industry, opportunity, and investment sought. Some groups use their own format to gather this information, online or offline. It's important to remember, that while many of these people are personally successful on a financial level, they usually lack the experience and know-how to properly evaluate a wide range of business opportunities. Try not to get stuck in the "process" and be sure to find an angel to introduce you to the group and ensure that you'll get a chance to present.

If you're selected to present to the full angel group, you need to focus on your 20-minute presentation. You have a relatively short amount of time to capture someone's interest and convince him or her that there is a sizable market and that your solution or product can meet market demand. Often, angel forums provide time for the angels to informally meet the companies for longer periods of time. But if you didn't catch their interest in the presentation, they will probably not come looking for you during the "cocktail hour."

Most companies use a PowerPoint presentation. Spend some time to make yours stand out from a marketing perspective. Rehearse your pitch extensively. Get colleagues to coach you so you sound assured and confident of your opportunity. The more complicated your product or service, the more you need to think about how to make it real. For example, if you have a really complex tech, medical, or engineering product and your audience is less likely to be savvy about the complexities, don't focus on dry details. Instead, focus on the market size, opportunity, and application. Make it real to your audience. If the angel forum is industry-specific, you may want to consider focusing on how you are different from the competition and why your company is likely to succeed. Most forums will allow you to distribute some literature or information.

Angel Forums as Intermediaries

Many angel forums will also specify that the group will receive a finder's fee, often around 1% to 2% at closing. This fee helps to defray any legal and other expenses of the angel forum. You shouldn't need to pay for the legal expenses of the angel investor, but again you may need to negotiate if a particular angel is important to you. The finder's fee for the angel forum can be in addition to a broker's fee if you are working with one, so be careful, as it can add up. Better to negotiate different rates for these types of forums. A broker can be useful in getting access to an angel forum, but you can negotiate for the broker to pay part of the fee, half or more, to the angel group. Law and accounting firms are often good entrées to angel groups. In fact, many are angels themselves, seeing it as a way to generate business from promising up-and-coming companies.

Angel Deals

Most angel deals are for equity, often with warrants attached. Some may ask for the option to buy in at the next round of financing. Many will want some sort of dilution protection. Some angels may ask for board representation. If you have done a group of angels as a series A, you can provide one board seat for the group as is standard. For individual investments, you'll need to determine the value someone brings and decide if it warrants a board seat. You may also consider creating a board of advisors as opposed to a board of directors. Industry experts are usually better placed on the board of advisors as they are more likely to help with business and do not necessarily need to have a fiduciary role. All of these are terms for negotiation.

Managing the Angel Relationship

You should treat angels as seriously as you'd treat a larger investor. In recent years, most have become more sophisticated investors and can provide valuable strategic input and advice. Many are often successful entrepreneurs, so in addition to industry advice, they can assist in steering the early growth. Having said that, be clear with your angels from the outset as to your expectations of their role, and make sure that you understand their expectations as well.

Angels bring in relatively small amounts of money, usually averaging from $25,000 to $100,000. However, they can become very time consuming to manage. Angels may expect to be briefed on the business often, and some may act like senior executives of the firm rather than board advisors or members.

I've heard of many an awkward situation where the angel perceived his or her investment as an entrée to a management role. I've also known VC investors to make the same assumption. Once I had a VC representative try to get on the payroll as a part-time, paid senior executive. This seemed to be representative of his standard operating mode with his portfolio companies. While a nice guy, he did not have any useful or relevant industry experience for my company.

Having an angel or VC representative on the payroll can present a conflict of interest, and you need to think very carefully before considering such an option. If you feel as though one of your VCs or investors can provide significant value, better to reward the person with equity or warrants than cash compensation. You'll find that most will prefer this option as they usually expect to offer their expertise as part of their investment.

Venture Capital

Venture capital money is the most talked about capital-raising source. A bit of reality: most venture capitalists do *not* fund start-ups (i.e., defined as non-revenue-generating companies). The aberration of the late 1990s continues to fool many who think that VCs will just give money to great ideas.

VC money comes in two forms, the good kind and the bad kind, much like cholesterol. You need to learn the difference, as the latter will most likely lead to an early crisis, if not demise. Venture capital is an industry, and the VC is your "customer." You need to understand how the industry operates, how to get your "product" (i.e., your company) noticed and how to close the sale (i.e., get your funding). While there are certainly nuances, treat it like a sales process from start to finish.

Understanding the Business of a VC

If you're thinking about going the VC route, learn more about the industry and community. VCs are basically fund managers who are looking for high returns for their investors. It's very simple.

VCs are not altruistic and hoping to fund the cure to cancer, although for many that would certainly be an added benefit. At the end of the day, the money is what matters—it's business for them. I make this point, perhaps a bit harshly, because most entrepreneurs are quite emotional about their product or service. They're passionate in believing that they have found the equivalent to the "cure for cancer" for their industry or market. Entrepreneurs are supposed to be zealous. You can't very well get others to invest in your grand idea if you're not singularly passionate about it. An entrepreneur who thinks that a VC has the same perspective is likely in for a rude awakening at some point in the process.

VCs run a business, one that they are held accountable to by their investors. More often than not, the people you meet at a VC firm are not the actual investors (although the senior principals may have some of their own money in the fund); they just work for the VC firm.

VC investment focus often follows market trends, whether it's green technology, social networking Web sites, or the current perceived "hot" industry. While it's still possible to get funding if you are not the current trend, it's certainly harder.

VCs typically look at groups of investments and in theory like to have 3 or 4 companies out of 10 in each fund that are likely to provide exceptional returns. They expect the rest of the businesses in the portfolio to either be low performers or to fail. Sounds harsh, perhaps, but this is purely statistical to the VC industry.

It's important to ask VCs about the expected returns for their fund. When VCs market their fund to potential institutional and wealthy investors, they have to indicate a vision, strategy, and target range for returns to these potential "buyers"—that is, investors. If you're beginning to think that a VC sounds suspiciously like an entrepreneur, you're correct. I've heard many senior partners at VCs say they are indeed owners and operators of growing businesses.

You need to realize that in the same way you're raising dollars from a VC, the VC is raising dollars from someone else. They are simply a sophisticated, value-added (or so you hope), middle person.

For those of you hoping to raise VC money, be aware that VCs expect a hefty return on their money. As mentioned, only 3 in 10 companies in a portfolio are usually considered likely to bring in a return. Remember too that VCs are held accountable to their projections by their investors – hence, the "money circle of life."

A key issue for most investors and VCs is exit strategy. It's great if a company does well, but they want to know how they're going to get their money out and when. Experienced VCs usually have a time horizon of 3 to 7 years. The entire life of their fund may be only 10 to 13 years, after which time their investors expect to receive their monies, the original investment plus all the returns, back.

While an initial public offering (IPO) is certainly a sexy exit strategy, it's not for every company. If you do business with the companies who are likely to buy your firm, then be sure to highlight this early on. Many VCs also like to see a list of possible strategic acquirers.

Many VCs will look at varying stages of development, although they rarely look at start-ups. They often consider a variety of investment structures, including equity; convertible debt, which allows them to convert debt to equity; short-term bridge loans with the option to convert to equity; and hybrids of these and other structures. Understanding what options may work for your firm may actually increase the range of possible investment firms.

Remember that when you're talking to a VC, you're entitled to "interview" the VC as well. Understand the VC's portfolio's mission and goals. Most have multiple funds in their portfolio each with different investment parameters based in part on the various investors. For example, a fund with public institutional funds may be more favorable to minority-owned-and-operated companies or firms that operate in urban development zones. There are many funds that receive monies from state agencies to promote entrepreneurship in their state or geographic area. You need to understand the investment parameters clearly. Not every VC is right for you and, of course, vice versa.

Additionally, learn about their investment style. Do they prefer to be heavily involved? Or are they hands-off? Is their investment style consistent with both your operating style and stage of business? Experienced and well-connected VCs can be very useful for an early stage company. I once made the mistake of not entirely appreciating the additional value VCs can bring, and so, while my core investors were nice guys, the kind of guys you might enjoy having a cocktail with, they knew nothing about my industry and couldn't contribute any contacts, networks, or customers.

Understand that there is a certain amount of groupthink to the VC industry as well. VCs move in herds like sheep. Few can distinguish themselves from the herd. My personal theory for this phenomena is the blame factor, the logic being that since VCs need to prove themselves to their investors, it's better for them to stumble in a group so they can blame many different factors. There's nothing worse than being the only one to stumble while all the others seem to prosper, hence the motivation for groupthink. Of course, the reverse is obvious. If other funds seem to be doing well, then they emulate the strategy, sometimes even if it seems unsound.

Many wise and experienced people understood that the dot-com period was not based on sound business principles, and yet most felt compelled to "follow the herd blindly" in order to provide their ever-demanding investors with astronomical returns. When the bubble burst, there was no shortage of blame including that placed on the analysts, which was a bit like blaming McDonald's for getting burned by their hot coffee. No sophisticated investor ever relies on the sole advice of a single, and in many cases, young analyst. Individual analysts usually provide just one perspective to be considered prior to making a decision. However, groupthink can enable the avoidance of responsibility.

What Makes a Good VC?

Most entrepreneurs would agree that what makes a good investor is a financial and strategic partner who works toward mutually beneficial success. The key areas to think about include the following:

- *Network*. What is their network? Are they in your industry? Do they know clients or partners or both and at what decision-making level? Are they willing to assist with networking on an active basis? Look at their portfolio companies closely to see if there's an overall synergy. It's helpful if the VC is willing to facilitate interaction with key strategic investors in the fund as well as other complementary portfolio companies.
- *Check-writing ability*. What is their process for obtaining more funding if warranted? VCs fund companies from one of their portfolio funds. If monies in those funds run out, then there's limited ability to find more funding. Most experienced VCs save a portion of each fund for follow-on funding for their portfolio companies (which are companies they have already invested in). Remember that VCs have an interest in making sure your company succeeds, so long as the business parameters warrant it. They are not likely to keep funding a venture with minimal life left in it.
- *Mutual respect*. Is there a mutual acknowledgement of respect and that you both need each other to succeed? Sure, you need money. But the VC needs to also be aware that they need good companies with solid ideas in order to be successful and profitable. Many VCs appear to operate as if this fact didn't exist. Just as you will likely turn to your VC for creative financing and exit strategies, they should respect your industry and management experiences. Success can only be achieved if there's mutual respect and a focus on creating a win for all involved.

- *Level of involvement*. How involved do the VCs want to be and are their expectations in line with yours? Do you and your management team perceive it as helpful involvement or intrusion? Negotiating a VC's level of involvement can be really challenging, as expectations may change over time. Some VCs who take a hands-off approach in the beginning may increase their involvement at the first hint of difficulties or problems. Overall, most VCs oversee investments in multiple companies, so they don't always want to be heavily involved. Just be sure that the level of involvement meets both of your needs and expectations.
- *Fit*. Are your professional styles compatible? Is there a cultural fit between your firm and the operating mode of the VC? Some VCs view their role as partners and others more as seasoned directors who offer guidance and directives early on. There can even be differences in operating and communications styles based on a factor like geography. An East Coast firm in the United States may sound and act different than one on the West Coast. Many have commented that VCs from the two coasts operate differently and have a different focus. West Coast firms are more likely to be hands-on and involved in the company's growth, whereas some say that an East Coast firm is more singularly focused on deal terms and finances. Stereotypes are at times challenging, but they can help you make sure you're sensitive to possible differences.

What Entrepreneurs Should Watch Out For

It's harder to identify exact issues that make less-than-desirable VCs, but following are a few issues to be wary of. In general, an unsuitable VC is someone whose interests are not in line with yours to grow an early stage company to long-term viability and profitability. (I'll talk about what VCs don't like in the next section.)

- *Unreasonable terms and demands*. Here, the VC is not motivated by a mutual win and seeks to extract terms from you that are potentially dangerous to the long-term health of the company. For example, the VC may try to extract personal terms from you, such as a deferred salary or personal guarantees. Even if you are independently wealthy, terms that may make your personal financial survival more difficult only distract you and make you less focused on the business, which should be your and the VC's priority. In such cases, the VC is less interested in your well-being: after all, everyone needs to pay their bills. These terms are never in anyone's best interest, let alone the company, and will undoubtedly come back to haunt both you and the VC. The entrepreneur should also be wary of having unreasonably high compensation demands.

- *No real management experience*. VCs predominantly still tend to come from the worlds of consulting and investment banking. Most have never worked for a company. As a result, their knowledge base of a corporation tends to be academic and theoretical and doesn't stem from any tangible experiences. They tend to be unfamiliar with corporate operating practices as well as general line management. Despite some efforts to hire entrepreneurs on their teams, most VCs still hire people, who are just like themselves, a practice that drastically limits the range of experiences and perspectives of their team. Look at the individual backgrounds to assess any diversity of experience and perspective.
- *Questionable integrity and greed*. Be wary of the VC who shows interest in doing your deal and suggests he or she receive a fee personally for doing so or wants to go on your payroll as an "advisor." Kickbacks are not legally standard in the VC world, although they occur in varied forms more often than not. The only persons who may be entitled to fees are those you have "retained" as investment bankers, advisors, or intermediaries. Additionally, a VC who operates this way is likely to have a pattern of doing so and is not likely to provide the kind of professional support needed during the challenging periods. Know the Securities and Exchange Commission (SEC) rules for your stage of firm and type of investment. It's just not worth

engaging in unscrupulous business practices. Even if in the short-term, it helps to fund your company, the long-term repercussions could be disastrous. Find another source, and above all, strive to keep your integrity in all your business dealings.

- *Personality, egos, and power trips*. VCs who are undeservedly full of themselves may be more interested in satisfying their egos than partnering to grow strong companies. Some VCs will show such characteristics by playing mind games at early meetings. Others may try to intimidate you or be unconstructively condescending—for example, demanding very aggressively and rudely that you close your PowerPoint presentation and answer obtuse questions in a hostile environment. You may find yourself the target of a barrage of foul language. While every industry has its share of egomaniacs, what you really need to focus on is can you build a level of professional trust that will enable you and the VC to work together during challenging periods? Some VCs can forget that it's a partnership with the entrepreneur, who is likely to have an equity interest in the company as well. The VC may seek to treat the entrepreneur as a subordinate or employee only, and not a co-owner as well. Without a sense of cooperative teamwork, you may not have the VC and board support you need at critical junctures.

Interestingly enough, the code of conduct that most professionals are expected to follow in the corporate world is not always standard in the VC world. Stay above it and stay professional. Despite the allure of money, you probably wouldn't want to do business with these types of people in any circumstance.

If I sound a bit strong on being wary of certain kinds of VCs, I am just trying to create some balance. Most entrepreneurs see the VCs in an incredibly elevated sense, a fact that's not lost on most VCs, as many use it to their advantage. As a result, many entrepreneurs fail to question the practices and approach of their VCs until it is often too late.

What VCs Watch Out For

I've spent some time talking about what to look for from a VC. The following are a few things that VCs do and don't like in entrepreneurs:

- *Be prepared.* Come to any VC meeting with a clear presentation and detailed business plan. If you can't answer a specific question, say so and promise to get back to them within a specified time frame with further information. Even if you don't have an answer, be sure to get back to them later with a follow-up that indicates you are still researching the answer.
- *Be professional.* Conduct yourself professionally at all times. Dress and act like you're going to a job interview. It's quite similar.
- *Don't act like you're "entitled" to funding for any reason.* You may think your idea is great, but VCs see many "great" ideas. Support your request for funding with clear business rationale and facts. Lose any attitude.
- *Don't name-drop or imply things you can't do or deliver.* Everyone can see through such ploys, and you'll just lose credibility. Only mention names of people to whom you have access and will actually help you and your company. Also, don't make claims about your product or service that can't be substantiated. Again, your credibility will suffer even if you actually have a solid product or service.

Finding a Good VC

There are a number of ways to find VCs. If you have angel investors, they can often help lead you to VCs, as can lawyers, accountants, and sometimes even bankers. Law firms actually often provide good access to VCs. The more ideal law firm is one that has a group dedicated to providing services to early stage companies. They have likely developed extensive relationships with certain VCs, either in a specific industry or geographic region.

There are people who act as intermediaries in exchange for a finder's fee, usually success-based. If you choose to retain an intermediary, be sure the person is credible and experienced. Most are simply just introducing you to potential VCs or investors by e-mail, letter, or phone. You will need to do all the work. These finder's fees can range from 1% to 3%, depending on the extent of their involvement. Higher rates are associated with investment banking firms, and the involvement is much different and more extensive.

Many intermediaries will call themselves investment bankers, while they are really not. An experienced investment banker will take over more of the capital-raising-process functions, including preparing the business plan, fine-tuning the presentation, and coaching management, as well as identifying and contacting VCs, strategic capital, and other suitable investors. Some may need to prepare an offering memorandum if you are doing a new series of financing. Investment bankers will accompany you to presentations and assist you through the entire due diligence process, the term sheet, and usually the deal negotiations.

For all this, most bankers can charge a success fee of between 7% and 10%, sometimes on a graded scale depending on the size of the funding. Some will charge you an up-front monthly retainer as well as expenses. Any up-front fees should be deducted from the final success fee. With investment banks, it's somewhat justifiable to receive monthly retainers to cover ongoing expenses; however, the success fee should compensate for the labor expenses more than adequately. I have always preferred to give a higher success fee, but a small or no monthly retainer. On occasion, some mutually agreed upon expenses—for example, travel-related expenses—can be paid on an ongoing basis rather than at the end.

There are many credible investment banks, some small and industry-focused. As your company gets established, you'll often receive unsolicited marketing materials from investment banks that help small and midsize companies merge, acquire, or be acquired. Try to establish relationships with the investment banks that service your industry, even if you are not looking for capital. Many of these firms are often retained by the very large companies when they are looking to acquire products, customers, or a market. It's helpful if the bankers are aware of your firm and can bring your company into consideration. You never know when an acquisition may seem right to you.

If you decide to seek out the VCs directly, you can find many lists, usually online and for a nominal fee. Unlike angels, VCs are more open to unsolicited business plans, and many indicate clearly on their Web sites how to submit yours. VCs want to be sure they get access to a range of great companies as well.

If you have a dedicated person to assist with the capital raising process, online searches might be a viable option. Just remember that the process can consume all of your time. The sites continue to evolve, with no one site standing out from the rest. You may want to start with an online search. Some of these sites also provide access to templates of business plans, term sheets, agreements, and even presentation materials. These are useful as guidelines, but don't assume that any of these materials can replace appropriate legal or accounting advice.

You'll find that having an experienced chief financial officer (CFO) is valuable, even if the person is part-time. When looking for someone to fill a CFO role, look for experience in fund-raising and making presentations. If you take this person with you to a presentation, he or she has to be credible, convincing, and capable. Don't use a controller or senior bookkeeper for this role. These roles are very different (please see Chapter 2 for more discussion on planning your team).

There are also many venture forums that select firms to present to VCs. Selection criteria differs widely, but it is usually based on a business plan and the anticipated interests of attending VCs. Some are just forums for presentations, a few may operate "boot camps," which can be an invaluable way to hone your plan, sharpen your presentation skills, and meet potential investors. The better boot camps tend to be targeted to certain kinds of entrepreneurs and ventures (please see later in this chapter for more information for women and minority firms and boot camps).

Some VCs may look for investment opportunities before they close a fund. This can be acceptable, assuming the timetable works for both of you and the VC has a track record of closing funds. Otherwise, make sure not to put all your eggs in one basket and continue to shop your deal. Closing a fund refers to whether the VC has been successful in raising money for a fund and has met at least the minimum requirements to stop fund-raising for that fund and start investing. If the VC does not close their fund, he or she cannot invest, and you're out of luck and will have to start your fund-raising process all over again.

You can also use a VC's Web site to find more VCs with similar industry and investment focus. Under the About Us section, many VCs list their advisors and boards of directors. In their brief bios, you can see each VC or company affiliation. Similarly, if you know of companies in your industry that have received investment funding, you can access their board of directors online to see which VCs did the deal. The backgrounds of the people listed on the Web site can often provide you with information on investors, key partners, and customers.

Another way to find a VC is through existing investors, especially when you are doing additional funding rounds. As you look to add more VCs, be sure to find out if there's a work or personal history between the VCs and perhaps even between the VC and your angel investors. If another deal soured between them and there's remaining bad blood, you don't want the investors and VCs using your company as a battleground to settle old scores. I didn't realize the possible impact and initially didn't know that two of my three largest investors had an awkward personal and professional history. This impacted how each viewed the other's investment and related terms in my company. If they do have a history, be sure that one party didn't benefit from another deal at the expense of the other investor. Entrepreneurship is enough of a ride without trying to manage competing VCs, unless of course, it's to your advantage.

Business Plan Screening

Business plans are a critical step in the fund-raising and planning stages. However, you need to understand how VCs are likely to assess plans.

Most VCs will rely on the plan for initial screening. If the market opportunity seems convincing and if the product or service has some unique fit, they are likely to consider additional review. VCs are most interested in proof of concept, product, and market. If you can get letters of intent or actual purchase orders, you'll find more VCs willing to review your plan.

More often than not, it really takes an introduction or intermediary to get a VC to review your plan. If you send a plan in without an introduction, try to get creative in order to be noticed. Think of your plan as a marketing tool. Package and present not just the information, but also the plan, in a tasteful, professional and unique way.

Other factors that impact a VC's decision to review a plan in detail may be unrelated to your company, including their internal deal flow and how many people are already assigned to potential deals, as well as how much money they have available for investment. You should try to get information regarding these factors when you interview a potential VC.

Every VC has his or her own approach to analyzing business plans. Most tend to be conservative and often will assume that the projections are too aggressive and cut them in half. In meetings with VCs, I have often experienced varying views of the same business plan. One would tell me that my growth projections were too conservative and small and that they needed to see a bigger "hockey stick" (a term that refers to the shape of the sport equipment, which plotted on a graph indicates quick and steep upward growth). I would go back and revise the numbers, only to be told by the next VC that he didn't think my projections had a chance in hell of being achieved. And sometimes they weren't even that kind in informing me of their opinions!

Yes, another typical mistake of early stage entrepreneurs is allowing a VC or investor to sway business logic and planning. You need to be comfortable with your projections regarding market size and opportunity. Not every VC will be the right partner. You may also find after talking to many VCs that while the size of a market sounds great to you, it may be too "small" for most VCs. Remember that they too have performance goals, including investment returns and a clear exit strategy. In such cases, strategic capital may be a better option, and I'll discuss it later in this chapter.

Meeting With a VC

The first meeting is likely to be a short presentation, perhaps up to an hour or two. Be clear about how much time you have and what they want to focus on in addition to your general presentation. You're not likely to have been given a meeting unless something in your executive summary or business plan struck their interest. The key to attracting VCs' attention is differentiation. Use more than just words to communicate your opportunity. Visuals are a powerful tool.

Like a good salesperson, prepare in advance. Find out what they liked about your idea and if they have any immediate concerns. Plan to raise them proactively in advance. Also, these days many VCs have a Web site and some even list their portfolio companies on their public site, as well as on the password-protected areas. Research their existing investments. Find out if any have been in your industry, and find out how the companies are doing. If their previous investments in your industry have not been doing well, you'll need to address their specific concerns. As noted previously, VCs also try to gain strength by specializing in an industry. Having portfolio companies that are complementary by way of products, industry, or customers is a plus. It's a good idea to highlight the ways your company may complement their current portfolio.

Some VCs like to think big and may look for opportunities to merge portfolio companies and then sell the firm for even a higher valuation or take it public. Your best bet is to be open to everything. No VC likes to hear that you have a singular path for your company. Remember, they need an exit strategy, and it needs to be broad with some clearly defined options. Multiple exit strategies are the best—IPO, mergers and acquisitions (M&A), strategic acquisition, and so on.

When interacting with VCs, manage your confidence. Again, it's a good idea to veer to the middle ground—you can be either too confident or not confident enough. Don't let their questions or tone or manner intimidate you. Some use these psychological strategies to test you and your vision and perhaps even commitment. Some just get a power thrill. Keep in mind that seasoned VCs think they have seen all types of entrepreneurs, and some may indeed have. They can be quick to stereotype or label you or your company based on previous experiences, for better or for worse.

Due Diligence

If a VC expresses interest in your firm, he or she is likely to conduct a research phase that can last from 1 to 6 months, although the average is about 3 months. During this phase, the VC will literally take your business plan apart, number by number, assumption by assumption. The VC will assess your market expectations and usually cut your projections in half and then some, while doubling your expenses—all along testing to see how the business is likely to fare under various conditions. The VCs are likely to want to talk to key customers, partners, or others to assess both your product and capabilities. They will go through much the same research as you did in compiling your plan. They will also want to learn more about you as the entrepreneur and CEO of the company. They need to be comfortable that you can execute the plan.

Negotiating and Structuring the Deal

If a VC is interested in making an investment in your company, he or she will likely start by sending you a term sheet that outlines the terms and structure of the investment. Term sheets are usually only a few pages long, but cover the critical terms. Term sheets are then followed by complete documentation as is legally appropriate for the type of deal. Some prefer to negotiate term sheets and then move to documentation, which also entails negotiations. Others prefer to negotiate everything at once. The term sheet is negotiable, and you should spend time sorting through it to make sure the structure and terms make sense for your company.

This book is not intended to be a comprehensive source on each and every funding variation. It's an evolving market, and new structures and hybrids come in and out of popularity based on market conditions. You're well advised to find a lawyer or financial advisor who stays current on these structures or, more importantly, knows how to ask the right questions and analyze any proposed term sheet with experience. Some terms can also be impacted by changes in tax and investment rules, so again, understanding the VC industry is critical.

There are some concepts to focus on in any deal. The valuation of a company and resulting equity percentage are critical factors. As a result, many structures and terms seek to increase or decrease an investment interest. Antidilution terms seek to protect earlier investors from the reduction of their investment interest with additional rounds of funding. The challenge is often that even with these terms in place, later VCs can force a restructuring of select terms as a condition for their investment. The following are some key issues to focus on.

Equity, Valuation, Structure, and Liquidation Preferences

In many cases, the fundamental challenge is that the entrepreneur and the VC are fighting over a finite item: equity. Sure, 100% of nothing is still nothing, but most companies will have a value in time. If your investors think that they are putting in that value by way of cash, they will try to get the lion's share of equity. At the same time, you, the entrepreneur, need to be sure that you are left with an equity stake that will motivate and incentivize you.

When you're doing your projections, realize that VC expectations are toward higher returns. They get that by investing early at a low value and selling eventually at a high value of the company. Value is usually a multiple of revenues or earnings, usually the latter, although the former created the huge monetary successes that were characteristic of the late 1990s Internet economy. It's unlikely that those kinds of multiples will return anytime soon, if ever again—although this *is* the United States, where optimism and groupthink can run amuck at least once in every century.

This is one of those business scenarios where it can be a "zero-sum" game, unless the VC is experienced and intends to create a mutual win. Seasoned VCs know well that too little equity can be disincentivizing to an entrepreneur. The trick is to find the right balance, and again, there are no hard-and-fast rules. Some may allow entrepreneurs to gain back equity by achieving financial or other milestones. Each deal is different, as are the motivations of the participants—entrepreneur and VC alike. Make sure you have a seasoned attorney to advise in this process, although it's likely you'll be doing the bulk of the actual negotiations. Ask questions and educate yourself.

The term sheet may propose an investment structure of, for example, debt or equity and combinations thereof. Depending on the stage of your company, you need to choose an investment structure that is conducive to growth and expansion. For example, don't fund a start-up with debt. Your balance sheet will be heavy with liabilities and it will be hard to raise equity capital. However, if you are a revenue-generating company and can pay interest, a debt structure may be a way to fund your expansion without giving up equity.

Based on the final terms, it's also likely that they will get out ahead of you depending on the structure. Liquidation preferences are important for the distribution of assets in the event a company is liquidated. In essence, this refers to the order in which investors; lenders, if applicable; and entrepreneurs get their money. Some VCs like to use debtlike structures because as creditors they would get their money out first whether it's a liquidation or a merger or sale of the company.

Control

Determining the right amount of board seats to give your VCs is critical, and you should spend some time thinking about it. As board members, they'll help steer the company, but they can also provide critical votes for and against issues that are important to you. The challenge is that most VCs are like consultants and investment bankers—well-educated and well-intentioned, but more often than not, with little or no experience in actually starting, growing, and running a company. Sure, some may have run a large company or unit, but running is step three in starting, growing, and running. Without hands-on experience in starting and growing, running is useless. It's just maintaining with respectable increases, not being "the little engine that could," chugging up steep mountains and against tough odds.

Many VC firms have realized this and often bring experienced entrepreneurs on board to help make funding decisions as well as act as advisors to companies. Seek out the experienced entrepreneur on a VC team: he or she is likely to be your best source of day-to-day advice. This person knows how to grow a company with limited resources—money, talent, and so on. They are expert at entrepreneurship on the fly.

Preferred, Participating Preferred, Double Participating Preferred, and Other Mind-Numbing Structures

Preferred stock is basically stock that has preferences over common stock, which is usually what you'll have as the entrepreneur. Many VCs will invest by way of preferred stock, which usually gives them dividends, preferential voting rights, redemption rights, and the right to convert to common stock on terms most beneficial to the VC.

Participating preferred stock is preferred stock with the additional benefit to the holder—that is, the VC—of getting more liquidating distributions at the common stock level. Many VCs will try to get participating preferred stock during the negotiation process.

Double participating preferred, while not common, is found in some deals and gives the VC the right not only to get all of his or her money back first but also to get dividends and distributions at the common stock level.

When you're structuring your deal, if you are putting in money, look to put it in on the same terms as the VC. This will help to align your mutual interests. Many entrepreneurs, myself included, usually just put their money in as periodic cash infusions as needed with little thought to the structure and terms. If you have outside investors, it's important that they value your investment, in terms of time and energy as well as cash.

As I noted earlier, some VCs may look to structure their investment as convertible debt. This gives them the protection of debt with the benefits given to equity. Obviously, you can see that this is likely to be more beneficial to the VC than the company. In my second company, the investment was structured as debt and convertible debt. This made it more challenging to get additional equity funding, as no equity investor wants to be behind large amounts of debt. We had an inverted balance sheet, which means that the debt was greater than the equity on the balance sheet. While it's not uncommon for all the earlier investors to restructure with new rounds of funding, it's never easy, and in our case, with conflicting objectives, it became impossible.

As with any negotiation, time is an important factor. If the VC knows you're running out of cash, the VC is more likely to be more aggressive in asking for terms that most benefit him or her. Expect the VC process to average between 9 and 18 months to actual closing of a deal and funding—assuming that your company's plan warrants funding. Give yourself time to find the right deal and negotiate it well.

These structures and terms can indeed be mind numbing, and you're not alone if your eyes start to glaze over in the negotiation process. Just keep in mind that most of these terms focus on getting the maximum monetary value and legal protection for the VC, and you need to work toward keeping it a win-win. There's an old Wall Street saying that can be a guiding principle here as well: "Bears and bulls make money, pigs don't."

Rejections

Don't get attached to anything. This is incredibly hard for most entrepreneurs, who are usually driven by passion and emotion as much as hard critical analysis. However, it's important to stay objective. If you find that you are being rejected by the VC community, try to objectively assess why. Is it the company, the product or service, the market or the timing? Again, your market opportunity may be too small for a VC but just fine for you individually. In that case, look at other ways to grow.

Just because a VC isn't interested in your business, product, or market does not mean it's not good. VCs are looking for the companies with the strongest hockey stick growth opportunities. Steady, moderate and profitable growth doesn't really excite most VCs, unless it's in a huge market. They need to satisfy their investment parameters, and most are looking for 20% to 50% growth with the opportunity to at least double or triple their money in 4 to 7 years. That takes us back to valuation. But another thing to keep in mind is that the due diligence—in other words, the research, legal, and documentation stage will cost just as much for a $1 million investment as a $10 million one. So guess which one looks better from a return on investment (ROI) point of view? The $10 million investment, even if it's more likely to come in stages of $3 million to $5 million per stage as certain product, sales, and market milestones are achieved. The challenge is that not every company warrants the higher investment.

The key is to move on and look at other ways to pursue your vision. There is no one sure path to successful entrepreneurship.

Tales From the Trenches

I'll reference my own experience to illustrate the importance of qualifying your VC, choosing the right ones for your stage of company, and structuring a mutually beneficial deal.

My second company was funded by a couple of funds, which were not quite seasoned VC firms, although one was led by a guy who thought he was. They were all really nice guys, and yes, it's still very much a guys' world, no matter what you read or think—but that's another book unto itself.

Unfortunately for both of us, we were mismatched. My investors did not fully understand the role that VCs of start-ups need to play nor did they have the skills or experience necessary in our industry. I was relatively naïve in the world of capital raising and agreed to structures and terms that weren't productive for the company or myself. I was also unsuccessful in persuading them of the need to restructure before it was too late.

It took me a long time to determine that while my concepts, ideas, and market were feasible, despite any temporary economic setbacks triggered by 9/11, the corporate structure stunk. I had an inverted balance sheet (more debt than equity), the funding markets were dried up, and my investors felt no imperative to restructure. Further, I was in a very disincentivizing structure where I finally saw no upside for myself. I had relegated myself to the back of the line in terms of every right and, having made just about every financing structural mistake known to early entrepreneurs, I couldn't have possibly been at a greater disadvantage. Still, despite the obvious problems, it took me a long while to part with the company.

In the end, we had a company with a good product, a decent and respectable market, but a lousy capital structure, nonsupportive investors, and a completely burned-out and disincentivized entrepreneur. It couldn't move forward, and it didn't. I recount my experience only because having outside investors does not guarantee success even if your product or service meets market demands. Further, focus on the issues I've highlighted in this chapter from the beginning. Don't assume that you can "fix" things once the company is operational, profitable, and successful.

Funding Options for Women-Owned and Minority-Owned Firms

The world of investments relies somewhat on trust, interpersonal interaction, and intuition, as well as on detailed and concrete business analysis. As a result, as in much of the business world, VCs, who tend to be men, seem to intuitively "connect" with male-run companies more than with women- and minority-run companies. There's a cultural fit of management and professional styles. For more than 17 years, I have made my living providing insight and products that help people understand the cultural fit among people from different countries, yet it's easy to forget that each industry has its own distinct culture as well.

This is no doubt fodder for another book, but it supports the emerging efforts of funds and forums designed to assist women- and minority-owned companies. The reality is that more than 90% of VC money still goes to male-owned-and-operated companies.

There are forums designed specifically to give minority- and women-owned companies the opportunity to present to VCs. Springboard (http://www.springboardenterprises.org) is focused on assisting women-owned companies in accessing capital. Over the past decade, more venture forums have emerged, usually geographically focused, and are dedicated to assisting women- and minority-owned businesses. A key value that these forums can provide is that selected entrepreneurs go through a relatively rigorous boot camp. Not all entrepreneurial forums offer boot camps, but those that do are worth seeking out. Some may charge fees, and you'll need to evaluate the cost-benefit to your firm.

These boot camps include training on the entire funding process, on enhancing the business plan, and most importantly, on presenting to and interacting with VCs. Even for talented entrepreneurs with great presentation skills, there is much to be gained from these boot camps. The advisors are usually a combination of legal, accounting, and marketing professionals as well as VCs themselves. I participated in a VC boot camp, which was very useful. Having also presented at regional VC events, I can attest that the boot camp process is critical and clearly a market differentiator between forums that do not offer this service.

The VCs that attend these targeted forums may not be the largest or most high profile VCs, but they are more likely to be open to companies owned and operated by women and minorities. The reality is that people do business with those they are most comfortable with. The VCs participate in these boot camps without necessarily expecting to make any investments. As a result of the diminished pressure, they are often more likely to candidly discuss the funding market and make useful suggestions and introductions.

Some VCs focus on women-owned and -operated companies. They can be a bit harder to find, but venture forums, like Springboard, can assist you in finding them. VCs like Fund Isabella (http://www.fundisabella.com), which look for women-owned and -operated companies, will invest in early stage companies starting with smaller amounts like $250,000. Each VC's Web site tells you more about targeted industries and investment parameters.

One thing to note about many of these women- and minority-focused VCs is that they usually have an active board of directors and advisors, many of whom work with the larger VCs. Exposure to these people obviously increases your chances of finding larger pools of capital should you want and need it for expansion as you grow.

Small Business Administration and Related Government Entities

The SBA is a relatively staid organization that provides capital for established businesses, usually with 2 or more years of revenues and profitability. Hence, don't bother if you're a start-up or are not yet profitable. If you're not yet profitable, you may want to reconsider your decision to borrow money rather than raise equity anyhow.

It's also important to remember that the SBA doesn't give you money directly; rather, it guarantees your loan, but a local bank actually provides the funds. In most cases, your local bank will handle the entire process, and you don't always need to go to the SBA first. However, as with any loan, you will need a good business plan, a clear and reasonable (for the bank, the SBA, and the company) repayment schedule, and good personal credit.

For those who are eligible, the rates can be reasonable, but understand that it's debt and not equity, so you have to pay it back. Usually it comes with a personal guaranty, which, as noted earlier, you should do your best to avoid. It's not uncommon for early stage companies to have to reorganize at some early point even if they go on to become huge successes. FedEx and AOL are just two of many big-name companies that restructured in their first decade of operations. The SBA has also opted to support affiliate programs, Small Business Investment Companies (SBIC) and New Markets Venture Capital (NMVC), to help early stage and small businesses gain access to capital. Both of these programs are discussed in more detail a little later in the chapter.

The SBA offers minority-owned and disadvantaged early stage businesses an opportunity to participate in a program, commonly known as 8a. Basically, if you qualify for certification, you can get federal contracts on a noncompetitive basis up to a certain dollar amount, $3 million or $5 million depending on your industry. Far from being an easy or guaranteed source of sales, the certification process can be cumbersome and lengthy and requires an operating history of 2 years. Also, you need to be sure the government is actively buying your product or service. The program can assist with developing government contracts, but you're going to have to spend a great deal of time cultivating those over a multiyear period.

I point this out because selling to the government, while profitable for some, usually entails a longer sales cycle than the private sector and with much thinner margins. Nevertheless, 8a can be a valuable program for those who qualify and are successful in understanding how to best manage the program.

Tales From the Trenches

In 5 years of participation in the 8a program, Martha Daniels, founder of Information Management Resources (IMRI), successfully became a $7 million California-based software developer. Her firm eventually "graduated" from the program once sales and her net worth reached milestones. Nevertheless, she had made valuable contacts, had proven the company's ability to deliver successfully, and had developed a pipeline of both public and private contracts. She used 8a to become a viable, successful, and profitable company.

Martha's experience highlights the evolution as well as the personal restrictions for participating in this program. The 8a program is no longer the program that, once in place, would make business owners "very wealthy, very quickly." The current program is no longer even technically limited to minorities and now embraces anyone who can prove that he or she has been restricted in his or her progress as a result of socioeconomic causes. The government has also streamlined the application process that originally deterred many qualified entrepreneurs from applying. Still, it's not a cheap, quick, or easy process. If an early stage business seeks consulting help to complete the voluminous application, they can still expect to pay between $10,000 and $15,000, and the process can take almost 6 to 12 months.

Martha was eventually in the program for 9 years, due to an extension to complete outstanding government contracts. During the entire term, she keenly felt a loss of personal privacy as a result of participation in the 8a. Any entrepreneur who participates in the program cannot have a net worth that exceeds $1 million. This includes the assets of a spouse and continues throughout the entire term. The government calculation doesn't include your primary residence or assets that are held in the business. However, vacation homes, rental properties, boats, art, stocks, and other businesses are all part of this valuation. The annual 8a paperwork requires a full disclosure for both the entrepreneur and spouse, all of which can seem very intrusive. Martha has seen people circumvent this restriction in many permissible ways. For example, some entrepreneurs use their business to guarantee a bank loan on an investment property. As a result of the guarantee, the property is considered a corporate asset and falls outside of the net worth calculation. For Martha, the benefits of the 8a eventually outweighed the discomfort with this intense analysis of her private life.

Small Business Innovation Research Program

There are other government options that are more innovative and come in the form of grants rather than debt. Small Business Innovation Research Program (SBIR; http://www.sba.gov/sbir) provides grant money totaling up to $750,000 in three phases for feasibility, development, and commercialization over the course of 18 to 24 months. SBIR tends be very competitive and focuses on technology solutions, but it can differ by government agency.

All the SBIR information is online. You'll have to check for annual schedules for Phase 1 grants. Usually the Department of Defense and the National Institute of Health have the most funds to give away. Keep in mind that if you receive the second- or third-phase money, the government may have some rights or preferences to use your product. Usually for the third phase, the government prefers VC, strategic partner, or private-sector capital involvement to ensure commercialization. However, you're past proof of concept, and any fund-raising should be at better terms for you.

SBICs

SBICs are privately held investment companies that invest their own capital as well as borrowed capital from the SBA. They are designed to provide capital to small businesses. Some SBICs target women- and minority-owned companies, while others are just focused on the size of the company. By definition, SBICs can invest in eligible firms that are defined as having a net worth of $18 million or less and average net income after taxes of less than $6 million. There are some exceptions, and you can find more information at the SBA Web site (http://www.sba.gov). The site also lists of SBICs by state.

Treat an SBIC like a VC, and approach them with the same strategy. Because their options are more narrow, SBICs are more likely to review unsolicited business plans and grant a meeting more easily. However, SBIC funds tend to be smaller, as they may have fewer private investors involved and have less money to invest. When you contact an SBIC, make sure to ask early on if they have funds and are making investments.

Unlike the SBA, which tends to only provide loans to profitable companies, SBICs will invest with equity in early stage and even preprofit companies.

New Markets Venture Capital (NMVC)

The NMVC is a relatively new program from the SBA designed to provide capital to companies operating in lower-income areas. Signed by President Clinton in 2000, it received its first funding in 2001 and only a handful of NMVC companies were created. The program is still in its infancy stages and really only appropriate for the small number of companies that operate in lower-income neighborhoods.

Alternative Options

Strategic Capital

Strategic capital is a valuable way to finance your company as well as expand your business and ensure long-term viability. It usually comes from a larger company in your industry that's interested in getting access to your product or service to expand its market.

The most challenging thing about using strategic capital is usually that it involves an exclusivity clause. As might be expected, many strategic partners don't want others in their industry to get access to your product, technology, or service before they can fully capitalize on the market. Only you can decide if what you get more than compensates for what you leave on the table. Having said that, strategic capital is often perceived as a relatively safer way to grow a company, particularly as the strategic partner provides one of hopefully several exit strategies. Be sure that any deal includes revenue-generating opportunities. Otherwise, you'll be at the mercy of the strategic partner for capital and they may use that as a way to buy you on the cheap or get access to your product or service.

Strategic capital can come in many forms, including an actual equity investment, loans, presales, bartering, and letters of commitment that may be able to be funded by investment banks or VCs depending on how strong they are. Some may look to barter services for equity. This can be useful, but be careful with the valuation, as it normally works to the benefit of the strategic capital. For example, in exchange for equity, a consulting firm may give you advisory services to help put together the business or marketing plan. They are likely to value these services at full retail cost, even though you'd never pay that amount in cash. Sure, there's a benefit, since you need the service and don't have cash, but you're also going to give up more equity.

With strategic capital, the mutual interest is not financing, but usually a product, service, or market that will enable you to be more creative than you would be with a traditional VC. Some of the larger companies that are likely strategic partners have VC arms that oversee these types of investments. Approach them as you would any VC with the added provision that they are interested in both how you can benefit them in terms or products, service, or customers and the long-term financial upside.

Sales, Retainers, and Bartering

These options can provide much-needed capital and can be some of the cheapest forms of funding. Getting your customers to "fund" you with orders that they pay for in advance is a cheap option. At most, they will impact your profitability and income statement and less likely your balance sheet, although you may be carrying a short-term liability if a customer has prepaid and you have yet to deliver the goods or services. Many companies also seek to have their customers commit to a monthly sales minimum, which can function like a retainer. This is enormously helpful in planning and managing your monthly cash flow needs.

These are every entrepreneur's favorite forms of funding. While I raised a lot of money for my second company, I am also a big fan of bootstrapping it in the early days. It helps you use what little resources you have very wisely and minimize mistakes and expenses, since you just don't have money to throw around. Customer-oriented funding approaches allow you to focus on quality product and the first set of customers, which means you'll more likely be moving toward building a lasting business.

Bartering is an effective way to do business without using cash directly. Find companies of any size who need your products or services and from whom you also need something, and then exchange those products and services. For example, a technology firm may swap services for a logo and marketing design with a marketing firm. Companies often swap advertising space for content, for customer databases, and for technology. As you get creative, you'll uncover more opportunities.

Accounts Receivable Financing and Factoring

Factoring or accounts receivable financing is a good but expensive way to generate cash flow to meet short-term obligations, without taking on any long-term obligations or giving up equity. The basic difference is that in accounts receivable financing, you're borrowing against an invoice. The customer continues to deal with you. Usually the structure is a line of credit, and your bank or finance company will set up an address for customers to send the payment in the name of your company.

In factoring, you're actually selling the invoice. This means that the customer must authorize that the invoice is valid, that they have received the goods or services, and that they commit to paying it to the factor directly. Factoring is widely used in the garment industry where retailers often pay 120 days after receipt of shipment. Factoring is not cheap; in fact, it's probably one of the more expensive forms of lending. However, it's short-term and only when you need it. If you have a line of credit, you'll find it's cheaper to use that for cash flow needs till your receivables come in. I have successfully used factors and it works best if you have large invoices of at least six figures each and need cash to pay for working capital needs. The larger your invoices, the better you can negotiate your rates with a factor.

You need to know a couple of things about factors, however. Choose your factor wisely. Many factoring companies are a bit rough around the edges in terms of customer relations. Remember that they will be interacting with your key customers and "representing" your firm. In our case, it became awkward, as we had Fortune 1000 companies who were not accustomed to the typical brusqueness of a factor. It can impact your business relationships. We prefer to use good customer relationships and get them to pay faster rather than factor invoices.

Some banks and groups will finance purchase orders, but usually through an established line that is secured by you personally. It can take up to 2 to 4 weeks to set up a factoring or receivables financing line, so plan ahead if you are considering this option. Your banker, lawyer, accountant, or a fellow entrepreneur are often the best places to look for reputable factors. Your bank may also have products that will allow you to finance receivables or factor invoices.

There are many options to finance a start-up or expansion of a company. Do your research thoroughly, and understand the motivations and expectations of all the funding sources.

APPENDIX

Choosing a Corporate Structure

Deciding on the right structure for your company can seem a bit tricky, but most entrepreneurs pick between an S or a C corporation or a limited liability corporation.

A corporation is basically a company, which is a distinct legal entity from the person(s) who formed it. Many people in the United States opt to incorporate in Delaware because corporate taxes are lower, but check with your accountant before you finalize your choice as it will depend on the type of business you have and where it does business.

Many entrepreneurs also who choose to be a corporation opt to elect to be a subchapter S corporation. This means that any profits are passed through to the individual shareholder(s) and taxed at their personal rate. Electing subchapter S can work in the early days. There are a few points to consider.

An S corporation cannot own a C corporation. This is important if you intend to set up related companies or make an acquisition. Further, if you choose to be an S corporation, you can elect to switch to a C corporation at a later date, but not vice versa.

A limited liability corporation (LLC) is a hybrid corporate entity that has some benefits and qualities of both a corporation and a partnership. It has become the structure of choice for many entrepreneurs; however, you should do your own research before finalizing on a structure. The best structure will depend on your business, geographic location, intended markets, and financing expectations.

All three options (LLC, S corp, and C corp) give you limited liability protection for business debts. This means that you won't be personally liable for business debts. To illustrate, if you didn't incorporate and your business was sued, the other party could sue you personally. Given how cheap and easy it is to incorporate these days, there's no reason not to.

The critical difference between all three is in how taxes are treated. In a subchapter S corporation, there's no risk of "double taxation" as your company is not a separate *taxable* entity (it is a separate legal entity). All profits or losses are passed to you and the shareholders and taxes are paid at the individual levels. In a C corporation, profits are taxed at the corporate rate and then any distributions to you are taxed again at your rate (hence the term "double taxation"). In an LLC, profits (or losses) are passed to shareholders and not necessarily in the same proportion as their ownership interests. Profits are taxed once at the individual shareholder level.

While an S corporation can have up to 75 shareholders, it can only issue one kind of stock. As a result, if you plan to raise investment capital, most investors and VCs prefer the flexibility of a C corporation, which can have multiple classes of stock. If you intend to immediately raise capital, you may want to consider first consulting with your lawyer and accountant. One structure may be more suitable than another in terms of the number and type of shares. If you set up correctly on day one, you can avoid the need and expense for changes a few months later when you're ready to accept investment capital. Instruct your lawyers to keep it simple as a junior associate may get overly ambitious and structure your company in a way that will trigger more annual filing fees than necessary.

To incorporate, you can find many online options, including The Company Corporation (http://www.incorporate.com) and Business Filings (http://www.businessfilings.com). Check out a few, and see which one has a package that works for your budget, as fees can differ by state. Many of these sites also have information on how to choose the best structure for your firm. Your accountant is probably the best source for this information as he or she probably knows your company and your personal matters. Even if you incorporate in Delaware, you'll probably still need to file to do business in your state. Simplify this by using one service, if possible. They should also send you annual reminders for filing fees and any additional paperwork if required. You also don't file for subchapter S at the time of incorporation. You can do that later on with the IRS directly at http://www.irs.gov, although you need to elect subchapter S before the end of your first tax year. All the business structures require annual paperwork, which is important to maintain.

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Starting Your Business

Sanjyot P. Dunung

In the hard-fought business world, only one new business in 20 lives to see its fifth anniversary. *Starting Your Own Business shares* the secrets of long-term survival and success, detailing practical guidelines and relevant “tales from the trenches” to help entrepreneurs tackle common concerns and obstacles.

Typical management books do not address the unique nuances of early stage companies. And most entrepreneurial books often profile successful entrepreneurs or companies who are better known, which usually includes only the small percentage that achieve stratospheric success. *Starting Your Own Business* provides a welcome combination of first-person how-to advice and peer mentoring support. This comprehensive, essential resource book provides sound, battle-proven advice for determining early structural decisions, uncovering innovative funding resources, and developing a business plan and budget. This resource is designed to work as independent resource or integrate into business curriculums.

Growing Your Own Business continues after the first book, *Starting Your Own Business*. Both resources are designed to work as independent resource or integrate into business curriculums.

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