

HOW TO START YOUR BUSINESS



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Planning

- 4 out of 5 entrepreneurs fail
- Why?
- A failure to plan is a plan to fail.
- The risk of failure can be mitigated.
- Some need to mitigate more due to inherent skills and talents.
- Mitigation comes from learning and experience.

What do most do?

- Great technicians
- Few business and financial skills
- Mix personal and business money, increasing risk
- Fail to get legal help
- Don't seek out or listen to mentors
- Run out of cash because ...

What is an Entrepreneur?

One who creates a new business in the face of risk and uncertainty for the purpose of achieving profit and growth by identifying opportunities and assembling the necessary resources to capitalize on them.

Characteristics of Entrepreneurs

- Desire for responsibility
- Preference for moderate risk
- Confidence in their ability to succeed
- Desire for immediate feedback
- High level of energy
- Future orientation
- Skilled at organizing
- Value achievement over money

Creativity and Innovation

Creativity – the ability to develop new ideas and to discover new ways of looking at problems and opportunities; *thinking* new things.

Innovation – the ability to apply creative solutions to problems or opportunities to enhance or to enrich people's lives; *doing* new things.



Entrepreneurship

- Entrepreneurship – the result of a disciplined, systematic process of applying creativity and innovation to the needs and opportunities in the marketplace.
- Entrepreneurs connect their creative ideas with the purposeful action and structure of a business.

Entrepreneur & Investor

- Entrepreneur (founder of several companies)
 - 2 “successful” harvests
- Investor (venture)
 - Over 30 “angel” investments

Overview – Entrepreneurship

- Idea – creativity and innovation
- Planning (esp. financial)
- Opportunity
- Management
- Funding – 3 basic ways
- Execution
- Revenue → Profits → Cash Flow → Liquidity

An idea is just a wish

- There are many ideas
- Few opportunities
- Ideas must be evaluated to see if they are real opportunities



Opportunity Driven

The Three M's

Separates Opportunities from Ideas

1. Market Demand
2. Market Structure & Size
3. Margin Analysis

What makes an Idea a Good Opportunity?

- High barrier to entry
- Low capital requirement
- Recurring revenue model
- Large market opportunity
- Low headcount need

Evaluating a Business Idea

1. What is the need you fill or problem you solve? (Value Proposition)
2. Who are you selling to? (Target Market)
3. How would you make money? (Revenue Model)
4. How will you differentiate your company from what is already out there? (Unique selling proposition)

Evaluating a Business Idea

5. What are the barriers to entry?
6. How many competitors do you have and of what quality are they? (Competitive Analysis)
7. How big is your market in dollars? (Market Size)
8. How fast is the market growing or shrinking? (Market Growth)

Evaluating a Business Idea

9. What percent of the market do you believe you could gain? (Market Share)
10. What type of company would this be? (Lifestyle or High Potential, Sole Proprietorship or Corporation)
11. How much would it cost to get started? (Start-up Costs)
12. Do you plan to use debt capital or raise investment? If so, how much and what type? (Investment needs)

Evaluating a Business Idea

13. Do you plan to sell your company or go public (list the company on the stock markets) one day? (Exit Strategy)
14. If you take on investment, how much money do you think your investors will get back in return? (Return on Investment)

Think Like An Investor!

The Investor's Mindset

"Heart on fire, Brain on ice."



The Investor's Mindset



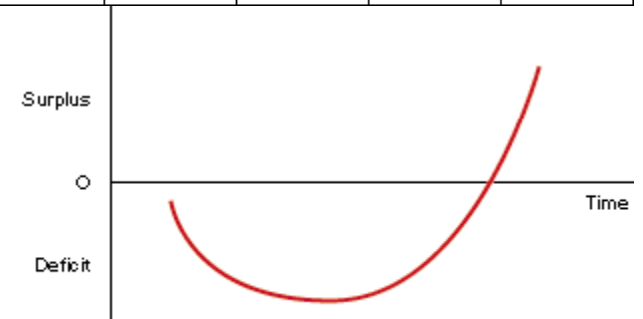
How much Capital?

- Two critical mistakes
 - Failure to determine the type of company and who owns what
 - Failure to plan financially, especially cash flow
- The all-important cash flow projection
 - 24-36 months of month-by-month projections
 - Next 2-3 years by year
 - Tells you your cash and capital needs

Financial Projections

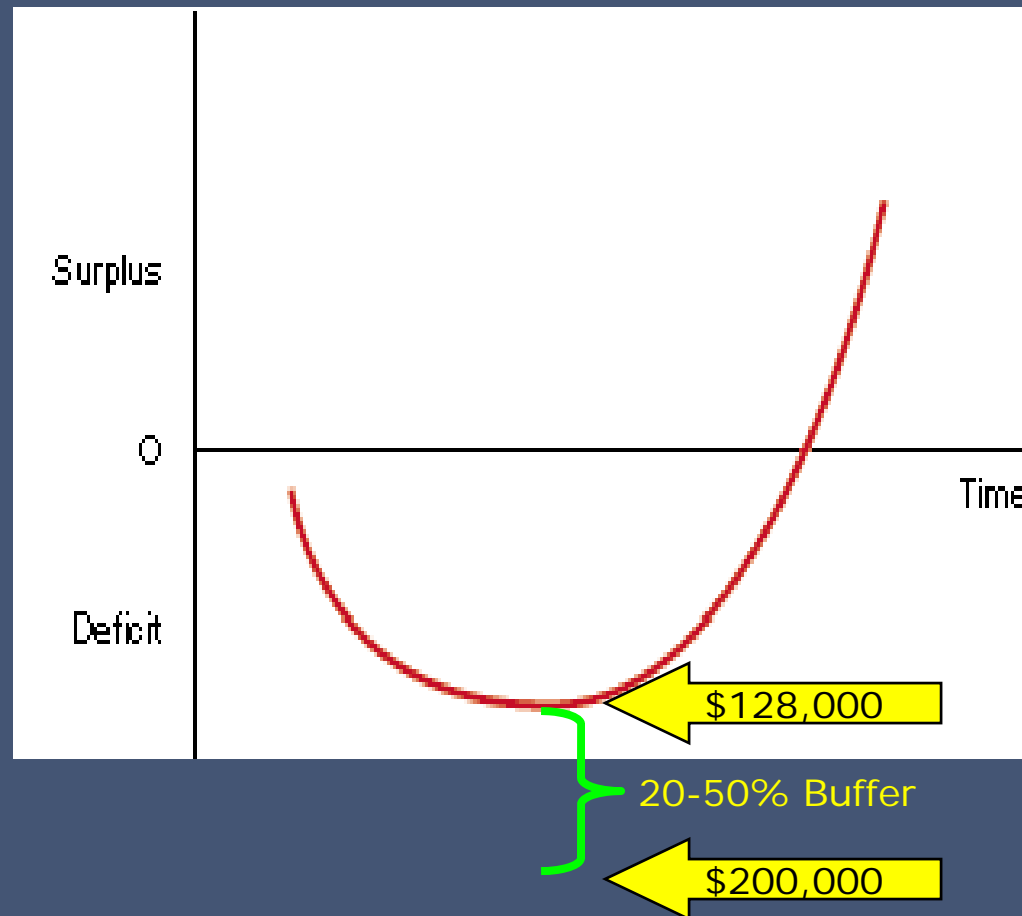
- A detailed, sophisticated process
- Takes experts 20-40 hours to do it right – moderates about 80 hours – and novices should not attempt without help and guidance
- All businesses start off with a cash flow J-curve

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Beginning Cash	\$ -	\$ (25,000)	\$ (48,000)	\$ (83,000)	\$ (113,000)	\$ (128,000)	\$ (123,000)	\$ (108,000)	\$ (83,000)	\$ (48,000)	\$ (3,000)	\$ 37,000
Cash Inflows												
Operations	\$ -	\$ 2,000	\$ 5,000	\$ 10,000	\$ 25,000	\$ 35,000	\$ 45,000	\$ 55,000	\$ 65,000	\$ 75,000	\$ 85,000	\$ 95,000
Financing	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Cash Outflows												
Operations	\$ (25,000)	\$ (25,000)	\$ (40,000)	\$ (40,000)	\$ (40,000)	\$ (30,000)	\$ (30,000)	\$ (30,000)	\$ (30,000)	\$ (30,000)	\$ (45,000)	\$ (45,000)
Financing	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Ending Cash	\$ (25,000)	\$ (48,000)	\$ (83,000)	\$ (113,000)	\$ (128,000)	\$ (123,000)	\$ (108,000)	\$ (83,000)	\$ (48,000)	\$ (3,000)	\$ 37,000	\$ 87,000



How much capital?

- Add 20-50% to the low point in the J-curve
- This is how much money (capital) should be raised



Ways to Get the Capital

- Bootstrap
- Sell equity (ownership)
- Obtain a loan (debt financing)

Bootstrapping

- Bootstrapping is a means of financing a small firm through highly creative acquisition and use of resources without raising equity from traditional sources or borrowing money from a bank. In short, **"bootstrapping" means starting a new business without start-up capital.** It is characterized by high reliance on any internally generated retained earnings, credit cards, second mortgages, and customer advances, to name but a few sources.

Strategies for Successful Bootstrapping

1. Get operational quickly.
2. Look for quick, break-even, cash-generating products.
3. Offer high-value products or services that sustain direct personal selling.
4. Forget about the crack team.
5. Keep growth in check.
6. Focus on cash (not on profits, market share, or anything else).
7. Cultivate banks before the business becomes creditworthy (keeping good books, immaculate records, and sound balance sheets from day one).

Specific Bootstrapping Techniques

- Prepaid licenses, royalties, or advances from customers
- Special deals on access to product hardware
- Development of product at night and on weekends while working elsewhere
- Customer-funded research and development
- Free or subsidized access to general hardware
- Turning a consultant project into a commercial product.
- Obtain research grants and commercializing university-based research.
- Foregone or delayed compensation
- Reduced compensation
- Personal savings
- Working from home
- Deals with professional service providers at below-competitive rates
- Space at below-market or very low rent
- Personal credit cards and home equity loans.
- Small Business Administration's guarantees, the entrepreneur's severance and parachute payments, barter arrangements, and special terms with customers.
- Buy used equipment instead of new
- Borrow equipment from other businesses for short-term projects
- Use interest on overdue payments from customers
- Hire personnel for shorter periods instead of employing permanently
- Coordinate purchases with other businesses (mutual purchasing of goods)
- Lease equipment instead of buying
- Use routines to speed up invoicing
- Cease business relations with customers who frequently pay late
- Offer same conditions to all customers (that is, no expense on preferential treatment to some)
- Buy on consignment from suppliers
- Obtain trade credit from suppliers
- Deliberately choose customers who pay quickly
- Share business premises with others
- Employ relatives or friends at non-market salaries
- Run the business completely from your home.
- Sharing of equipment and employees with other local businesses to reduce fixed commitments.
- Withhold entrepreneur's salary payment for short or long period of time
- Pay employees with company stock (that is, save on cash expenditures and give the employees some ownership and additional motivation to work hard)
- Seek out best purchasing conditions with suppliers
- Deliberately delay payment to suppliers
- Use the entrepreneur's private credit card for business expenses
- Obtain capital via the entrepreneur's assignments in other businesses
- Obtain loans from relatives and friends
- Barter underused products or services with other firms
- Franchise or license the product or business idea to others for a royalty fee.
- Raise capital from a factoring company (through selling the firm's accounts receivable to the lender) and obtaining central or state subsidies.



Equity Capital

- Represents the personal investment of the owner(s) in the business.
- Is called *risk capital* because investors assume the risk of losing their money if the business fails.
- Does *not* have to be repaid with interest like a loan does.
- Means that an entrepreneur must give up some ownership in the company to outside investors.

Debt Capital

- Must be repaid with interest.
- Is carried as a liability on the company's balance sheet.
- Can be just as difficult to secure as equity financing, even though sources of debt financing are more numerous.
- Can be expensive, especially for small companies, because of the risk/return tradeoff.



Sources of Equity Financing

- Personal savings
- Friends and family members
- Angels
- Partners
- Corporations
- Venture capital companies
- Public stock sale



Personal Savings

- The *first* place an entrepreneur should look for money.
- The most common source of equity capital for starting a business.
- Outside investors and lenders expect entrepreneurs to put some of their own capital into the business *before* investing theirs.



Friends and Family Members

- Three out of four entrepreneurs start their businesses with capital from outside sources.
- After emptying her own pockets, an entrepreneur should turn to those most likely to invest in the business: friends and family members.
- Careful!!! Inherent dangers lurk in family/friendly business deals, *especially* those that flop.



Friends and Family Members

(continued)

- Guidelines for Family and Friendship Financing Deals:
 - Consider the impact of the investment on everyone involved. Keep the arrangement “strictly business.”
 - Settle the details up front.
 - Create a written contract.
 - Treat the money as “bridge financing.”
 - Develop a payment schedule that suits both parties.



Debt v. Equity

- Debt
 - Paid while you wait
 - Priority over equity
 - Debt service and due date = automatic discipline
- Equity
 - Riskier
 - Dilution
 - Cram-downs
 - Common v. Preferred



**Convertible
Debt**

What type of entity?

- **Sole Proprietorship** – never do this. 100% liability risk. Cannot raise money in traditional sense.
- **Partnership** – may fit some businesses, but GPs get full liability and hard to raise money.
- **Limited Liability Company (LLC)** – 100% liability protection. Tax advantages.
- **"S" corporation** – most often LLC is preferred over this. Will not discuss in detail today.
- **"C" Corporation** – 100% liability protection; less tax advantages first year or so; more traditional.

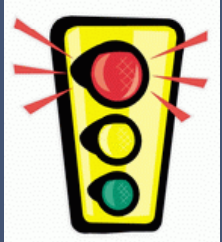
Cap Table Planning

Investor	Founders Round		F&F(&F) Round		Angel I Round		Angel II Round		VC Round		IPO		TOTAL	
Price Per Share	\$0.0005		\$0.1000		\$0.5000		\$1.0000		\$2.0000		\$12.0000			
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Shares	%
Bob	2,000,000	\$ 1,000		\$ -		\$ -		\$ -		\$ -		\$ -	2,000,000	12.70%
Sally	2,000,000	\$ 1,000		\$ -		\$ -		\$ -		\$ -		\$ -	2,000,000	12.70%
F&F(&F)		\$ -	1,000,000	\$100,000		\$ -		\$ -		\$ -		\$ -	1,000,000	6.35%
Angel I investors		\$ -		\$ -	500,000	\$250,000		\$ -		\$ -		\$ -	500,000	3.17%
Angel II investors		\$ -		\$ -		\$ -	250,000	\$250,000		\$ -		\$ -	250,000	1.59%
VCs		\$ -		\$ -		\$ -		\$ -	4,000,000	\$8,000,000		\$ -	4,000,000	25.40%
Public		\$ -		\$ -		\$ -		\$ -		\$ -	6,000,000	\$72,000,000	6,000,000	38.10%
Shares this round	4,000,000		1,000,000		500,000		250,000		4,000,000		6,000,000			
Total Shares	4,000,000		5,000,000		5,500,000		5,750,000		9,750,000		15,750,000		15,750,000	100.00%
Amount this round	\$2,000		\$100,000		\$250,000		\$250,000		\$8,000,000		\$72,000,000			
Pre-Money Valuation	\$0		\$400,000		\$2,500,000		\$5,500,000		\$11,500,000		\$117,000,000			
Post-Money Valuation	\$2,000		\$500,000		\$2,750,000		\$5,750,000		\$19,500,000		\$189,000,000			



“Red Light” Questions

- What is the pre-money valuation?
- What is the most recent monthly cash shortfall (averaged over last three months) or first projected three months of the plan?
- How much are you raising and does this investment round take company to profitability?
- Is there an escrow break in the raise? How much?
- How much hard cash (not sweat equity, accrued salaries, etc.) have in the company?
- What is the Market Demand?
- What is the Market Size?
- What are the gross and net margins?
- What is the target market share?
- What is the annual growth for first 3 years?
- Are the customer sales channels in place?
- Do the customer sales channels have sufficient capacity?
- How long before the customer is paid back?
- What resources is the company going to own?
- How has the technology in the company been tested?
- Explain how the management team has venture experience, a strong track record, domain knowledge, industry & local relationships, and vision, drive, and judgment.
- Who are all the investors in the company (Cap Table)?
- What are all the terms of the round?
- Explain the large, growing opportunity.
- Explain the sustainable competitive advantages.
- Explain customer validated value proposition.
- Are you willing to have me serve on the board of Advisors?
- Is there any unusual history to be aware of?



"Red Light" Triggers

- > \$4MM pre-money valuation (> \$1.5MM for non-revenue)
- > \$35K monthly cash shortfall
- Desired funds do not take company to profitability
- No escrow break in raise or convertible note with minimum 8% rate and monthly interest payments (non-revenue company does not secure note with real estate equity or share revenues to assure higher ROI)
- Managers and founders with no "Skin in the game"
- Problem with The Three M's
 - Market Demand
 - Market Size
 - Margin Analysis
- < 20% market share
- < 20% annual growth
- Customer is not reachable – channels not in place and/or insufficient capacity in channels
- Customer not paid back in less than one year
- Resources: "Maximizes & Owns" vs. "Minimize & Control"
- Untested technology
- Management Team lacks ...
 - Venture experience
 - Strong track record
 - Domain knowledge, industry & local relationships
 - Vision, drive, judgment
- No sophisticated, capable, like-minded co-investors
- Poor terms
- Lack of a large, growing opportunity
- Lack of sustainable competitive advantages
- Lack of a customer validated value proposition of product/service
- No ability to have personal operational impact
- Any funny business

Q & A