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Business Planning for New Ventures

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BUSINESS PLANNING FOR NEW VENTURES

- Assessing Entrepreneurial Aptitude
- Identifying Sources of Capital
- Selecting a Legal Structure
- Preparing the Business Plan
- Presenting the Plan to Capital Providers

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State of Connecticut
Department of Economic and
Community Development

CAT
Connecticut Center for
Advanced Technology

Connecticut
Development
Authority

CERC
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Business Planning for New Ventures

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The Entrepreneur Self-Assessment

By: Ken Kollmeyer, Small Business Development Specialist, CT Small Business Development Center

INTRODUCTION:

It is a common practice for a budding entrepreneur to want to leap into the fray and to 'get on' with starting-up their business. They are excited about and anxious to make decisions about products, customers, markets, facility and a plethora of other relevant issues. After all, isn't this the appropriate activity for a pre-venture or nascent entrepreneur? Yes, it is; however, perhaps an even more important question is in order and it needs to be answered with complete honesty even before seeking answers to the afore-mentioned decision points. That special question is: Am I 'cut out' to start, own and operate a business? Basically, the pre-venture or nascent entrepreneur needs to come to fully understand the personal skills, qualifications and motivators that she must have in order to have a fair chance at being successful. It's truly the time to stand before the full length mirror and take a long hard look at the whole (mostly your personal makeup) person you see staring back at you.

Take Your Time-Think About What Being In Business Will Be Like. Starting up and sustaining a growing and profitable business will be no easy undertaking. The fact is that 8 out of 10 new businesses will fail during their first five years of existence; approximately 70% of these failed businesses will be profitable. Insufficient operating capital will be the primary reason for failure during year one. Beyond year one, numerous factors will come into play to sink businesses and they can all be lumped together under the banner labeled 'management problem'. In a nutshell, the entrepreneurs were not ready and able to start-up and/or operate a business. Don't be a casualty asking that infamous question, 'What could I have been thinking'? as you exit your place of business and lock the door behind you for the final time. So what proactive steps can you take?

Firstly, one needs to thoroughly understand their reason(s) for taking the big leap. Some of the more common reasons given for starting a business include: having flexible hours; choosing where you will work; choosing what you will wear; being able to run the show; being able to fire a customer if inclined, being the business hero who can meet an unsatisfied market opportunity and making lots of money. While these motivators are all appropriate and real, having a solid chance for business success must go beyond one's emotions and feelings. A decision to start a business must include a healthy dosage of realism and logical purpose. Have you looked at your business concept from all angles and under a microscope? Have you drafted a Business Plan? Have you performed a 'hands-on' survey to test the viability of your marketplace potential? Have you articulated your personal rationale for why you are starting a business to your entrusted circle of family members and friends? Did you listen to their responses?

Secondly, the entrepreneur must conduct an introspection of what it is they like to do and what it is they don't like to do. In most situations, an individual will tend to deliver an overall higher quality of work when completing those tasks that are more closely aligned with their 'likes'. Conversely, an individual will not tend to perform as well when dealing with tasks that are more closely aligned with their 'dislikes'. It will be beneficial for every prospective entrepreneur to make a listing of their specific likes and dislikes. After creating this list, the individual should create another listing of all business related activities that will need to be completed on a week in week out basis in order to conduct business. Lastly, you should add a column for self-assessing your predisposition for and your proficiency for carrying out these specific tasks. Keep in mind that you may be very capable of performing a certain task but may find it extremely uninteresting, boring or difficult. Examples might include paying the bills, cleaning the shop or firing an employee. Since starting and running a business will necessitate that all business-related tasks be completed, you will need to figure out who will actually do the work. If your business is you and you will be doing everything, you will need to have some knowledge of all business areas and should also have a solid background in most areas of the business's operations. When you have reached a point where you enjoy doing the work and are being compensated for it as well, consider yourself fortunate. While it will not be easy, an entrepreneur should always attempt to maximize their likes and minimize their dislikes.

Thirdly, take a look back in time and come to a realistic appraisal of where you have succeeded in both your personal and professional lives. Think about those projects that required demonstrated planning and management skills; they are key ingredients for business success. Community service projects, parties and events, home improvement projects, coaching little league sports and writing policy and procedure manuals are all fair game for consideration. How did you perform? If you fared well and positive results were achieved, then you most likely have some of the talents and skills required for running a successful business. It is probably very safe to add and that in all likelihood, your planning efforts did not materialize exactly as expected. Such is often the norm. You may have faced unforeseen issues that you had to adapt to modifying your plan along the way. Yes, you were managing. Your planning and managing skills may be very rudimentary indeed, but the good news is that they exist and they can be grown and refined.

Lastly, any pre-venture or nascent entrepreneur should dig down deep and try to proactively determine how they will feel about the loss of 1) a steady income, 2) paid holidays and vacations, 3) regular working hours, 4) reduced family time, 5) peace of mind and 6) financial security. Some not too far-fetched scenarios for consideration might include: 1) it's 2am; your phone rings and it's a representative of your alarm company advising you that a door alarm at your building has been activated. They ask you if you will be driving to the facility to meet the police. What will you do? Or, 2) you just opened a small boutique across from the regional mall and you have decided that you will open on the July 4th holiday and take advantage of the traffic that will be created by the colossal sale events being held at the regional mall. Sally, your lone employee has agreed to cover the day but is taken ill unexpectedly and she contacts you during the early morning hours on the Holiday. You have committed to spending the day at the beach with your family; all family members have been looking forward to this day. What will you do? Will you open the shop and abandon your family plans or will you keep the shop closed? What if you had already purchased a newspaper ad indicating that you would be open for business?

Small Business-a Roller Coaster Ride: Starting and operating a small business can truly be a 'double-edged sword'. There can be exhilarating highs and there can be harsh lows. Think about the following possibilities and how they can be the makings of a thrilling roller coaster ride with adrenalin rushes generated by heart stopping excitement and fear along the way. Consider the following pros and cons to being in business:

- ✓ You are the focal point and carry the prestige that owning a business can bring; you are the proverbial point at which the buck stops.
- ✓ You have independence and can come and go as you wish; you will need to accept 60-84 hour work weeks as a fact of entrepreneurial life and you can't quit.
- ✓ Running a successful small business can be extremely gratifying and uplifting; if your business is underperforming and you are struggling to pay your bills, your ego may suffer.
- ✓ Attaining your dream of financial security can bring a lifestyle filled with many creature comforts; owning a business can result in fluctuating levels of income and the loss of your investment …..**You may even lose your home.**
- ✓ Since your business is your dream, it is your 'labor of love'; in some instances, however, the pressures and stresses of running a business may turn your avocation into drudgery.
- ✓ You set out to create a product and/or service that fill a void creating economic value and jobs for the community; however and for example, you must live with the ever-present risk of being responsible for some sort of accident which can leave a negative impression on the community.

INSIGHTFUL QUESTIONS:

Therefore, it's time come to grips with whether or not you have what it takes to be a successful entrepreneur or business owner. Here are some insightful questions that should be answered before crossing the point of no return. They are:

	PREPAREDNESS	YES = 5	4	3	2	NO = 1
1	Do I have the skills to start and operate a business?					
2	Do I have substantial experience in the type of business I want to start?					
3	What is motivating me to act and can these motivators be sustained?					
4	Do risk taking and I get along?					
5	Can I afford to lose the money I need to invest in the business?					
6	Have I allowed my family or significant others to voice their true feelings about this significant commitment of family time and finances?					

Inventory Your Skills: Have you taken an inventory of your skills? Do you possess a reasonable level of proficiency across the various business disciplines (e.g. sales, marketing, finance, operations, etc.)?

- Basic math skills are a necessary evil. You will need to be reasonably comfortable working with numbers (e.g. addition, subtraction, multiplication, division, ratios). Can you analyze revenue and expense figures in order to determine what products and or service are profitable and which are unprofitable? Can you determine what level of sales and profit increases might justify a 20% increase in advertising?
- People skills are indispensable. Running a business will require that you interact with other people nearly every hour of the day. If you are not engaged with people, you will probably not be as successful as you would be if you were interacting productively with business stakeholders. After all, your customers, employees, suppliers, lenders and advisors are people.
- Solid written and verbal communication skills are critically important to your success. Observe almost any 'help wanted' classified advertisement? How many positions of leadership do not require 'strong written and verbal' communication skills? Not many!
- A solid grounding in technology is also a logical prerequisite for a successful small business journey. Technology must be viewed as a tool that can help to market your business, sell your product or service and help your business to operate more efficiently keeping your costs structure as lean as possible. You must embrace technology, become comfortable with it and strive to make it work for your business. Do not fear it; it is your friend. It is a means to an end rather than an end unto itself.
- While not a specific skill set, possessing an ongoing 'Passion to Learn' will serve you well. You may ask, what is a 'Passion to Learn'? Well, it's an unquenchable curiosity that just won't stop; it is an incessant drive that causes you to look at all facets of your business searching for an understanding of why it is working or not working. This quality tends to be within the makeup of most successful individuals.
- Lastly, are you grounded in reality? Can you be honest and face your strengths and weaknesses? We all have our pluses and our minuses; you are most likely not an exception to the rule. Therefore, understanding what you can do well and what you cannot do so well will serve you well as you move forward and decide upon what tasks you will tackle and what tasks you should not tackle without assistance.

  It is recommended that you compare your skill set proficiency against these requirements and should you arrive at the conclusion that you are indeed deficient in one or more competencies, do not despair. Help is available. Individual and multiple session seminars, workshops, and courses are available through the Small Business Development Centers in partnership with local Community Colleges and Adult Education Programs across the state. While classroom sessions are the norm, online learning opportunities are also becoming more and more commonplace and convenient.

Why Criticism Will Be of Value:
Most of us will claim that we are open to criticism, but most of us will also develop a knot within our stomach as quickly as the first critical word falls upon our ears. Successful entrepreneurs and business people understand that their primary role is one of meeting a market need more effectively than their competition. Consumers are indeed fickle and their tastes are ever changing; perfection can be a 'fool's mission. Therefore, a primary goal for any entrepreneur or business person will be to 'continuously improve' their product and service. Constructive criticism is a valuable ingredient to the 'continuous improvement' process and this practice can help you to reach your goals. How would you respond to the following questions?

	SELF-CRITIQUING SKILLS	YES = 5	4	3	2	NO = 1
7	Do I seek advice and feedback?					
8	Do I listen to my critics?					
9	Do I take the criticism to heart?					
10	Do I apply what I learn?					

Having the ability to answer yes to all of the above questions is a state of being we should all aspire to reach.

Being a Student of Your Business:
Within an earlier section of this chapter, I stated that successful entrepreneurs and small business owners will usually exhibit a 'Passion to Learn'. Directly related to this concept is the need for the entrepreneur and small business owner to know every 'facet' of their business and to know it inside and outside, upward and downward. Will an accountant be helpful? Yes, unless you are an educated and experienced accountant, retaining one with experience in your business and industry will be a very important decision for you to make. After all, accounting is the 'language of businesses'. You will need to understand where your business has been and you will need to chart a course for where you will take it going forward. The financial and operating numbers will enable you to understand where you've been and to articulate your path into the future.

Furthermore, make it your business to learn every 'nook and cranny' of your business. For example, do you know the answers to the following business -related questions?

- What are my busiest days, weeks, months?
- What percent of revenues is my cost of goods sold?
- During what months will my cash flow be stressed?
- What are my service challenges?
- What forms of advertising are most effective for my business?
- Etc.?

The Family's Role:
Now let's bring your family into the mix. Have you shared your dream and your plans with your family members? If you have done so, congratulations are in order. However, did you also talk about the 'downside risk' as well as the 'upside benefits'? If you have not, then you have not communicated the whole story to them. And, don't they deserve and have a right to learn everything about your business dream and how they might be affected? After all, their lifestyle, as they know it today, might change in the not too distant future. Your family time together will most likely be diminished. Will your children and spouse be needed to pitch in during the evening or on weekends? Have they bought into this arrangement? The stresses related to starting a business can also take its toll on the family unit; if all members are not on the same page, the family unit can break apart.

COMMON CHARACTERISTICS OF SUCCESSFUL ENTREPRENEURS AND OWNERS:
Successful entrepreneurs and small business owners just don't happen. While some luck is always a welcomed ingredient, the primary reasons for success can generally be traced to a series of characteristics that are possessed by or developed by the entrepreneur or small business owner. Here are the important characteristics:

- **Experience**

  Do you have general business, specific business and specific industry experience? Are you a seasoned decision-maker? You may be a very bright person; however, common errors of omission and commission can be fatal to a start-up business. Learning from mistakes is not necessarily wrong, however, the pre-venture entrepreneur should try to learn on someone else's wallet if possible.

  Therefore, take the necessary time to learn as much as you can about your business. If you have never performed your intended business's work, take a job(s) that will provide you with the necessary insights and feel for its unique rhythm and challenges. For example, if you have no relative experience, whatsoever, but seek to own and operate a sporting goods retail store featuring hockey equipment, supplies and apparel along with a skate sharpening service just because you love hockey and believe it's an excellent activity for the town youth, do yourself a large favor and get the necessary experience working for an established company before charging forward. On the other hand, if you have worked in the retail industry but have a family shoe store background rather than a sporting goods retail store background, it is very plausible to pick up pointers by dialoguing and networking with other sporting goods retailers with whom you will not compete. Following the principle that people will generally try to help out other people in need, there is a very good chance that you can learn enough from these conversations and may move forward with your endeavor.

- **Personality**
  Personality is a component of the 'art form' of management. In many respects, it's part of your DNA. Please answer these questions honestly:

	IS THIS REALLY WHAT I WANT	YES = 5	4	3	2	NO = 1
11	Do I like to sell?					
12	Can I persevere and stay focused?					
13	Can I interact effectively with others?					
14	Can I inspire and motivate others?					
15	Am I an effective listener?					
16	Am I competitive?					
17	Am I a self-starter?					
18	Am I comfortable with ambiguity?					

  If you were not able to answer yes to the vast majority of these questions, you probably will find the road to entrepreneurship or small business ownership success to be very bumpy and possibly distressful.

- **Managerial Ability**
  In the business world, achieving positive results through other people is an ever present challenge. You won't be able to do everything that must get done; you'll go to your grave trying. Furthermore, you will need to be incessantly planning, organizing, implementing and monitoring your ideas and your business results on a daily basis. Are you skilled and able to do the following?

	MANAGERIAL ABILITY	YES = 5	4	3	2	NO = 1
19	Manage people?					
20	Deliver results?					
21	Maintain a tight control over the money?					
22	Keep accurate records?					
23	Understand the dynamic relationships between resources, assets and financial results?					

- **Wearing Many Hats**
  You will most likely be doing the vast majority of the jobs when you start-up your company. Listed below are many of these functions. Take a 'self-inventory'. Are you knowledgeable as to what these business functions are and do you have the skills to competently perform them? Know your strengths; know your weaknesses.

Hats to Wear: be prepared to act as general manager; marketing manager; advertising manager; copywriter; graphic artist; production manager; website developer; mailing list manager; bulk mail expert; order fulfillment clerk; shipping clerk; materials manager; administrative assistant; customer relations representative; order taker; file clerk; bookkeeper; accountant; computer expert; personnel specialist; benefits administrator; etc.

While larger companies will typically have at least one person for each of these jobs, it would be virtually unrealistic for you to know the ins and outs of each position. However, recognize that many of them will need to be performed in a proficient manner in order for your company to attain success. How will you ensure that this happens?

For example, let's say that you are going to be opening a restaurant business and have worked in this business for several years but mostly performing and supervising tasks related to the delivering top flight culinary service in dining room. You understand what happens in the kitchen, but have never had to perform job duties related to inventory control. Short of having a knowledgeable partner or a highly trusted and knowledgeable employee in place to watch over this situation, it will be incumbent upon you to do so. Therefore, if an employee of yours will be handling the inventory control duties and your role will be to supervise the process, how will you be certain that the inventory is indeed being accounted for properly and is not falling into the 'black hole' and becoming 'shrinkage'? Without the proper inventory management practices in place, a significant portion of your start-up money can be stolen before you even open the doors. How will your organization ensure that this situation will never arise?

Once again, should you not possess this necessary skill set, do not despair. Bricks and mortar and online seminars, workshops and courses are available through the Small Business Development Centers in partnership with local Chambers of Commerce, libraries, Adult Education Programs and Community Colleges across the state of Connecticut.

- **Vision**

Our world is ever changing; this is a given. The pace at which change occurs continues to accelerate. Keeping up with customer preferences and the markets is at best a daunting necessity. If your business is not changing, it is probably dying. What new concept has your competition just rolled out? What will be the next market 'breakthrough'? Will your business be a leader, a follower or a laggard? Therefore, can and will you:

Be able to identify and react to changes in the marketplace in a timely manner?

	VISION	YES = 5	4	3	2	NO = 1
24	Be able to know an opportunity when you see one?					
25	Be able to identify and react to changes in the marketplace in a timely manner?					

- **Courage**
  Starting and running you a business will require that you deal with business issues 'front and center'. Procrastination will usually translate into costs and will reduce profit. Therefore, can and will you:

	COURAGE	YES = 5	4	3	2	NO = 1
26	Deal with adversity 'head on'?					
27	Make bold and difficult business decisions in a timely fashion?					
28	Not become easily discouraged or intimidated?					

IN CONCLUSION:

Beginning your own business is indeed a very serious matter. The preceding thoughts and information are meant to provide a 'reality check' and 'food for thought' for all would be entrepreneurs and business owners. In many instances, deciding not to take this plunge will be the correct decision. Entrepreneurship and business ownership is not for everyone. Eight of ten businesses will fail within the initial five years of operation. Finding out the hard way can lead to the loss of your home, financial security, health and even your family.

However, let's not lose sight of the fact that many storied entrepreneurs have indeed forged ahead starting and owning small businesses that have grown into very significant companies. It can be done. Examples include: Intel; Jet Blue; Subway Restaurants; Microsoft; and Wal*Mart to name but a few. All started with an entrepreneur's dream and that dream was nurtured with hard work, capital and more ideas, dreams, passion and capital. Their evolution continue.

The key is to be informed and to be true to yourself; then, make the big decision.

Sources of Capital

Types of Capital

THERE ARE TWO TYPES OF BUSINESSES:

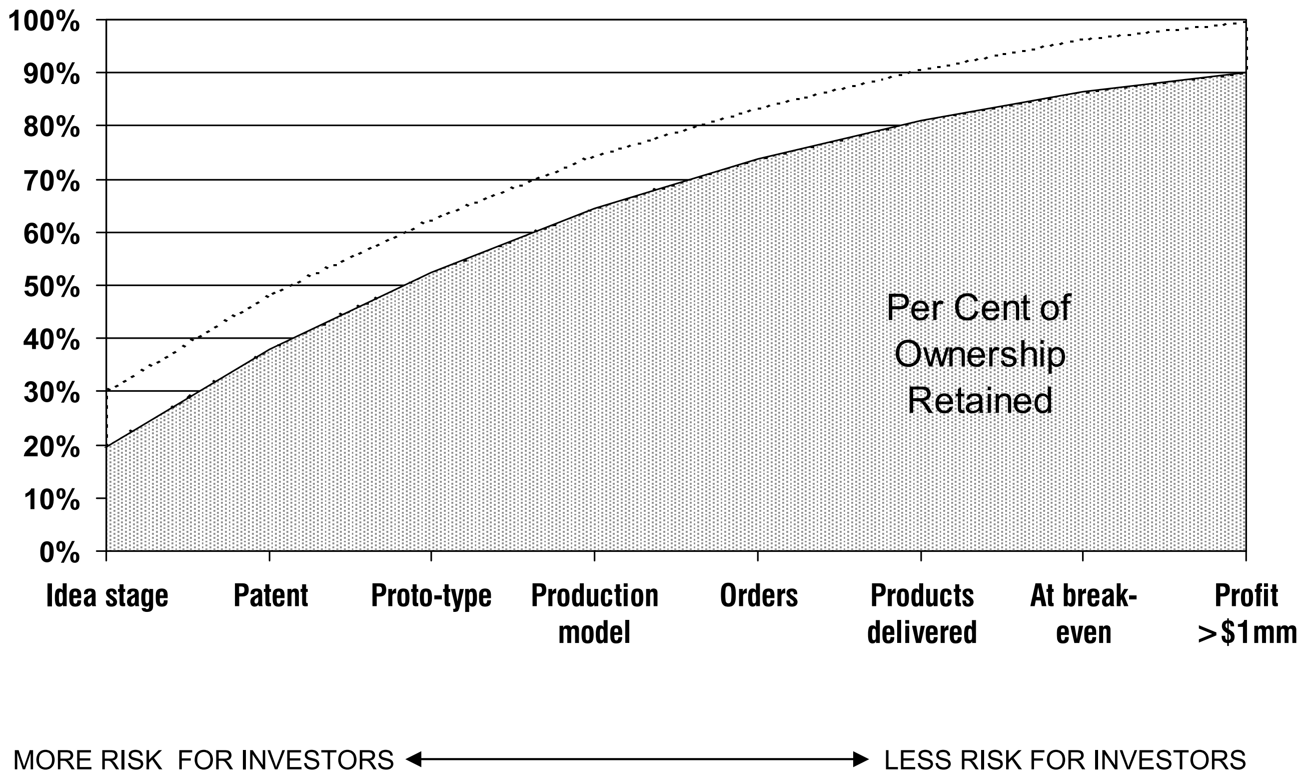
1. ***Personal Business.*** These businesses typically are funded through personal savings, family, and loans from a bank. They have one or more of the following characteristics:
    a. Relatively small size: (potential sales under $50 million, often under $1 million)
    b. 1-20 employees
    c. Consumer product or service
    d. Local
    e. Low tech
2. ***Venture Enterprise.*** These businesses typically are funded with outside equity capital. They have one or more of the following characteristics:
    a. Large potential market: $50 million or more
    b. Multiple employees upon funding, with a potential exceeding 100.
    c. Business to business product or service
    d. Regional or national in scope
    e. High tech with patent protection

THERE ARE ALSO TWO TYPE OF CAPITAL:

1. ***Debt Capital*** *(a loan)* carries with it a legal obligation to repay the investment within a specified time period, with interest. Commercial lenders will generally require collateral or the borrower's personal guarantee in case of default. This protects the lender and ensures that the borrower has a sufficient personal interest at stake to work diligently at the business.
2. ***Equity Capital*** (investment by an individual “Angel” investor or Venture Capitalist in exchange for shares). Unlike loans from Commercial Banks or Government Lenders, with the exceptions in certain cases, you are not morally or legally obligated to refund an equity investment if the business fails. However, if the business is successful, you may wind up paying back more than you would have with a loan. A loan calls for a specific interest rate, no more and no less. However, an equity contract will contain an agreed upon share of ownership for the investor. This may result in a larger or smaller amount than interest and principal payments to a bank.

    Equity investing can be especially useful if the company is already carrying a large amount of debt. Loading up with increasing amounts of debt may eventually drive the company into insolvency. Banks can call in overdue loans and force the company to liquidate its assets in order to pay down debt. However, equity is generally utilized in early stages because lenders won’t usually lend to businesses with little or no “hard” collateral or earnings track record.

The following chart illustrates the concept that an equity investor will expect a percentage of ownership in relation to the perceived risk. Although the percentages in this chart are hypothetical, the concept that the more advanced the development of your product and business, the less ownership the investors will require in order to balance their risk.



There are additional factors that may affect the percentages in the preceding chart. These variables may exert an upward pull on the percentage of ownership the entrepreneur might retain (dotted line); or they may lower the ownership percentage the entrepreneur should expect to retain.

External factors (variables not within your control):

- The Economy
- Investor Confidence
- Total amount of capital available in the investment market

Internal Factors (variables under your control):

- Newness or uniqueness of product or service
- Prior experience (Serial entrepreneurs can retain a larger share of ownership)
- Profit potential

Sources of Capital for Start-Ups

1. **Personal Savings** (*Equity Capital).* The more money you personally invest in your business, the easier it will be to attract financing. Banks and outside investors feel confident you will stick with the venture if you have "skin in the game." Also, your personal investment leverages their investment. Investors will only consider cash contributions on your part, not the value of your time. But only invest what you can afford to lose; be careful about betting your retirement fund on a new business. Determine how much capital you need to start the business and set that as your savings goal, plus a reserve for contingencies. (Don't forget to include twelve months of living expenses in your capital needs. You probably won't be able to draw money out of the business for at least that long.)
2. **Family and Friends** *(Debt or Equity Capital)*. Along with personal savings, this is the most common source of capital for new businesses. Often, these loans are forgivable. Family members and friends may not require personal guarantees and therefore will not foreclose on your home, but be careful not to risk more family and friends than you can afford to lose.
3. **Commercial Banks** *(Debt capital).* Savings and Loan Associations (S&Ls) do not make business loans.
4. **Government Lenders** *(Debt capital)*.
    a. STATE LENDER. The Connecticut Development Authority (CDA) will in certain cases guarantee 10-20% of a loan from a commercial bank, in borderline cases where the guarantee serves as the deciding factor for the entrepreneur to receive the loan commitment. The business must have the potential to contribute jobs and new taxes for the state.
    b. NATIONAL LENDER. The Small Business Administration (SBA) will often lend money if a business has been rejected by two banks. Interest rates are slightly higher. (Your business is assumed to be a higher risk because you have been turned down by the banks). The SBA does not loan money directly, but serves as a guarantor of loans made by commercial banks.
5. **Venture Capitalists** (*Equity Capital).* A Venture Capitalist is a professional firm that specializes in investments in entrepreneurial ventures. A VC receives funds from individuals, pension funds, banks, insurance companies and other *Limited Partners* to invest on their behalves. Venture Capitalists are generally reluctant to invest in start-ups because of their higher risks.

    Venture capitalists prefer established companies (although not necessarily profitable) with proven concepts and the potential for $50 million in annual sales. The possibility of a public stock offering (IPO) is critical to venture capitalists. Quality management, a competitive or innovative advantage (including patented intellectual property), and industry growth are also major considerations. They also look for firms that require typically $1,000,000 to $20,000,000 in new capital. Many VC firms have over $100 million under management and if they made $100,000 investments, they would have more portfolio companies than they could efficiently oversee.

    Venture capitalists will typically invest in only one opportunity for every 100-300 that they see.

VCs may prefer to influence a business passively, but they will insist on corrective action when a business does not perform as expected and may even insist on changes in management. Many VCs will require board seats. Relinquishing some of the decision-making authority is the main disadvantage of equity financing. However, venture capitalists, through their contacts and *portfolio companies* (companies they have invested in), can often encourage others to invest, provide helpful advice and counsel on business strategy, and introduce you to potential customers. In many cases, this access to industry experience, knowledge and contacts is more valuable to the enterprise in the long run than the cash investment.

You may contact VCs through the Connecticut Venture Group, a non-profit association of venture capital firms. CVG can be reached at (203) 256-5955 or through its web site: www.CVG.org.

6. **Private Individual Investors** *(Equity Capital).* A private investor, or *Angel*, operates like a venture capitalist. Typically angels are successful entrepreneurs themselves looking to reinvest some of their winnings helping others. Because of his or her prior entrepreneurial experience, an angel investor may desire to be actively involved in the management of the business. This can bring a wealth of free expertise and assistance; and sometimes the frictions attendant to even the most harmonious of marriages. So, don't get engaged on the first date. It is important for you and the angel investor to get to know each other, test compatibility, and to clearly understand each others expectations through several preliminary meetings.

   Angel Investor Clubs *(Equity Capital).* A group of angel investors that invest individually or collectively through a common fund that each angel contributes to, usually in the range of $50k-$250k per annum. Some of these pools are professionally managed by experienced fund managers that screen deals, perform due diligence, and negotiate investment terms with the entrepreneur.

   Even when the angels do not invest through a common fund, but individually, they will sometimes *syndicate* deals. That is, several angels may each invest a portion of the amount required by an entrepreneur. The advantage of a club to the angels is that it allows them to spread their risk over more deals, and provides for a second opinion about deals from co-investors. For the entrepreneur, the advantage of approaching a club versus an individual investor is that the club has greater investment resources. Although it is almost impossible to find one private individual who will commit to provide $500,000 to $1 million in capital, a club, through a common fund, or syndication (say 10 individuals committing $50,000 $100,000 each), could conceivably provide that much capital for one deal.

7. **In-Kind Sources** (*Equity Capital).* Consider the resources you want to obtain with the new capital. Can you obtain these assets or services directly as capital? Suppliers of services may demand a relatively high proportion of stock—relative to the value of their services—because of the higher risk. If you expect a landlord to supply free rent worth $50,000, you may have to give up $100,000 in stock, because, if the business fails, the property owner will receive nothing. Examples of in-kind investments include…

   a. SPACE. There are a number of business incubators in the state that may exchange free space, as well as advice, for a share in the company. Contact the Connecticut Business Incubation Association, administered by John Keegan of the Oxford Regional Innovation Center: jkeegan@oxfordinnovation.org (203) 262-6686.

   b. LEGAL SERVICES. For new businesses, legal expenses in connection with organization or patent filings can represent a significant share of start-up expenses.

Look for an attorney who will perform these functions for stock. The lawyer, in effect, becomes an investor. You will need to have a frank discussion of the value of the legal services and the value of the company to arrive at an equitable share of ownership in exchange for services. Be cognizant of conflicts of interest that arise if your lawyer is also an investor.

c. KEY EMPLOYEES. It was common practice during the dot.com heyday for programmers to work for shares instead of salary. Because so many of these "partners" ended up with nothing, it is harder to find takers for this payment practice. However, founding members of the company should be willing to accept all or part of their remuneration in stock instead of salary, especially if they are planning on keeping their day jobs until the new venture achieves profitability. In fact, they may insist on this arrangement.

Capital Source	Amount Available	Advantages	Disadvantages
Personal Savings	$	You retain complete control	Risk losing savings
Family and Friends	Limited	Already know you	Failure means frosty reception at family affairs
Commercial Banks	$50k and up	Already know you. You retain control.	Assets taken if you default. Skittish in bad times
Government Lenders	$25k and up	More willing to lend	Higher rates. Assets may be taken if you default.
Venture Capitalists	$1MM-$20MM	Cannot take your home. Valuable industry contacts and knowledge.	May take control if they lose confidence in you or strategy. Will want you to sell company or take public in five years.
Angel Investor	$50k-$500k	Cannot take your home. Industry experience.	You'll have to share control. Want to cash out in 3-5 years.
Angel Investor Clubs	$250k-$1MM	Cannot take your home	You'll have to share control
In-Kind Sources	10%-50% of total	No risk to you	Will expect high ownership stake because of their risk

Chart prepared by Matthew Smith

Sources of Growth Capital for Established Businesses

For established businesses, expansion capital can often be generated from within the company by managing cash flow better or by converting other assets into cash. Examples include:

1. CASH FLOW MANAGEMENT.
    a. Will a large customer prepay in exchange for a discount in price?
    b. Can you eliminate credit to customers and require payment at time of order?
    c. Are you paying bills sooner than required?
    d. Have you tried to renegotiate credit limits or payment terms? If you are required to pay C.O.D., attempt to obtain credit. If you are required to pay bills within 30 days, ask for more liberal net 60 or net 90 terms. If you are a good customer, have been meeting payment obligations on time, and have a rationale (your business is cyclical like the fashion or toy industries, or it takes you 60-90 typically to collect), then you may have a convincing case.
    e. Look at annual payments such as insurance. Do they come at the worst time of the year? If so, talk to the vendor about changing the payment date; or spreading out the payments into quarterly or monthly installments.
    f. Paying salespeople a commission, after the customer pays, is one way of keeping down risk and negative cash flow. Some magazine and web sites will also accept ads whereby payment is based on inquires or actual orders received as a result of the ad. (Again, payment is *after* the sale.) Consider offering a commission to web sites in your industry.

2. CONVERTING ASSETS INTO CASH
    g. ***Surplus Inventory***.
        1) Do you have excess inventory that should be placed on sale to free up cash for more better selling products?
        2) Can any merchandise or supplies be returned for cash or credit?
    a. ***Factoring***. Have you tried to sell purchase orders to a *factoring agent*? Practitioners of this little-known source of business financing will buy a purchase order from you at a discount, assuming the customer has good credit. There are not many companies that offer this service but you should be able to find one in your region by searching the web. The discount may be steep.
    b. ***Lease Versus Buy***. Everyone understands that leasing a car or truck for a business instead of purchasing it conserves cash. There are also leasing agents and finance companies that will purchase capital assets that you own and lease them back to you.

Capital Providers in Connecticut

I - EQUITY INVESTMENT

CONNECTICUT VENTURE GROUP (CVG) is a non-profit membership organization of Venture Capital investors, Private Individual ("Angel") investors, public agencies that provide equity, grants and loans, and commercial banks. To access this network, entrepreneurs may attend meetings of the organization or complete a free on-line funding application that can be accessed through the web site: www.CVG.org. A calendar of events is also posted on the web site.

CONNECTICUT INNOVATIONS (CI) was created by the General Assembly in 1989 and is charged with growing Connecticut's entrepreneurial technology economy by making risk-capital investments in high-technology companies. Since 1995 CI has financed equity investments solely through its own investment returns. 200 Corporate Place, Rocky Hill 06067. Call 860-563-5851 or visit www.ctinnovations.com. CI programs include:

- ***The Eli Whitney Fund***, CI's primary investment fund, focuses on technology sectors that present the greatest potential for economic growth: information technology, bioscience, photonics (applied optics) and energy and environmental systems. Investments, which typically range from $500,000 to $2 million on the initial round, are made in early-stage Connecticut companies that meet established criteria. E-mail investments@ctinnovations.com.
- ***Connecticut BioSeed Fund*** was established to help accelerate the growth of early-stage biotech enterprises in Connecticut. The fund provides seed capital to address the initial financial needs of young bioscience companies, sustaining them until they are able to attract a lead institutional biotech investor. Initial investments up to $500,000. Call 860-563-5851 or e-mail Bioseedfund@ctinnovations.com.
- ***BioScience Facilities Fund*** provides financing for construction of wet laboratory and related space. The financing can take a variety of forms, and terms are commensurate with the level of risk associated with the transaction and the specialized needs of the companies. Companies already in Connecticut, or those wishing to move to the state, may apply for financing through this $55 million fund. Call 860-563-5851 or e-mail Biofacilityfund@ctinnovations.com.

ANGEL INVESTMENT CLUBS.

- ***Angel Investor Forum.*** 222 Pitkin Street, Suite 113, East Hartford, CT 06108. (860) 289-0878 x337. www.angelinvestorforum.com.
- ***Connecticut Angel Group***. 1895 Post Road, Fairfield, CT 06824. (203) 319-1902. www.EntrepreneurshipFoundation.org.

II - LOANS

CONNECTICUT DEPARTMENT OF ECONOMIC & COMMUNITY DEVELOPMENT (DECD)

- ***Business Lending Partnership Program*** with some Connecticut financial institutions to provide companies with access to low-interest financing. Participating financial institutions include Citizens Bank and Sovereign Bank. www.ct.gov/ecd/cwp/view.asp?a=1097&q=289992.
- ***The Economic and Manufacturing Assistance Act (MAA)*** provides incentive-driven direct loans for projects with strong economic development potential. Eligible uses for the funds include planning studies, acquisition of real property, construction/renovation, working capital and business support services. www.CT.gov/ecd/cwp/view.asp?a=1097&q=253408.
- ***The Naugatuck Valley Loan Fund (NVRLF)*** provides manufacturers and eligible wholesale distributors in certain Connecticut communities with matching funds for the purchase of land or buildings, construction, renovation, rehabilitation and/or purchase and installation of machinery and equipment. Maximum loan amount $200,000, with a 2:1 match of funds to a bank loan. Available in the Northwest and Southwest regions only. www.ct.gov/ecd/cwp/view.asp?A=1097&Q=253416.

CONNECTICUT DEVELOPMENT AUTHORITY (CDA) provides financing including direct loans, revenue bonding and loan guarantees to businesses in Connecticut for working capital, equipment and real estate. Call 860-258-7800 or visit www.ctcda.com for a current list of lenders. Lending programs include:

- ***Connecticut Brownfield Redevelopment Authority (CBRA)*** offers redevelopment grants, assessment grants, financing and the one-stop center for programs that encourage and stimulate the development of Connecticut's brownfield sites. Brownfield Assessment Grants (BAG) are available to reimburse developers and municipalities for Phase I (up to $3,000) and Phase II (up to $10,000) site assessments and investigations. www.ctcda.com/brownsfield_redevelopment/index.html.
- ***Direct Loans*** supplement capital needs of borrowers with below-market interest rate loans to induce an enterprise to expand in or relocate to Connecticut. Direct loans and equity-equivalent investments are made in concert with or independent of private lenders when private capital cannot fully meet a borrower's needs.
- ***Guaranteed & Participating Loans*** are available in tandem with banks, private investors, CDA Direct Loans, SBA guarantees or with SBA 504 loans and can cover up to 40 percent of a loan. Targeted businesses for these loans are manufacturing, telecommunications and information systems, financial services, health services and high technology. Other industries can be considered.
- ***The Connecticut Business Development Corporation (CBDC)*** is sponsored by CDA under the SBA 504 Loans Program. These loans provide secured fixed-rate financing for acquisition of equipment and real property and offer long-term financing at interest rates that may be below those available from other sources. There is no limit on the size of the

total 504 loan, but the CBDC-funded portion of the loan cannot exceed $1 million. Call 203-458-2765.

- ***Industrial Revenue Bonds for Manufacturers***. The bonds can be issued for up to $10 million and can equal 100 percent of project cost. Interest on the bonds is exempt from federal and state income taxes, reducing debt service. Some programs applicable to targeted communities only. Call 860-258-7834.

- ***Urbank*** is for small Connecticut companies unable to secure conventional financing. Insures Loans up to $500,000 are insured for small businesses with special consideration afforded to minority and female-owned businesses. Call 860-258-7825 or e-mail john.lobon@ctcda.com.

THE COMMUNITY ECONOMIC DEVELOPMENT FUND (CEDF) underwrites loans of $5,000 to $250,000 to small companies and mixed-use property owners. There is no longer a location restriction for certain applicants seeking business loans, but if a business operates in a Target Investment Community, owners are eligible for assistance from CEDF regardless of income. (Eligibility for other companies based on owner's household income.) 430 New Park Ave., West Hartford 06110 (860-249-3800) or 900 Chapel St., New Haven 06510 (203-782-4377). www.cedf.com/loans.html.

- ***Standard Loan Program*** is designed for start-up or existing businesses. Loans can range from $5,000 to $250,000. Call 860-249-3800, ext. 309.
- ***Grow Your Business Loans (GYB)*** offers loans up to $250,000 for profit and non-profit businesses in operation for three or more years. Call 860-249-3800, ext. 309.
- ***SBA MicoLoans*** are provided through CEDF. Loans up to $35,000 are available and can be used in conjunction with other CEDF loans totaling up to $105,000. Free business consulting assistance from CEDF staff is included. Call 860-249-3800, ext. 304.
- ***Micro Loan Guarantee Program for Women and Minority Owned Businesses***, offered in conjunction with state's Department of Economic & Community Development (DECD), helps female- and minority-owned companies obtain flexible financing. Loans range from $5,000 to $50,000. Call 860-249-3800, ext. 304.
- ***CT Inner City Business Loan Guarantee Program***, in conjunction with state's Department of Economic & Community Development (DECD), underwrites guarantees for small-business loans in designated industry clusters located in Waterbury, Hartford, New Britain, Bridgeport and New Haven. CEDF employs flexible eligibility criteria and DECD provides a 30-percent guarantee. DECD guarantee allows CEDF to reduce the interest rate by one percentage point. Loans range from $50,000 to $250,000. Call 860-249-3800, ext. 304.

U.S. SMALL BUSINESS ADMINISTRATION (SBA). The Hartford District, 330 Main St., Hartford 06106, serves the entire state of Connecticut. Call 860-240-4700 or visit www.sba.gov/regions/states/ct/. SBA loan initiatives include:

- ***Basic 7(a) Loan*** is the primary business loan program to help qualified small companies obtain financing when they might not be eligible for business loans through conventional lending channels. It is also the agency's most flexible business loan program, since financing under this program can be guaranteed for a variety of general business purposes. Loan proceeds can be used for most sound business purposes including working capital, machinery and equipment, furniture and fixtures, land and building (including purchase, renovation and new construction), leasehold improvements, and debt refinancing (under special conditions). Loan maturity is up to ten years for working capital and generally up to 25 years for fixed assets. Visit www.sba.gov/financing/sbaloan/7a.htm.
- ***LowDoc Program*** reduces the amount of paperwork and red tape involved in getting small business loans of $150,000 or less. Simplified application process allows a rapid response from the SBA: within 36 hours of receiving a complete application. Visit www.sba.gov/financing/lendinvest/lowdoc.html.

THE CONNECTICUT COMMUNITY INVESTMENT CORP (CTCIC) is a private non-profit corporation providing economic development financing to qualified small businesses throughout Connecticut. CTCIC was established as a local development corporation under U.S. Small Business Administration (SBA) regulations. CTCIC offers loan products and business consulting services to small Connecticut companies, including the SBA 504 Loan Program, Defense Loan, Direct Loan, MicroLoan, Child Care MicroLoan and the Technology Investment Fund. 100 Crown St., New Haven 06510. Call (866) 776-6172 or visit www.ctcic.org.

- ***The MicroLoan Program*** assists individuals seeking to start up and operate a successful business and assists existing small businesses unable to secure credit. A typical financing package of up to $35,000 fixed rate micro loan can be combined with other financing sources up to a total of $75,000. Call 203-776-6172, ext. 24 or 29 or e-mail gtoole@ctcic.org or jtorello@ctcic.org.
- ***The SBA 504 Program*** offers long-term, fixed-asset financing to small companies for the acquisition, construction, expansion or renovation of land and buildings, machinery and equipment. To be eligible a company must be a for-profit corporation with a net worth not exceeding $6 million. Loans cannot be made to businesses engaged in speculation or investment in rental real estate. Financing available up to 90 percent. Call 203-776-6172, ext. 31 or e-mail dpanagrossi@ctcic.org.
- ***The Direct Loan Fund*** helps create, expand or modernize businesses within the 15 communities that comprise the South Central Regional Growth Partnership (Bethany, Branford, East Haven, Guilford, Hamden, Madison, Meriden, Milford, New Haven, North Branford, North Haven, Orange, Wallingford, West Haven and Woodbridge). Call 203-776-6172, ext. 24 or ext. 31, or e-mail dpanagrossi@ctcic.org or gtoole@ctcic.org.
- ***The ChildCare Facilities MicroLoan Fund*** helps increase the availability of child care to working families. CTCIC is Connecticut's statewide intermediary lender for this program in partnership with Connecticut's Health & Educational Facilities Authority and the U.S. Small Business Administration. Loans to child-care facilities of up to $25,000 at a fixed rate of financing can be combined with other financing sources up to a total of $75,000. Program available statewide. Call 203-776-6172, ext. 24 or ext. 29 or e-mail gtoole@ctcic.org or jtorello@ctcic.org.

III. GRANTS

SMALL BUSINESS INNOVATION RESEARCH PROGRAM (SBIR)

The Small Business Innovation Research Program (SBIR) awards federal funding to U.S. small high-tech businesses. Phase I awards are typically $100,000 and Phase II awards are $750,000. This is R&D funding that DOES NOT have to be repaid. The program has awarded over $20 billion since its inception in 1982.

The Small Business Technology Transfer program (STTR) is a sister program that awards federal funds to small businesses (same awards) that subcontract to universities or research institutions.

The Connecticut SBIR Office opened its doors in 2004 to help CT high tech businesses compete for and win SBIR / STTR awards. The two programs represent strategies to increase a company's R&D budget without taking out loans and without giving up equity or intellectual property. Both promote commercialization.

If you are a small technology business, majority US-owned firm with less than 500 employees -- or if you are manufacturer eager to work or partner with a small high tech company-- please take the time to learn more about the grant money available through the SBIR and STTR Programs. Additionally, the CT SBIR Office is committed to help Connecticut businesses commercialize their Phase 2 prototypes. For more information: (860) 257-2894 or visit: www.ctsbir.com

BUSINESS PLAN COMPETITIONS. See www.EntrepreneurshipFoundation.org for current collegiate competitions.

Structure

Legal Forms

One of the first decisions you will need to make is the choice of a legal form for your company. There are a number of options, each with advantages and disadvantages. The basic business structures are:

1. **Sole Proprietorship** – You and you alone own and control the company and are responsible for its liabilities. Earnings are taxed as personal income and are subject to self-employment taxes (Social Security and Medicare taxes).
2. **General Partnership** – Two or more owners with equal responsibility and financial liability. Partner earnings “pass through” directly without first being taxed at the company level, and are subject to self-employment taxes (Social Security and Medicare).
3. **Limited Partnership** (LP) – Allows for two classes of owners: general partners who control the company and bear the burden of paying obligations the company is not able to meet, including debts and legal judgments; and limited partners who are silent partners with no financial risk beyond their original investment. Partner earnings “pass through” directly without first being taxed at the company level.
4. **Limited Liability Partnership** (LLP) – All owners are equal and have limited risk.
5. **Limited Liability Company** (LLC) – Like a Partnership, an LLC allows for multiple owners, but with limited personal financial liability as under a Corporation structure. Not subject to the requirements to elect a board and hold regular meetings with minutes, as required under the C Corporation structure. An LLC, after it is formed, can elect to be taxed as a corporation or partnership. The LLC form is popular with start-ups and small closely-held companies.
6. **C Corporation** – A traditional corporation. Allows for multiple owners and limits personal liability. Managed by a Board of Directors that is elected by the shareholders. The shareholders and Board must meet at least annually and keep minutes of important decisions. Corporate profits are taxed by the IRS and the states. Dividends (which can only be distributed from after-tax profits) are reported on the individual tax returns of the shareholders. Owners are therefore “double-taxed” on income from the company.
7. **S Corporation** – Similar to the traditional C Corporation. However, company profits “pass through” directly to you without first being taxed at the company level. Earnings from the business are reported as income on your personal income tax return.
8. **Non-Profit Corporation** – A tax exempt organization established under section 501(c)(3) of the IRS tax code. There are no owners. The entity is controlled by a board of directors, who receive the same financial protection as do the owners of a traditional C Corporation. To qualify for tax exemption, the purpose of the entity must be charitable, religious, educational, scientific, literary, artistic, recreational, fostering national or international amateur sports competition, testing for public safety, or preventing cruelty to children or animals. “Charitable” includes relief of the poor, civil rights and combating community deterioration and juvenile delinquency.

The structure you select will affect:

- risk to your personal assets (savings, home) if the business loses money or is sued
- control you will have over the business and therefore your business career
- taxes you will have to pay on business profits
- the effort and expense necessary to start the business (government paperwork and fees)
- relative ease of raising capital
- ability to one day sell the business

The following tables organize the decision variables for comparison. However, before you make your decision, it is advisable to consult with a business attorney and an accountant.

Note: This section is not intended to provide legal advice. That can be provided only by an attorney.

Alternative Legal Structures – COMPARATIVE ADVANTAGES

SOLE PROPRIETORSHIP. Sometimes referred to as a DBA (Doing Business As). You are the business and the sole owner. You can operate under your own name or adopt a company name. If you chose “Acme Distributors” as a company name, you would then be John Smith DBA Acme Distributors.

A Sole Proprietorship is not an entity legally separate from its owner. Therefore, the owner is personally liable for the company and its debt and income is added on the owner personal tax return (pass-through taxation).

ADVANTAGES	DISADVANTAGES
1. Ease and low cost of setting up 2. No sharing of income or control 3. *Pass through* entity. Business profit or loss reported on personal tax returns of the partners (therefor, no *double taxation*)	1. Owner personally liable for debts and legal judgments against the business 2. Difficult to raise capital from outside investors 3. Less incentive for co-workers, who will not have an ownership stake in the company

GENERAL PARTNERSHIP. A traditional partnership of two or more owners. With the right people a partnership can be very dynamic, taking on more challenging projects than could be managed by one person. However, if the principals quarrel over every decision and who is doing the most work, it can be like a bad marriage. It is therefor advisable to spell out rights and responsibilities in a *Partnership Agreement*. The Agreement should include:

- The rights and duties of the partners under the Agreement
- Amount of capital each partner is to pay in and when
- How profits or losses will be shared (if the company loses money, the partners may have to pay in additional capital)
- How money may be withdrawn from the company by partners and in what form (salary, draw, commission, distribution of profits at year end, etc.)
- Terms for adding a partner, a member withdrawing, or dissolving the partnership
- Lines of authority and how disputes will be resolved

Attorney Cliff Ennico has posted some suggested terms for a partnership agreement at www.EntrepreneurshipFoundation.org.

ADVANTAGES	DISADVANTAGES
1. Easy to form 2. *Pass through* entity. Business profit or loss reported on personal tax returns of the partners (therefor, no “double taxation”) 3. Easier to attract talented executives since they will be able to share in the financial rewards	1. Owners (partners) are personally liable for debts and legal judgments against the business 2. Less authority and control for founder, and possible confusion and conflicts over decisions

LIMITED PARTNERSHIP (LP). Similar to a General Partnership, except that it has two classes of owners: a General Partner and one or more Limited Partners. The General Partner is a full partner who manages the company and assumes all of the risk. Limited Partners have limited rights and influence over decisions, and limited exposure to risk. (Only their original investment is at risk. They do not have to cover losses with additional capital investment.) Sometimes called *limiteds,* the Limited Partners are "silent partners."	
ADVANTAGES	DISADVANTAGES
1. *Pass through* entity. Business profit or loss reported on personal tax returns of the partners (therefor, no *double taxation*) 2. Easier to attract talented executives since they will be able to share in the financial rewards	1. The General Partner is personally liable for debts and legal judgments against the business 2. Difficult for owners to *exit* (recoup investment and any appreciation, by selling ownership interest to someone else)
LIMITED LIABILITY PARTNERSHIP (LLP). Similar to a Limited Partnership, except that *all* partners are equal and have limited financial exposure	
ADVANTAGES	DISADVANTAGES
1. Protects personal assets 2. *Pass through* entity. Business profit or loss reported on personal tax returns of the partners (therefor, no *double taxation*) 3. Easier to attract talented executives since they will be able to share in the financial rewards	1. Difficult for owners to *exit* (recoup investment and any appreciation, by selling ownership interest) 2. Less authority and control for founder, and possible confusion and conflicts over decisions
LIMITED LIABILITY COMPANY (LLC). After it is formed and registered with a state, an LLC may elect to be taxed as a Corporation, as a Sole Proprietorship, or one of the Partnership structures. An LLC is a hybrid of a corporation and a partnership. It provides for a simple management form and "pass-through" taxation (if desired), with the liability protection of a Corporation. Also like a corporation, an LLC is a separate legal entity, but no stock is issued. The owners are called "Members." Control and management of an LLC is governed by an "Operating Agreement" written by the owners.	
ADVANTAGES	DISADVANTAGES
1. Protects personal assets 2. *Can elect "pass-through" taxation* 3. Allows for one or unlimited number of owners 4. Simple structure (does not require shareholders, directors and officers) 5. No mandatory annual meeting of shareholders, or minutes, as required of "C" Corp 6. Easier to transfer ownership (easier exit for investors) than with a partnership 7. Less financial disclosure required of owners	1. Cannot issue stock 2. Will cost $100 to $1000 to set up, depending on state fees and attorney fees 3. More paperwork and compliance issues than for a Sole Proprietorship 4. Other states in which the company operates may require each owner to file a state tax return 5. If one of the owners is forced to withdraw due to bankruptcy, death or other cause, this can create financial problems for remaining owners

“C” CORPORATION (a traditional corporation; also called a “C Corp”).

A Corporation is a distinct legal entity, separate from its owners. As such it can incur debts, sue or be sued. This structure protects the owners from liability for company debts or judgments, unless owners provide “personal guarantees,” which are typically required to obtain a company credit card, telephone service, bank loan, or lease.

Under a Corporate structure, shareholders own the corporation and elect a Board of Directors to look out for their investments. Responsibilities include the hiring and oversight of Officers to manage the company day-to-day.

The shareholders must meet at least once a year, to elect the board. The board must meet at least annually and keep Minutes, showing when and where the meeting took place, who was in attendance, and important decisions that were made at the meeting.

The rules governing these activities and details of the organization structure are contained in Corporate By-Laws adopted by the board.

If you organize as a C Corp, you can elect to be taxed as an S Corp. (See *S Corporation*).

ADVANTAGES	DISADVANTAGES
1. Protects personal assets 2. Business is a perpetual entity, and this gives some additional confidence to potential employees, vendors, customers, and investors (versus a Sole Proprietorship that would cease to exist with the death of the owner) 3. May issue stock to raise capital 4. May issue stock to raise capital 5. Easier to transfer ownership than with a Partnership structure. Owners can exit by selling their shares to another person. (However, a ready buyer may not always be available, unless the stock is actively traded on a stock exchange) 6. Because of relative ease of transferring ownership, it is also somewhat easier to raise capital (than under Sole Proprietorship or Partnership structures) 7. Company expenses for employee healthcare, travel and entertainment are deductible when computing taxable corporate income. (*See also “Double Taxation” under Disadvantages.*)	1. Must hold annual meeting of shareholders and keep minutes of important decisions at shareholder and board meetings. This is not onerous for a small company with only one or a few shareholders 2. Double Taxation (Company profits are taxed by the states and IRS, and then if any remaining *after-tax profits* are distributed to the owners as dividends, these are taxed on the shareholders’ individual returns)

SUBCHAPTER “S” CORPORATION (also referred to as an “S Corp” or “Sub S”).

After formation, a corporation may elect "S-Corporation Status" by submitting a form to the IRS. The corporation is then taxed like a sole proprietorship (if there is only one owner) or partnership. Income "passes through" to the shareholder(s) to be added as earnings on their personal tax returns. The Sub-S structure is popular with small businesses with one owner, because it avoids double taxation. A S-Corp can always revert back to a C-Corp.

ADVANTAGES	DISADVANTAGES
1. Protects personal assets, like a C Corp 2. Business profit (or loss) reported on personal tax returns of owners	1. Limited to 100 owners, who must all be U.S. citizens or residents 2. Must hold annual meeting of shareholders and keep minutes of shareholder and board meetings 3. Cannot deduct some health insurance, travel or entertainment expenses

NONPROFIT CORPORATION Also known as a 501(c)(3), a reference to the section of the IRS tax code that defines eligibility.

ADVANTAGES	DISADVANTAGES
1. Protects personal assets, as does a C Corp for-profit structure 2. Exempt from federal income tax 3. Eligible to receive government grants and grants from private foundations 4. Contributions are tax-deductible by the donors 5. Perpetual existence 6. Exempt from property taxes in some locales 7. Lower postage costs	1. Cannot issue shares of stock to raise investment capital 2. Founder(s) can extract earnings only as salary or fees for contracted services. A non-profit cannot distribute surpluses in the form of dividends. 3. The scope of activities a non-profit may engage in is limited 4. Earnings cannot inure to any private shareholder or individual. 5. If entity is liquidated, assets must be turned over to another non-profit

Alternative Legal Structures – OWNERSHIP IMPLICATIONS								
	Sole Proprietor-ship (DBA)	**General Partnership**	**Limited Partnership (LP)**	**Limited Liability Partnership (LLP)**	**Limited Liability Company (LLC)**	**C Corporation**	**S Corporation**	**Non-Profit Corporation (501c3)**
Owned by	An individual	Partners	General and Limited partners	Partners	Its "Members"	Shareholders (stockholders)	Shareholders (stockholders)	na
Number of owners	One maximum	Two or more	Unlimited, but at least 1 General and 1 Limited Partner	Two or more	One or more (but can get unwieldy with a large number)	One or more	One or more, with an upper limit (Check current IRS regulations)	none
Controlled by	The individual owner	Partners, according to the Partnership Agreement	Partners, according to the Partnership Agreement	Partners, according to the Partnership Agreement	Members	Board of Directors elected by Shareholders	Board of Directors elected by Shareholders	Board of Directors
Managed day to day by	The individual owner	Managing Partner, elected from among the partners	General Partner	Managing Partner, elected from among the partners	Members or a hired manager, per "Operating Agreement"	President or CEO, elected by Board	President or CEO, elected by Board	President (or Executive Director) appointed by Board
Owner(s) liable for business debts	**Yes**	**Yes**. All partners are liable, "jointly and severally"	**No**, but banks and credit card companies require personal guarantees	**No**, but banks and credit card companies require personal guarantees	**No**, but banks and credit card companies require personal guarantees	**No**, but banks and credit card companies require personal guarantees	**No**, but banks and credit card companies require personal guarantees	**No**, but banks and credit card companies require personal guarantees

Alternative Legal Structures – TAX IMPLICATIONS

	Sole Proprietor-ship (DBA)	General Partnership	Limited Partnership (LP)	Limited Liability Partnership (LLP)	Limited Liability Company (LLC)	C Corporation	S Corporation	Non-Profit Corporation (501c3)
Federal Income Tax on company profit	Taxed as personal income	Each partner's share taxed as personal income	Each partner's share taxed as personal income	Each partner's share taxed as personal income	May elect to be taxed as Corporation or Partnership	Company taxed on profits; owners taxed on dividends and gain on sale of stock. (However, May elect to be taxed as an S Corp)	Taxed as personal income	na
Company losses deductible on personal taxes	**Yes,** up to amount invested	**Yes,** up to amount invested	**Yes,** up to amount invested by each partner	**Yes,** up to amount invested by each partner	**Yes,** up to amount invested, if company elects to be taxed as a partnership	**Yes,** if stock is sold at a loss or written off	**Yes,** up to amount invested	na
Minimum Federal tax	None	None	None	None	None	None	None	None
Required to pay Estimated Federal Tax each quarter to IRS (see www. irs.gov)	Yes, if you expect to owe $1000 or more. Due 15th of month following end of each quarter (See form 1040-ES)	Yes, if you expect to owe $1000 or more. Due 15th of month following end of each quarter (See form 1040-ES)	Yes, if you expect to owe $1000 or more. Due 15th of month following end of each quarter (See form 1040-ES)	Yes, if you expect to owe $1000 or more. Due 15th of month following end of each quarter (See form 1040-ES)	Yes, use form 1040-ES if company is taxed as a partnership; form 1120-W if taxed as a corporation	Yes, if you expect to owe $500 or more. Due 15th of month following end of each quarter (See form 1120-W)	Yes, if you expect to owe $1000 or more. Due 15th of month following end of each quarter (See form 1040-ES)	na
Minimum State Tax **CT**	none	None	$250 "business entity tax"	$250 "business entity tax"	$250	$250	$250 "business entity tax"	none
DE	$250	$250	$200 per partner	$200 per partner	$250	$75 if more than 5000 shares	Yes, based on number of shares	none

The Business Plan

Preparing the Business Plan

PURPOSE

1. To thoroughly assess a business concept prior to committing resources. The planning process allows an entrepreneur to evaluate a business idea in a time-tested and systematic process.
2. To make sure all potential eventualities and competitive scenarios are considered so that the business has every opportunity to succeed.
3. To convince lenders and investors that the plan will succeed; that their investment will be returned, and with the expected level of *ROI (Return on Investment*).

WHERE TO BEGIN

A convincing business plan starts with research. The facts you will need to assemble include:

1. The market demand for your product or service
2. The resources you will need to produce, market and distribute your product or service
    a. Capital
    b. Space
    c. Equipment
    d. People
    e. Product or Service Components
    f. Licenses
4. The costs to produce, sell, and deliver your product or service
5. Strengths and weaknesses of the competition

Standard Business Plan Outline

PART I - OVERVIEW

TITLE PAGE WITH CONTACT INFORMATION (*1 page*):

- Business Name
- Address
- Telephone
- E-Mail

TABLE OF CONTENTS (*1 page*). Number pages to make it easy to find information.

EXECUTIVE SUMMARY (*2-5 pages*). Investors are looking for clear, compelling and credible information to have confidence in you and your idea. Write this section last. Be concise but cover all the bases. (Lengthy explanations and examples should be left to the body of the full plan or the appendices.) Cover the same information as you would in a three-to-eight-minute oral presentation. Three-to-eight pages should suffice.

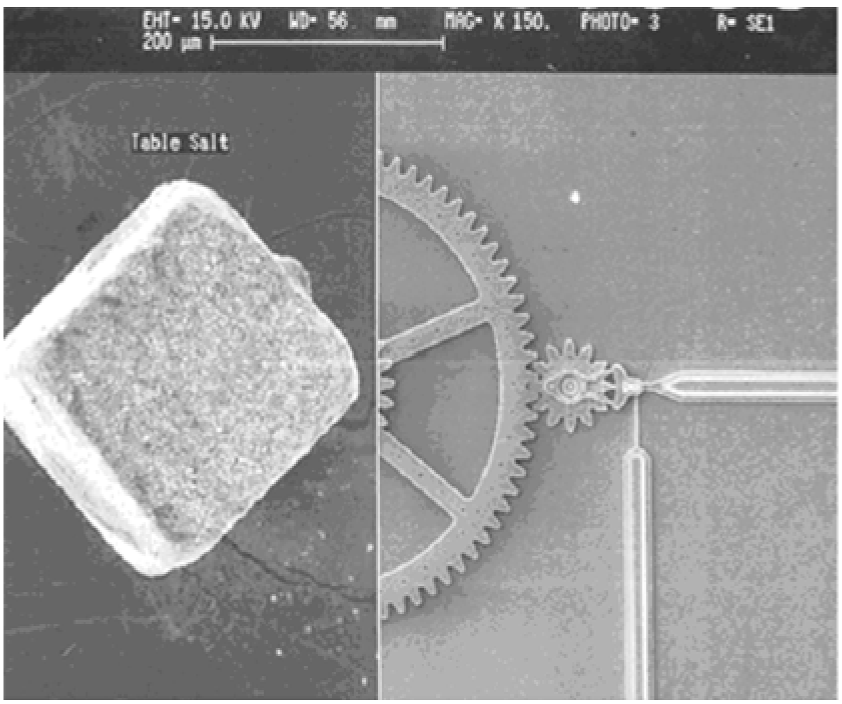
1. Business Description.
    a. Indicate whether the plan is for a start-up, purchase of an existing business, or expansion of a business. If the business is a franchise, so indicate and include a copy of the *Franchise Agreement* in the appendices to your business plan.
    b. Legal form of ownership: sole proprietor, partnership, corporation, etc.
    c. Brief description of product or service.
    d. Development status of new or improved product or service
    e. How you will make money (The *business model*)
    f. If expanding an established business, also include the following:
        1) years in business,
        2) number of employees,
        3) growth rate, and
        4) current sales volume
2. Market opportunity. Define the potential customers in your market niche and the pain they are experiencing without your product.
    a. Your solution to this customer problem; and the amount of money, aggravation, and time your product will save customer.
    b. Market growth trend
    c. Your sales potential within five years in your market niche (number of customers and annual dollar volume)
    d. Competitive advantage
    e. Marketing and sales strategy
3. Management team highlights
4. Amount of funding requested and intended use of new capital

PART II – PRODUCT OR SERVICE (*3-4 pages*)

Describe your product or service and its important features. Include a photo or drawing if helpful to understand product and its unique characteristics.

What are the benefits your product provides to the customers in your target market? And more to the point…

1. Exactly what is it about your product that customers can't do without?
2. What urgent need or desire does your product fulfill?



Microelectromechanical Biopump.
Grain of table salt shown for size comparison.

PART III – SALES AND MARKETING (*4-8 pages*)

MARKET NICHE

It is difficult to take on the whole world. In the words of Hall of Famer Willie Keeler, "Hit 'em where they ain't." When planning your company, look for a *market niche* to target, a portion of the market in which you have a unique advantage; or a small corner largely overlooked or underexploited by the competition. Some sub-markets are just too small for a Microsoft or General Electric to bother with; but might provide adequate income for a young lean enterprise.

The book publishing industry, for example, has many niches. There is a worldwide market for books; but sports books would be a niche, albeit a large niche, and still tough to break into. Books on fishing would be a narrower niche and one in which it would be easier to establish a beachhead; fly fishing narrower still.

Describe your market niche, your target customers, their characteristics and geography (their *demographics*).

For consumer products or services, demographics often include:

- Age
- Gender
- Location
- Income level
- Occupation
- Education
- Other (specific to your industry)

For business customers, the demographic factors include:

- Industry
- Location
- Size of firm
- Technology platforms
- Other (specific to your industry)

SIZE OF MARKET NICHE (The Sales Potential)

Define the size of your targeted market and provide evidence that the market is as large as you contend. Your market research data will be the basis of the sales projection and therefore the income projection of the company. Be specific: give numbers and sources. (Potential investors will want to double check your information. This is called *Due Diligence*, the process of making sure everything in your plan is accurate.)

- Number of customers and the amount they spend annually.
- Percentage of the market you have now and that you realistically expect to capture.
- Obstacles you must surmount to achieve a) break even, and b) full potential. Examples might include:
  - Consumer acceptance and brand recognition. *(There are hundreds of superior mousetraps in the annals of the patent office, but no one is beating a path to the doorways of the inventors. Humans are creatures of habit. They buy what is familiar, not the new and untested, in spite of the marketing claims.)*
  - Unique technology and patents of competitors
  - Union restrictions
  - Shipping costs (*The Internet pet supply company, Pets.com, failed because the cost of shipping dog food made them more expensive than the local pet store. Glib sock puppets will not compensate for defective strategy*.)
  - Tariffs and quotas
- How you will overcome the barriers

SOURCES OF SUBSTANTIATING DATA:

- ***Trade journals***. Every industry has one or more periodicals. Check the business reference department of your local library or the web. The trade publications will often include information about market conditions in the industry. How many subscribers does the magazine have?
- ***Professional Societies***. Research the associations your customers might join. How many members do they have? How many in your area? Is the organization growing?
- ***Trade shows***. Attending a trade show for your industry will provide useful information and insights into trends. How many people were at the event. Were the aisles packed? With buyers or just other vendors? Which booths were attracting the most attention? Why do you think that was and what does this suggest for the potential for your chosen market niche?
- ***Census data*** will provide demographic profiles in your area.
- ***Mail List Companies*** have the number of people with particular titles within any geographic area or group of zip codes.
- ***Traffic Monitoring.*** Who will be your chief competitors and how many cars/pedestrians flow past their establishments in an average day?

COMPETITION

List the significant competitors in your niche, with their addresses.

Also indicate alternatives to your product. If there is a way customers can solve their problem or satisfy their need without your type of product, this should be noted. *For example, if you operate a theatre chain, you would probably compare your operation to other theaters. However, video stores, DVD mail-order subscriptions, HBO and movies downloadable from the Internet are also competition. Even other entertainment venues will impact your sales.*

What are the *Market Drivers*? Determine what product differentiators drive customer decisions. Criteria might include some of the following variables.

- Price
- Quality
- Range of choices
- Service and Support
- Reliability
- Expertise and Reputation
- Location
- Credit Policies
- Advertising budget

Analyze each competitor, summarizing its strengths and weaknesses, especially as regards these critical customer decision-making factors.

Competitor	Strengths	Weaknesses
A		
B		
C		
D		

BARRIERS TO ENTRY (Protecting your market niche)

How will you keep competitors from entering your market with similar products? Barriers can include:

- Patents
- Exclusive contracts with sole suppliers of critical components
- Long-term contracts with customers
- A long product development cycle. For example, a complicated software program that would take someone else at least two years to reverse-engineer, test and deploy.
- Significant *first-mover* advantage. For example, anyone can offer to sell books on line, but Amazon has had such a long head start that it would be difficult to entice many of its customers to switch to a new online supplier.

MARKETING AND SALES STRATEGY

How will you capture the market share necessary to meet sales projections?

Advertising and Promotion. *How will customers find out about your product, its features and benefits? This is especially critical if you are relying on an* intermediary *(retail store, wholesale distributor, contractor, etc.) to sell your product. Advertising channels might include some or all of the following:*

- Print advertising (magazines and newspapers)
- Radio and TV advertising
- Web advertising
- Guerrilla marketing (spreading the word through the grapevine). This works in a tight-knit community of buyers
- Direct mail (Indicate where you will obtain lists of prospects)
- Trade shows

Indicate how much you plan to spend on each marketing channel …

- At startup to establish the brand
- Annually thereafter

Corporate Identity Program. Do you have graphic design standards to project the necessary image consistently? Components of a design program that impact a company's image include:

- Logogram,
- Web site,
- Print material (business cards, brochures, etc.)
- Signage,

Distribution Channels. *(How will you sell your products or services?)*

- Directly to consumers (mail order, Web, catalog)?
- Through retail stores?
- Through wholesalers?
- Through your own sales force?
- Through manufacturers' reps?
- By bidding on contracts?

Credit Policies

- Will you need to extend credit to customers?
- If so, what policies will you have of how much credit to extend and for how long?
- How will you check the creditworthiness of new applicants?
- How will you collect from slow-paying customers?

SALES FORECAST

Now that you have described your products, services, customers, markets, and marketing plans in detail, you're ready to attach some numbers to your plan.

	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Year 1
Product A					
Units sold	100	110	120	130	460
x Price	$100	$100	$100	$100	
= Amount	$ 10,000	$ 11,000	$ 12,000	$ 13,000	$ 46,000
Product B					
Units sold	100	100	100	100	400
x Price	$200	$200	$200	$200	
= Amount	$ 20,000	$ 20,000	$ 20,000	$ 20,000	$ 80,000
TOTAL					$ 126,000

You may want to do two forecasts:

1. Best guess – which is what you really expect, and
2. Worst case – low estimate that you are confident you can reach no matter what happens.

Keep notes on your research and your assumptions as you build this sales forecast. Investors will definitely grill you on your assumptions.

PART IV – RISK ANALYSIS (*3-8 pages*)

POTENTIAL RISKS ("What can go wrong will" – Murphy).

- Human resources risks. Is there an adequate supply of labor available with the skills you require at a wage you can afford to pay?

  Will new employees require training?

  How long will the training take and what will it cost?
- Technology risks. What theoretical technologies could overtake you if they become practical realities?
- Economic risks. What happens to your company in a recession or inflationary cycle?
- Political risks. What happens to your power plant in Bali if there is a coup?
- Competitive risks. What happens if you really are wildly successful and Bigco decides your niche is valuable after all.

ADVERSITY PREPAREDNESS

Just as the weather bureau needs to monitor new developments that might turn into natural disasters, you need to keep an eye out for the winds of change in your key technologies, consumer behavior, and the economic climate in general. An effective early warning system can help you minimize any negative impact.

Just as important are strategies to deal with adversity. Do you need to borrow money regularly because your business is cyclical, like the fashion industry or toy sales? If so, what would happen to your bottom line if interest rates doubled in a year? Imagine the worst thing that could happen to your company or your customers or the country, then figure out what you could do to survive that catastrophe. Is there a prudent change you might make to your business plan to reduce your susceptibility to this contingency. Perhaps plan to raise more equity capital so that you are not overly dependent upon the debt market to perpetuate your company. The lack of emergency preparedness has sunk many a venture.

Include in your plan the steps you would take to respond to changes in ...

- Consumer preferences
- Technology *(Do you have a license to record music on CDs? What if a new technology replaces CDs, as they replaced records, as they replaced sheet music?)*
- Government regulations
- The economy (How would you retrench if you only achieve half the sales you forecast for year one?)

PART V - PRODUCTION (OPERATIONS) (*3-4 pages*)

- How and by whom is your product or service be produced? What portions of the product or service will be produced “in house” by your firm and what components will be produced by subcontractors?
- How reliable is the supply chain?
  - What is the source of each critical component and raw material?
  - How reliable are the subcontractors?
  - Are they in economically and politically stable countries?
- Are supply costs steady or fluctuating? If fluctuating, how would you deal with changing costs?
- Production capacity of your space and equipment
  - Planned production level
  - Break-even production level
- Quality control
  - What procedures will be followed to establish and monitor quality standards?
  - Who will provide customer service?
- What R&D processes will need to be continued and for how long?
- What type and level of inventory will you need to maintain? (raw materials, supplies, finished goods, etc.)
  - Average value (your inventory investment)?
  - Annual turnover rate and how this compares to the industry averages?
  - Seasonal buildups?
  - Lead-time for ordering?

PART VI - MANAGEMENT (*2-5 pages*)

MANAGEMENT TEAM

New businesses are usually dependent upon the enthusiasm, dedication, special expertise and contacts of its founders. List the key management positions and the qualifications and relevant education and experiences of the individuals that are filling these critical roles (or who will fill the positions once the company is funded.) Bases that need to be covered, at a minimum, are:

- CEO (Chief Executive Officer). As the top manager, the CEO is typically responsible for the entire operations Indicate prior successful management experience in growing a similar company.
- CMO (Chief Marketing Officer). Indicate prior sales experience with similar products and key contacts with buyers in the industry.
- CTO (Chief Technology Officer). What evidence is there that this individual has the expert knowledge of how to produce the product or deliver the service.
- CFO (Chief Financial Officer). the CFO is responsible for analyzing and reviewing financial data, reporting financial performance, preparing budgets and monitoring expenditures and costs. Business failure is often related to mismanaging cash flow, failing to monitor accounts receivable adequately, inaccurate budgeting, poor purchasing practices, or failure to meet government reporting and compliance regulations. Indicate education and relevant experience of the CFO.

What measures will be taken to insure the survival of the business if it loses one of the key managers? For example, will you have *key man insurance* to at least refund investment in the company?

PROFESSIONAL AND ADVISORY SUPPORT

List any of the following that you have or plan to retain:

- Corporate Attorney (who advises you on contracts, investor deals, and incorporation)
- Intellectual Property Attorney (who is making sure that your important patents and trademarks are bullet proof?)
- Accountant
- Insurance agent
- Banker
- Board of directors (Indicate members with relevant experience, expertise or valuable contacts in your industry)
- Advisory board (Indicate members with relevant experience, expertise or valuable contacts in your industry)
- Mentor
- Consultants

PART VII – HUMAN RESOURCES (*1-3 pages*)

At least half the operating cost of most businesses is personnel.

1. Ultimately, how many people will you need and what skills must they have for you to…
    a. Get started?
    b. Reach break-even?
    c. Meet your five-year projection?
    d. Meet ultimate sales potential?
2. How do you know these human resources are available?
3. Where/how will you recruit the workers you need?
4. What is the cost per hour and per year of each type of worker?
5. Will you have to provide benefits in order to compete for these workers?
    a. What benefits will you provide?
        i. Health Insurance?
        ii. Dental?
        iii. Paid vacations?
        iv. Retirement plan?
    b. What will this cost?
6. Will they need training?
    a. Who will provide necessary training?
    b. What will this cost?

Human Resources Requirements Worksheet

EMPLOYEE CATEGORY	Number Needed	Annual Wage per Employee	Taxes and benefits **	Total Annual Cost per Employee

** As a rough rule of thumb, add 10% for taxes; 30% for taxes and health insurance

Personal Budget. The most expensive line item for most new businesses is the personal living expenses of the founder. Determine how much you will need to live on and assume the business will not be able to pay you for at least one year. This amount will need to be included in your start-up capital (unless you plan to keep your day job).

Home (Rent or mortgage payment and property taxes)	$___________
Household Maintenance	$___________
Homeowner's/Renter's Insurance	$___________
Heat	$___________
Electric	$___________
Water/Sewer	$___________
Trash Removal	$___________
Auto Lease (or savings set-aside for purchase of replacement)	$___________
Auto Insurance	$___________
Auto Maintenance	$___________
Gas and Oil	$___________
Health Insurance	$___________
Life Insurance	$___________
Food	$___________
Clothing	$___________
Entertainment/ Eating Out	$___________
Vacation	$___________
Incidental Personal Expenses	$___________
Gifts	$___________
Savings	$___________
TOTAL	$___________

PART VIII – FINANCE (*5-8 pages*)

The financial plan consists of a 12-month profit and loss projection, a 3-year profit and loss projection (optional), a cash-flow forecast, and a projected balance sheet. These documents will help you and potential investors evaluate the reasonableness of your plan.

PROFIT AND LOSS PROJECTIONS should be accompanied by a narrative explaining the major assumptions used to estimate company income and expenses. Keep careful notes on your research and assumptions, so that you can explain them during interviews with skeptical investors.

THE CASH FLOW FORECAST will tell you how much capital you will need to start the business. Explain your major assumptions, especially where the cash flow differs from the *Profit and Loss Projection*. For example, if you make a sale in month one, when do you actually collect the cash? Probably the same month if a retail cash-and-carry operation; but perhaps month two or three if yours is a service business that extends credit. Similarly, when do you have to pay for raw materials in relation to when you receive them?

Don't forget to show *draw* (payments to yourself to live on).

Depreciation should not appear on a Cash Flow Forecast. (You will not write a check for depreciation.) However, the full purchase price of capital equipment should appear on the Cash Flow Forecast.

THE BREAK-EVEN ANALYSIS predicts the sales volume, at a given price, required to recover total costs. In other words, it's the sales level that is the dividing line between operating at a loss and at a profit:

$$\textit{Unit Sales} = \frac{\textit{Fixed Overhead Costs}}{\textit{(Selling price - Cost per unit)}}$$

For example, if your product sells for $100 per unit, and the variable cost to produce each unit is $40, and your overhead costs are $100,000, the BREAK-EVENT POINT is …

$$\textit{Unit Sales to Break Even} = \frac{\$100{,}000}{\$100-\$40} \quad \textit{or …}$$

$$\textit{Unit Sales to Break Even} = \frac{\$100{,}000}{\$60} = \textit{1667 Units}$$

A Budget Worksheet in the form of an Excel document is downloadable from *www.entrepreneurshipfoundation.org*

By plugging in the **bold** numbers on the "Budget Worksheet" (sample on following page), your assumptions will riffle through to generate the necessary financial reports for your business plan.

The spreadsheet was developed and is updated annually by Professor Benoit N. Boyer, Ph.D., Chair of the Accounting Department, Sacred Heart University.

BUDGET WORKSHEET		**Q1**	**Q2**	**Q3**	**Q4**
Selling price per unit	**$ 25.00**				
Total market per year	**1,000,000**				
Market share	**10%**				
Annual Growth	**5%**				
Percentage of sales per quarter		**10%**	**30%**	**40%**	**20%**
Sales per quarter		10,000	30,000	40,000	20,000
Cash receipts same quarter	**70%**				
Ending inventory finished goods	**25%**	next quarter sales			
Raw material per unit	**15**	pounds per unit			
Raw material inventory	**20%**	next quarter purchases			
Cost of raw materials	**$ 0.25**	per pound			
Cash payments same quarter	**80%**				
Direct labor per unit	**0.80**	hours			
Labor cost per hour	**$ 7.50**				
Variable overhead	**$ 2.00**	per hour of direct labor			
Fixed overhead		**$ 60,000**	**$ 60,000**	**$ 60,000**	**$ 60,000**
Depreciation included above		**$ 12,000**	**$ 12,000**	**$ 12,000**	**$ 12,000**
Variable sales cost	**$ 1.80**				
Advertising			**$ 20,000**		**$ 20,000**
Executive salaries		**$ 50,000**	**$ 50,000**	**$ 50,000**	**$ 50,000**
Insurance			**$ 20,000**		**$ 35,000**
Property taxes					**$ 17,500**
Depreciation - selling		**$ 10,000**	**$ 10,000**	**$ 10,000**	**$ 10,000**
Equipment purchases		**$ 30,000**	**$ 45,000**	**$ 22,500**	**$ 18,000**
Dividends		**$ 8,000**	**$ 8,000**	**$ 8,000**	**$ 8,000**

BEGINNING BALANCE SHEET					
Current Assets					
Cash				**$ 10,000**	
Accounts receivable				**$ -**	
Raw materials	**0**	Pounds	$0.25	**$ -**	
Finished products	**0**	Units	$11.35	**$ -**	$ 10,000
Long-term assets					
Land				**$ -**	
Plant and equipment			**$ -**		
Accumulated Depreciation			**$ -**	$ -	$ -
Total assets					$ 10,000
Liabilities and Equity					
Liabilities					
Accounts payable					**$ -**
Bank Borrowing					**$ -**
					$ -
Equity					
Common Stock					**$ 10,000**
Retained earnings					**$ -**
					$ 10,000
					$ 10,000

Minimum cash required	**$ 40,000**
Borrowing by multiples of	**$ 1,000.00**
Interest	**10%**

	Quarters				
Sales	1	2	3	4	Year
Budgeted sales in units	10,000	30,000	40,000	20,000	100,000
Selling price per unit	$ 25.00	$ 25.00	$ 25.00	$ 25.00	$ 25.00
	$250,000	$750,000	$1,000,000	$500,000	$2,500,000
Cash input					
Accounts receivable	$ -				$ -
Same Quarter sales	$ 175,000	$ 525,000	$ 700,000	$ 350,000	$ 1,750,000
Previous Quarter Sales		$ 75,000	$ 225,000	$ 300,000	$ 600,000
	$ 175,000	$ 600,000	$ 925,000	$ 650,000	$ 2,350,000
Accounts receivable at the end				$ 150,000	$ 150,000
Production budget					
Budgeted sales	10,000	30,000	40,000	20,000	100,000
Ending inventory	7,500	10,000	5,000	2,625	2,625
Total needs	17,500	40,000	45,000	22,625	102,625
Beginning Inventory	-	7,500	10,000	5,000	-
Production	17,500	32,500	35,000	17,625	102,625
Direct Materials Budget					
Required Production	17,500	32,500	35,000	17,625	102,625
Raw Materials per unit	15.00	15.00	15.00	15.00	15.00
Raw materials needed	262,500	487,500	525,000	264,375	1,539,375
Ending inventory	97,500	105,000	52,875	47,250	
Total needs	360,000	592,500	577,875	311,625	1,539,375
Beginning Inventory	-	97,500	105,000	52,875	-
Purchases	360,000	495,000	472,875	258,750	1,586,625
Cost per pound	$ 0.25	$ 0.25	$ 0.25	$ 0.25	$ 0.25
Cost of raw materials	$ 90,000	$ 123,750	$ 118,219	$ 64,688	$ 396,656

Cash output

Accounts payable beginning	**$ -**				$ -
Same Quarter	$ 72,000	$ 99,000	$ 94,575	$ 51,750	$ 317,325
Next Quarter		$ 18,000	$ 24,750	$ 23,644	$ 66,394
	$ 72,000	$ 117,000	$ 119,325	$ 75,394	$ 383,719
Account payable at the end				$ 12,938	$ 12,938

Direct Labor Budget

Required Production	17,500	32,500	35,000	17,625	102,625
Direct labor time per unit	0.80	0.80	0.80	0.80	0.80
Total hours needed	14,000	26,000	28,000	14,100	82,100
Labor cost per hour	$ 7.50	$ 7.50	$ 7.50	$ 7.50	$ 7.50
Total Labor Cost	$105,000	$195,000	$210,000	$105,750	$615,750
Pay as you go					

Overhead Budget

Direct Labor Hours	14,000	26,000	28,000	14,100	82,100
Variable Overhead Rate	$ 2.00	$ 2.00	$ 2.00	$ 2.00	$ 2.00
Variable Overhead	$ 28,000	$ 52,000	$ 56,000	$ 28,200	$ 164,200
Fixed Overhead	$ 60,000	$ 60,000	$ 60,000	$ 60,000	$ 240,000
Total Overhead	$ 88,000	$ 112,000	$ 116,000	$ 88,200	$ 404,200
Less depreciation included above	$ 12,000	$ 12,000	$ 12,000	$ 12,000	$ 48,000
Total Overhead Disbursement	$ 76,000	$ 100,000	$ 104,000	$ 76,200	$ 356,200

Selling and Administrative Expenses

Budgeted sales	10,000	30,000	40,000	20,000	100,000
Variable costs per unit	$ 1.80	$ 1.80	$ 1.80	$ 1.80	$ 1.80
Total Variable costs	$18,000	$54,000	$72,000	$36,000	$180,000
Fixed costs					
Advertising	$ -	$ 20,000	$ -	$ 20,000	$ 40,000
Executive salaries	$ 50,000	$ 50,000	$ 50,000	$ 50,000	$ 200,000
Insurance	$ -	$ 20,000	$ -	$ 35,000	$ 55,000
Property taxes	$ -	$ -	$ -	$ 17,500	$ 17,500
Depreciation	$ 10,000	$ 10,000	$ 10,000	$ 10,000	$ 40,000
Total fixed	$ 60,000	$ 100,000	$ 60,000	$ 132,500	$ 352,500
Total selling and administrative	$ 78,000	$ 154,000	$ 132,000	$ 168,500	$ 532,500
Less depreciation	$ 10,000	$ 10,000	$ 10,000	$ 10,000	$ 40,000
Cash Disbursement	$ 68,000	$ 144,000	$ 122,000	$ 158,500	$ 492,500

Cash Flow Budget

	Quarters 1	2	3	4	Year
Cash Beginning	**$ 10,000**	$ 40,000	$ 40,000	$ 139,450	$ 10,000
Cash receipts	$ 175,000	$ 600,000	$ 925,000	$ 650,000	$ 2,350,000
Total available	$ 185,000	$ 640,000	$ 965,000	$ 789,450	$ 2,360,000
Cash disbursement					
Purchases	$ 72,000	$ 117,000	$ 119,325	$ 75,394	$ 383,719
Direct labor	$ 105,000	$ 195,000	$ 210,000	$ 105,750	$ 615,750
Overhead	$ 76,000	$ 100,000	$ 104,000	$ 76,200	$ 356,200
Selling and Administrative	$ 68,000	$ 144,000	$ 122,000	$ 158,500	$ 492,500
Equipment purchases	$ 30,000	$ 45,000	$ 22,500	$ 18,000	$ 115,500
Dividends	$ 8,000	$ 8,000	$ 8,000	$ 8,000	$ 32,000
Total disbursements	$ 359,000	$ 609,000	$ 585,825	$ 441,844	$ 1,995,669
Excess (Deficit) cash	$ (174,000)	$ 31,000	$ 379,175	$ 347,606	$ 364,331
Financing					
Borrowing	$ 214,000	$ 9,000	$ -	$ -	$ 223,000
Repayments		$ -	$ (223,000)	$ -	$ (223,000)
Interest		$ -	$ (16,725)	$ -	$ (16,725)
Interest					
Interest					
Total financing	$ 214,000	$ 9,000	$ (239,725)	$ -	$ (16,725)
Cash at the end	$ 40,000	$ 40,000	$ 139,450	$ 347,606	$ 347,606

Peak borrowing and therefore, the amount of start-up capital required.

Manufacturing Costs

Direct Materials			
	Beginning Inventory	$ -	
	Plus purchases	$ 396,656	
	Less ending inventory	$ (11,813)	$ 384,844
Direct Labor			$ 615,750
Overhead			$ 404,200
			$ 1,404,794

Income Statement

Sales			$ 2,500,000
	Beginning inventory	$ -	
	Plus Manufacturing Costs	$ 1,404,794	
	Less Ending Inventory	$ (29,794)	
COGS			$ 1,375,000
Gross margin			$ 1,125,000
Selling and Administrative			$ 532,500
Net Income before interest			$ 592,500
Interest Expense			$ 16,725
Net Income before taxes			$ 575,775

Balance Sheet *(At End of Year One)*

Current Assets			
Cash		$ 347,606	
Accounts receivable		$ 150,000	
Raw materials		$ 11,813	
Finished products		$ 29,794	
			$ 539,213
Long-term assets			
Land		**$ -**	
Plant and equipment	$ 115,500		
Accumulated Depreciation	$ (88,000)	$ 27,500	
			$ 27,500
Total assets			$ 566,713
Liabilities and Equity			
Liabilities			
Accounts payable		$ 12,938	
Bank Borrowing		$ -	
			$ 12,938
Equity			
Common Stock		$ 10,000	
Retained earnings		$ -	
Net income		$ 575,775	
Less Dividends		$ (32,000)	
			$ 553,775
Total Liabilities and Equity			$ 566,713

PART IX - RESOURCES NEEDED TO LAUNCH BUSINESS (*1-2 pages*)

SPACE

Consumer Businesses. Location is particularly important for retail, restaurant or consumer service enterprises since customers must come to you. The location must obviously be convenient and project the proper image for your target clientele. Indicate for your intended place of business:

- Physical address. Include a map with the location marked.
- Access *(Is it convenient to transportation arteries?)*
- Size (square footage)
- Amenities
- Type of heat and air conditioning
- Does it conform to government requirements for your industry?
    - Zoning laws
    - Building codes
    - Health department regulations
    - Handicap access
    - Fire codes
- Interior design. (Does space need extensive remodeling?)

Business to Business Enterprises. A factory or warehouse might not need to meet high standards for ambience, but there are efficiency and costs considerations. Is it all on one floor, or will you have to move goods up and down elevators? Is it accessible to tractor-trailers? How close is the turnpike entrance? Indicate the physical characteristics of the intended space:

- Amount of space (square footage)
- Type of construction and age
- Zoning restrictions
- Power supply
- Heating system

EQUIPMENT

- What equipment will you need?
- Will you lease or buy? Why?
- What will the equipment cost?

INTANGIBLES

- Licenses
- Bonding, if required
- Insurance
- Trademarks and copyrights
- Patents

PERSONNEL (See “Human Resources” section.)

CAPITAL

The amount of cash you will need to cover start-up expenses and to cover operating expenses until the company attains profitability. The Cash Flow Forecast should indicate the amount of capital required each year. If you need an infusion of cash for more than the first year, break down the capital requirement into periodic *traunches*. Investors prefer to mete out cash when (and if) interim goals are met. The traunches may be annual, semi-annual, or based on important milestones, such as receiving a patent, demonstrating a working prototype, or concluding the first sale.

PART X – FUNDING PLAN (*1-2 pages*)

Now that you know how much capital you need, you will want to outline in your plan:

- The intended source(s) of the required capital
- A determination of the value of the business (if you plan to approach equity investors)
- Your *Exit Strategy* (to allow equity investors to harvest their money after 3 to 5 years)

1. SOURCE OF CAPITAL. decide whether to save the money yourself or to pursue *debt capital* (a loan) or *equity capital*, an investment by an Angel or Venture Capitalist in exchange for stock. (See section on "Sources of Capital for Start-Ups" for a thorough discussion of alternate sources of capital.

2. VALUATION. If you decide on equity capital, or a mix that includes equity financing, you will need to address the market value of your business. *Valuation* is the art and science of estimating the worth of a business based on its potential future earnings. If only the physical assets were considered (cash, inventory, furniture and fixtures, equipment, land and buildings) this straightforward process would be termed an *Appraisal*. This is relatively simple as most hard assets can be priced in the marketplace. A business valuation is much more difficult. For an established business, the physical assets would also be taken into consideration as well as liabilities, but for a start-up the assets may be intangible: the business concept, strategy, skills and experience of the founders, and intellectual property (such as software coding and patents).

   Since a start-up has no track record, future earnings potential will have to be computed from the sales forecast. And here's where the numbers start to get mushy. You can't prove a future number. The entrepreneur will probably be very optimistic about sales and profit projections, whereas the investor will be, understandably, more skeptical.

   But let's skip ahead a few rounds of negotiations and assume that you and an investor come to an agreement that, *if* your product performs as predicted, and *if* 2% of the buyers in your market niche beat a path to your doorway, and *if* you can produce and sell the product at a 50% margin, then your Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA) will be $1,000,000 per year. And we'll assume for this example that you need $1,000,000 to start a new company (or add a new division to an existing company).

   There may be some discussion between you and the investors as to whether the valuation should be based on sales forecast 5 years out, 3 years out, or 1 year out, but for the sake of argument, let's say you have agreed to look forward 5 years.

   So what is the business worth? That depends on the *Earnings Multiplier* agreed to. Again, you and the investor may begin the negotiations with markedly differing views. You will point to average stock market P/E ratios of say 8 for your industry, giving your business a valuation of $8,000,000. The investor will argue that those are proven businesses with real sales and profit margins. Your profits are hypothetical. The investor will counter with 1 or 2 times earnings, or a valuation of $1,000,000 to $2,000,000.

   One of the mathematical variables to contend with is the opportunity loss to the investors. Let's pick a number in the middle and say you agree that the business is worth $4,000,000. The investors still will not see their share of that money for five years, and then only on paper. They cannot *cash out* unless a larger firm buys your company or you conclude a successful public stock offering. The investors will want to be compensated for their money being tied up and at risk for five years. More negotiating. Economic conditions and other external factors will also push the valuation up or down.

More give and take, but finally you all agree to value the company at $1,000,000 *pre money* (that is, before the capital infusion). But after the company receives the $1,000,000 in cash from the investors, its balance sheet would now show that it has $2,000,000 in assets (the original value plus the new capital). This is called the *post-money valuation*.

So, mathematically, the investors would be entitled to half the stock and you would retain half ownership. In this example you are bringing to the bargaining table a company worth $1,000,000 (*pre-val*), and the investors are providing $1,000,000 in cash. The combined, or post-investment value would be $2,000,000.

The preliminary written agreement between you and the investors is called a *Term Sheet*. The document should also contain clauses to protect the interests of the investors and entrepreneur and stipulate how the proceeds are to be distributed if the company is dissolved or sold. Obviously, it would help for both the investors and you to each have experienced attorneys guiding you through the process.

Contact your local bar association for a list of attorneys in your area active in venture financing.

For a free online questionnaire to valuate an established company, visit caycon.com/valuation.php.

3. EXIT STRATEGY. If you are planning to keep the business as your job for life, then you won't have to think about an exit strategy for awhile. However, if you accept equity capital, the investors will insist that you have a reasonable plan for them to exit the business. They will not have your love for the business. They just want to get their cash out as soon as possible, with a profit of 3 to 5 times the amount invested. You can still stay on as president, if you retain enough shares to keep control; or, as *serial* entrepreneurs do, start another business. There are several exit strategies in common use:

    a. ***Buy-back by Founders through an LBO*** *(Leveraged Buy-Out).*
    b. ***Acquisition***. Sell the company to a larger firm that can leverage your technology, patents, goodwill, or customer base. If this is your intended exit strategy, be prepared to name logical buy-out candidates.
    c. ***Private Equity***. Private Equity Firms purchase companies to manage, typically when they reach an annual profit level of around $10 million.
    d. ***Initial Public Offering (IPO)***. Issuing stock to the public creates a market for the stock you and the investors own. It is difficult to sell new stocks in a recessionary economy, so don't lead with this exit strategy in a down market. Also, be advised that neither you nor your investors will be able to sell your shares immediately. (That would drive your stock value down precipitously.) You will have to cash out over time. If this is your intended harvesting strategy, be prepared to give examples of similar companies that have launched successful IPOs and the market value of all the outstanding stock. (This *Market Cap[italization]* should be equal to or greater than the *Business Valuation* as claimed by you in your business plan–or your valuation won't be credible.)

PART XI - APPENDICES

- Brochures and advertising materials
- Industry studies or articles that support growth predications
- Letters of endorsement from potential customers
- Any other materials needed to support assertions in the plan

Modifying The Standard Outline To Fit Your Business

To be sure, point out your strongest advantages; but also your company's weak areas and then explain the adroit steps you have taken to mitigate potential adversity. (Sophisticated investors will find the chinks in your armor, so you might as well take credit for candor and point them out yourself.)

In addition, you may need to modify the generic business plan outline due to unique factors determining success or failure in your industry. Two online resources contain detailed information specific to a wide variety of industries:

1. **Sample Business Plans for Over 60 Small Businesses** *may be found at:* http://www.bplans.com/sp/businessplans.cfm
2. **Start-Up Guidelines** *from* Entrepreneur *Magazine for a variety of services, including:* Apparel, Bar, Bridal Consultant, Business Support Service, Child-Care, Cleaning Service, Consulting, Freight Brokerage, Gift Basket Service, Import/Export Business, Information Consultant, Internet Entrepreneur, Mail Order, Medical Claims Billing, Personal Concierge, Restaurant, Retail Store, Staffing Service, and e-Business. http://www.entrepreneur.com/toolkit

As an example of industry-specific considerations, consider the following success factors in the RETAIL industry:

1. ***Proposed Location***. This is the time to think about what you want and need in a location. Many startups run successfully from home for a while. If customers come to your place of business:
   a. Is it zoned for retail?
   b. Is it convenient?
   c. Parking?
   d. Is it consistent with your image?
   e. Where is the competition located?
   f. Pricing
   g. Markup. Price should be competitive and in accordance with company image, but still allow for a safe profit margin.
2. ***Inventory Level***: Look up average annual inventory turnover rate for your type of store (this information is available in the Combined Financial, Merchandising & Operating Results Of Retail Stores, published annually by the National Retail Merchants Association. Multiply your initial inventory investment by the average turnover rate. The result should be at least equal to your projected first year's cost of goods sold. If it is not, you may not have enough budgeted for startup inventory.

Tailoring The Financing Proposal To The Audience

FOR BANKERS. Lenders want assurance of orderly repayment. If you intend to pitch to lenders, include:

- Amount of loan
- How the funds will be used
- What this will accomplish—how will it make the business stronger?
- Requested repayment terms (number of years to repay). You will probably not have much negotiating room on interest rate but may be able to negotiate a longer repayment term, which will help cash flow.
- Collateral offered, and a list of all existing liens against collateral

FOR INVESTORS. Equity investors have a different perspective. They are looking for dramatic growth and a 3x to 5x return on investment. Highlight for investors:

- Funds needed short-term to take you to the next plateau of business development
- Funds needed over next 3 to 5 years
- How the company will use the funds, and how this will propel growth.
- Estimated return on investment at harvest time
- Exit strategy for investors (buyback, sale, or IPO)
- Percent of ownership that you will give up to investors
- Milestones
- Financial reporting to be provided to investors
- Involvement of investors on your board

Scrutinizing Your Plan: Is It Bullet-Proof?

INVESTORS see thousands of business plans each year. With so many opportunities, most investors simply focus on finding reasons to say no. Following are the most common errors found in business plans. (This article was written by Akira Hirai, founder of Cayenne Consulting, specialists in helping companies raise capital. www.caycon.com. © Cayenne Consulting.)

CONTENT MISTAKES

Failing to relate to a true pain. Pain comes in many flavors: my computer network keeps crashing; my accounts receivable cycle is too long; existing treatments for a medical condition are ineffective; my tax returns are too hard to prepare. Businesses and consumers pay good money to make pain go away.

You are in business to get paid for making pain go away.

Pain, in this setting, is synonymous with market opportunity. The greater the pain, the more widespread the pain, and the better your product is at alleviating the pain, the greater your market potential.

A well written business plan places the solution firmly in the context of the problem being solved.

Value inflation. Phrases like "unparalleled in the industry;" "unique and limited opportunity;" or "superb returns with limited capital investment" - taken from actual documents - are nothing but assertions and hype.

Investors will judge these factors for themselves. Lay out the facts - the problem, your solution, the market size, how you will sell it, and how you will stay ahead of competitors - and lay off the hype.

Trying to be all things to all people. Many early-stage companies believe that more is better. They explain how their product can be applied to multiple, very different markets, or they devise a complex suite of products to bring to a market.

Most investors prefer to see a more focused strategy, especially for very early stage companies: a single, superior product that solves a troublesome problem in a single, large market that will be sold through a single, proven distribution strategy.

That is not to say that additional products, applications, markets, and distribution channels should be discarded - instead, they should be used to enrich and support the highly focused core strategy.

You need to hold the story together with a strong, compelling core thread. Identify that, and let the rest be supporting characters.

No go-to-market strategy. Business plans that fail to explain the sales, marketing, and distribution strategy are doomed. The key questions that must be answered are: who will buy it, why, and most importantly, how will you get it to them?

You must explain how you have already generated customer interest, obtained pre-orders, or better yet, made actual sales - and describe how you will leverage this experience through a cost-effective go-to-market strategy.

"We have no competition". No matter what you may think, you have competitors. Maybe not a direct competitor - in the sense of a company offering an identical solution - but at least a substitute. Fingers are a substitute for a spoon. First class mail is a substitute for e-mail. A coronary bypass is a substitute for an angioplasty.

Competitors, simply stated, consist of everybody pursuing the same customer dollars.

To say that you have no competition is one of the fastest ways you can get your plan tossed - investors will conclude that you do not have a full understanding of your market.

The "Competition" section of your business plan is your opportunity to showcase your relative strengths against direct competitors, indirect competitors, and substitutes.

Besides, having competitors is a good thing. It shows investors that a real market exists.

Too long. Investors are very busy, and do not have the time to read long business plans. They also favor entrepreneurs who demonstrate the ability to convey the most important elements of a complex idea with an economy of words.

An ideal executive summary is no more than 1-3 pages. An ideal business plan is 20-30 pages (and most investors prefer the lower end of this range).

Remember, the primary purpose of a fund-raising business plan is to motivate the investor to pick up the phone and invite you to an in-person meeting. It is not intended to describe every last detail.

Document the details elsewhere: in your operating plan, R&D plan, marketing plan, white papers, etc.

Too technical. Business plans - especially those authored by people with scientific backgrounds - are often packed with too many technical details and scientific jargon.

Initially, investors are interested in your technology only in terms of how it:

- solves a really big problem that people will pay for;
- is significantly better than competing solutions;
- can be protected through patents or other means; and
- can be implemented on a reason-able budget.

All of these questions can be answered without a highly technical discussion of how your product works. The details will be reviewed by experts during the due diligence process.

Keep the business plan simple. Document the technical details in separate white papers.

No risk analysis. Investors are in the business of balancing risks versus rewards. Some of the first things they want to know are what are the risks inherent in your business, and what has been done to mitigate these risks.

The key risks of entrepreneurial ventures include:

- Market risks: Will people actually buy what you have to sell? Will you need to create a major change in consumer behavior?
- Technology risks: Can you actually deliver what you say you can? On budget and on time?

- Operational risks: What can go wrong in the day-to-day operations of the company? What can go wrong with manufacturing and customer support?
- Management risks: Can you attract and retain the right team? Can your team actually pull this off? Are you prepared to step aside and let somebody else take over if necessary?
- Legal risks: Is your intellectual property truly protected? Are you infringing on another company's patents? If your solution does not work, can you limit your liability?

This is, of course, just a partial list of risks.

Even though you may feel that the risks are negligible, potential investors will feel otherwise unless you demonstrate that you have given a lot of thought to what can go wrong and have taken prudent steps to mitigate these risks.

Poorly organized. Your idea should flow in a nice, organized fashion. Each section should build logically on the previous section, without requiring the reader to know something that is presented later in the plan.

Although there is no single "correct" business plan structure, one successful structure is as follows:

- Executive Summary: This is a brief, 1 to 3 page summary of everything that follows in the plan. It should be a stand-alone document, as many readers will make their initial decision based on the executive summary alone. This should usually be written last; otherwise, you have nothing to summarize!
- Background: If you are in a highly specialized field, you should provide some background in layman terms since most investors will not have advanced degrees in your field.
- Market Opportunity: Describe how businesses and consumers are suffering, and how much they are willing to pay for a solution.
- Products or Services: Describe what you do, and how your solution fits into the market opportunity.
- Market Traction: Describe how you have succeeded in attracting customers, marketing and distribution partnerships, and other alliances that demonstrate that experts in your market are betting on your solution.
- Competitive Analysis: Identify your direct and indirect competitors, and describe how your solution is better.
- Distribution and Marketing Strategy: Describe how you will go to market, how you will price your products, etc.
- Risk Analysis: Identify major sources of risks, and describe how you are mitigating them.
- Milestones: Showcase a strong past track record, and describe key checkpoints for the future.
- Company and Management: Provide the basic facts about your company - where and when you incorporated, where you are located, and brief biographies of your core team.
- Financials: Provide summaries of your P&L and cash flows, and the assumptions used to come up with these. Also describe your funding needs, how you will use the proceeds, and possible exit strategies for investors.

As stated earlier, there is no "right" structure - you will need to experiment to find the one that best suits your business.

FINANCIAL MODEL MISTAKES.

Forgetting Cash. Revenues are not cash. Gross margins are not cash. Profits are not cash. Only cash is cash.

For example, suppose you sell something this month for $100, and it cost you $60 to make it. But you have to pay your suppliers within 30 days, while the buyer probably won't pay you for at least 60 days.

In this case, your revenue for the month was $100, your profit for the month was $40, and your cash flow for the month was zero. Your cash flow for the transaction will be negative $60 next month when you pay your suppliers.

Although this example may seem trivial, very slight changes in the timing difference between cash receipt and disbursement - just a couple of weeks - can bankrupt your business.

When you build your financial model, make sure that your assumptions are realistic so that you raise sufficient capital.

Lack of Detail. Your financials should be constructed from the bottom-up, and then validated from the top-down.

A bottom-up model starts with details such as when you expect to make certain sales, or when you expect to hire specific employees.

Top-down validation means that you examine your overall market potential and compare that to the bottom-up revenue projections.

Round numbers - like one million in R&D expenses in Year 2, and two million in Year 3 - are a sure sign that you do not have a bottom-up model.

Unrealistic financials. Only a very small handful of companies achieve $100 million or more in sales only five years after founding.

Projecting much more than that will not be credible, and will get your business plan canned faster than almost anything else.

On the other hand, a business with only $25 million in revenues after five years will be too small to interest serious investors.

Financial forecasts are a litmus test of your understanding of how venture capitalists think.

If you have a realistic basis for projecting $50-100 million in Year 5, you are probably a good candidate for venture financing. Otherwise, you should probably look elsewhere.

Insufficient financial projections. Basic financial projections consist of three fundamental elements: Income Statements, Balance Sheets, and Cash Flow Statements. All of these must conform to Generally Accepted Accounting Principles, or GAAP.

Investors generally expect to see five years of projections. Of course, nobody can see five years into the future. Investors primarily want to see the thought process you employ to create long-term projections.

A good financial model will also include sensitivity analyses, showing how your projected results will change if your assumptions turn out to be incorrect. This allows both you and the investor to identify the assumptions that can have a material effect on your future performance, so that you can focus your energies on validating those assumptions.

They should also include benchmark comparisons to other companies in your industry - things like revenues per employee, gross margin per employee, gross margin as a percentage of revenues, and various expense ratios (general and administrative, sales and marketing, research and development, and operations as a percentage of total operating expenses).

Conservative assumptions. Nobody ever believes that assumptions are conservative, even if they truly are.

Develop realistic assumptions that you can support, refrain from using the words "conservative" or "aggressive" in your plan, and leave it at that.

Offering a valuation. Many business plans err by stating that their company is worth a certain amount. How do you know? The value of a company is determined by the market - by what others are willing to pay - and unless you are in the business of buying, selling, or investing in companies, you probably don't have an acute sense of what the market will bear.

If you name a price, one of two things can happen: (a) your price is too high, and investors will toss your plan; or (b) your price is too low, and investors will take advantage of you. Both are bad.

The purpose of the business plan is to tell your story in the most compelling manner possible so that investors will want to go to the next step. You can always negotiate the price later.

STYLISTIC MISTAKES

Poor spelling and grammar. If you make silly mistakes in your business plan, what does that say about how you run your business? Use your spelling and grammar checkers, get other people to edit the plan, do whatever it takes to purge embarrassing errors.

Too repetitive. All too often, a plan covers the same points over and over. A well-written plan should cover key points only twice: once, briefly, in the executive summary, and again, in greater detail, in the body of the plan.

Appearance matters. At any point in time, an investor has dozens if not hundreds of plans waiting to be read. Get to the top of the pile by making sure that the cover is attractive, the binding is professional, the pages are well laid out, and the fonts are large enough to be easily read. On the other hand, don't go too far - you don't want to give the impression that you are all style and no substance.

EXECUTION MISTAKES

Waiting until too late. The capital formation process takes a long time. In general, count on 6 months to a year from the time you start writing the plan until the time the money is in the bank.

Don't put it off. Your management team should be prepared to invest about 500 hours into the plan. If you are too busy building your product, company, or customers (which is arguably a better use of your time), consider outsourcing the development of the business plan.

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Failing to seek outside review. Make sure that you have at least a few people review your plan before you send it out - preferably people who understand your market, sales and distribution strategies, the VC market, etc.

Your plan may look perfect to you and your team, but that's probably because you've been staring at it for months. Good, objective reviews from outsiders with a fresh perspective can save you from myopia.

Over-tweaking. You could spend countless hours tweaking your plan in the pursuit of perfection.

A lot of this time would be better spent working on your product, company, and customers.

At some point, you need to pull the trigger and get the plan out in front of a few investors.

If the reaction is positive, and they want to move forward, great.

If the reaction is negative (assuming that the investor was a good fit to begin with), then you may have been heading down the wrong path. Get feedback from a couple of investors, and if a general consensus emerges, go back and refine your plan.

Conclusion. It's a tough investment climate, but good ideas backed by good teams and good business plans are still getting funded.

Give yourself the best possible chance by avoiding these simple mistakes.

The Pitch

"The value of a killer technology is zero unless you can show how it can be turned into a profitable business."

— W. Daniel Mothersill

Types of Presentations

There are several levels of oral presentations to investors:

1. THE ELEVATOR PITCH. As its name implies, this is a brief statement about your investment opportunity that you can get out in one breath. The sole purpose of the elevator pitch is to pique the interest of the investor. Success is an exchange of business cards and an offer for you to call and set up an appointment for an in-depth interview.
   The elevator pitch should be memorized and rehearsed enough so that you can give it without it sounding rehearsed. You never know where you might meet a potential investor: at a cocktail reception, football game, even in an elevator. An elevator pitch might sound like this:

   > *"Newko has developed a low-cost and more reliable method for preserving organs for transplant. We are currently raising $100,000 for patenting and testing."*
   >
   > *"Sugarcoate systems reduce the time to bring new drugs to market by 20%."*

2. THE FORMAL PRESENTATION AT A VENTURE FAIR or BUSINESS PLAN COMPETITION. You will probably be expected to have a PowerPoint presentation to support your verbal commentary.

   The time allotted for pitches varies from 3 to 10 minutes, with 5-8 minutes being the middle of the bell curve. There may be Q&A during or after presentations. Obviously, you can cover a lot more material in 3 to 10 minutes than in an elevator pitch, but generally there will not be time to cover financial projections in detail or the resumes of the management team. For finances, cover sales and profit projections and funding sought; for the management team, mention only significant successful and related experiences of key members.

3. THE PRIVATE INTERVIEW in the office of the investor. This is what you hope the elevator pitch or formal presentation leads to.

   If meeting with a VC firm, be prepared to present to an investment team of 3 to 5 people. Plan to give a formal 10-20 minute introductory presentation. Expect to be interrupted with questions.

   Ask about logistics at the time you receive the invitation, or at least prior to the meeting, so you know what to expect:

   a. Number of people in room?
   b. Who are the decision makers? (Look up their bios on investor's web site.)
   c. Can you (should you) deliver a PowerPoint presentation?
   d. How many people will be in the audience?
   e. What is the total amount of time allotted for the interview?

f. Anything you should particularly be prepared to cover? (The answer might reveal their biggest concern.)
g. Research the firm. Who have they invested in (who are their portfolio *companies*?)
    i. Would a relationship with your firm strengthen any of their portfolio companies? Are there any potential synergies?
    ii. Call some of the CEOs of the portfolio companies.
        1. What advice do they have?
        2. What is it like working with the investors? Do some due diligence yourself
h. What is their sweet spot for investing? $1 million? $2 million? $5 million?
i. What is the process for securing capital from the firm? If this is not on the web site, ask.

Bring to the private meeting:

a. Copies of executive summary for all attendees.
b. Copies of the full plan to leave behind. Exclude confidential information, trade secrets, or content that might be useful to competitors until you obtain a signed NDA (*non disclosure agreement*). Discuss the process and timing with your venture finance or intellectual property attorney.
c. Purchase orders and contracts
d. If you are meeting with a lender, bring a list of assets that can be pledged as collateral
e. Business cards (to create a brand identity and project an aura of being in business)

If you make it through this round you will probably be called back to answer more detailed questions about the full plan and to begin negotiations over the *term sheet* (the contract with investors.)

Stay loose.

<u>Substance: (Content of Oral Presentation to Investors)</u>

The following is a comprehensive outline for an oral presentation. Adjust the amount of detail to the time allotted. Investors are looking for clear, compelling and credible information. Be concise but comprehensive.

1. PRODUCT

INTRODUCE SELF AND COMPANY

OPEN WITH A STRONG STATEMENT TO GRAB ATTENTION. Bait the hook.

> *"Eighty per cent of organ transplants are rejected within three years. Compatico has developed immune therapeutics to reduce rejections to 50%. The annual market for our new drug, once approved, is $200 million."*

PRODUCT/SERVICE DESCRIPTION and How it is New and Different

- Describe what creates the demand for your solution:
  - "Pain" and/or
  - High cost of alternatives
- Explain the "value-proposition"
  - How much customers need or want your solution. <u>Give dramatic examples</u>.
  - What's it worth to them, literally? Prove it.

PRODUCT/SERVICE DEVELOPMENT STAGE

- Current development status
- Patent status
- Work, timeline and expense remaining before the product achieves full functionality
- Major development risks or challenges

2. POTENTIAL

- What is you market niche?
  - Define the characteristics of the companies or consumers that need a solution
  - How many potential customers are there? Is number growing or declining? Why?
  - How many customers do you have now?
- What is the potential dollar sales annually in your niche?
- if the market is growing explain why.
- Marketing and Sales Strategy. Briefly explain the expected selling cycle: how you propose to reach your targeted customers
  - *<u>Marketing</u>* – to raise awareness of product and stimulate buying
  - *<u>Sales</u>* – to give *decision-makers* a convenient way to learn details and place order
  - *<u>Support</u>* – to help customers understand your product during installation and in use

- If you rely on indirect channels, explain:
    - Your approach to reaching distributors
    - Whose responsibility it is to raise awareness and generate demand among end-customers
    - Who provides sales and customer support
    - Describe special sales incentive programs (if any)

3. POSITIONING (Versus Alternatives)

- Technology edge [do not delve into too much detail. Not everyone gets excited about dual phase paradigm interferometer ether shifts like you do.] Just explain that it will allow jets to save 50% on fuel costs. That they will understand.
- Market competition and why your company is better.
- How will the big dogs (well-known companies with established relationships with your target customers) react to your initiatives?
- Are there companies that might leapfrog your solution with better technology?
- How will you overcome *Market Inertia*? (What will it take to get customers to change what they are using today?)
- Patents or other barriers to entry into your market niche by potential competitors.
    - Patents – Received, pending. US and abroad.
    - Black box technologies – Is your technology difficult to reverse engineer?
    - Lead time advantage – Would it take a competitor years to reproduce your technology?
    - Major Customers locked in with exclusive long-term agreements
    - Critical suppliers locked in

4. PEOPLE.

- MANAGEMENT TEAM [Backgrounds should be varied and include individuals with business backgrounds; not just technical people.] Has anyone on team led a similar company to a successful IPO or buy-out?
    - CEO (Chief Executive Officer) – Prior entrepreneurial experience in similar business. You may know your technology, but <u>how do investors know you can run a business</u>?
    - CTO (Technology) – Proven know-how in your core technologies
    - CMO (Marketing) – Proven knowledge of the target markets; strong relationships with distributors or key customers
    - CFO (Financial) – Prior IPO or acquisition experience

  Identify who is full-time and who is part-time or on the sidelines awaiting funding.

- BOARD OF DIRECTOR MEMBERS OR ADVISERS who add strategic value.

5. PROFIT (This is not the place to go into detail.)

- FINANCIAL FORECAST

	Year 1	Year2	Year 3	Year 4	Year 5
Units Shipped					
Revenues					
Gross Margin %					
Gross Profit					
EBITDA					

- REQUESTED FUNDING AND INTENDED USE OF FUNDS
    - Funding already received
    - Involvement of owners in funding (skin in the game)
    - Amount of new funding needed. How long will it last? (To what milestone?)
    - Intended use of funds

- EXIT STRATEGY. Investors naturally want to know what's in it for them. Tell them how much they can make in 3 to 5 years, and how they will cash out. If you are seeking equity capital, how will the investor get his money back? When? If you anticipate ***being acquired***…
    - Identify the two or three most likely buyers
    - Explain why they would be interested
    - If possible, describe recent acquisitions of comparable companies and the deal values
    - Describe any relationships you already have with potential acquirers and investment banks or VCs that might facilitate your *liquidity* plans

SUMMARIZE MOST COMPELLING ARGUMENTS:

- Accomplishments. Milestones already reached. Show momentum.
- Why is this an exciting investment opportunity? Allow for *pitch decay*. A week later your audience will probably only remember about 10% of your presentation. So make sure what they recall are your strongest points:
    - Reason to invest in us #1 (e.g. - Strategic alliances.)
    - Reason to invest in us #2

<u>Questions You Should Be Prepared to Answer</u>

You should expect questions. The first one will probably be the one you were hoping you wouldn't be asked. However, you can ensure that you will appear professional and competent if you spend some time trying to anticipate questions and prepare clear, concise answers. Don't try to memorize responses word-for-word, but do commit to memory important statistics. Finally, be open to advice from your audience. Investors want to partner with someone who is easy to get along with and who will consider their ideas for the company.

MARKET OPPORTUNITY

- Why is the customer's problem important?
- For whom? That is, who, specifically is the customer?
- How do we know the market exists? What evidence can you cite, such as independent market research?
- For <u>industrial</u> products…
  - What 2-3 industries comprise the most important prospects in Year-1? In Year-3?
  - What are the job titles of the buyers (decision-makers) in these prospects?
- For <u>consumer</u> products…
  - What are the demographics of the two or three most important customer segments?

SOLUTION: PRODUCT/SERVICE

- What, specifically, is the product?
- What does the product do?
- Why would the customer buy this product?
- What makes the product unique or special?
- How is the product better than other products or alternative methods of solving the problem?
- How much better is it than other solutions?
- Can you demonstrate that the product is cost effective?
- What special issues relate to manufacturing the product? Any special materials or processes needed?
- What special equipment or facilities are required?
- What investment is required to set up manufacturing? For what capacity?
- How do you know you can manufacture the product at a cost that will yield acceptable gross margins?

COMPETITIVE POSITIONING

- How else can the customer solve the problem?
- How do you compare to each alternative solution?
  - How are you better?
  - In what ways are you worse?
- Who are the vendors of these other solutions?
- How do they compete with each other?
- Where will you fit into the industry?
- Why will you be able to compete effectively against them long term?

BARRIERS TO ENTRY INTO THE MARKET BY COMPETITORS

- Why are you confident that no new entrant will come along with a better solution and blow you away?
- Why do you think you can dominate your market niche?
- What, if any, proprietary technologies are used to make the product?
- Are there patents? If so, what, specifically, do they protect?

PRODUCT/SERVICE DEVELOPMENT

- What needs to be done to finish your first product? What's your next act?
- How much of the development process does your company perform?
  - How much do you rely on outside contractors for development?
  - How much do you license from others?
- What expertise do you have at developing this kind of product?
- What development challenges are most important or difficult to overcome? How do you intend to do so?

MARKETING AND SALES

- What channels of distribution will you use to deliver your products to your customers?
- How will these channels be established? By whom? When?
- What expertise does your company have to execute the marketing and sales program?
- How are you going to stand out among all the established competitors?
- How can you boil down the advantages of your sophisticated technology so prospects will understand it, quickly and easily?

MANAGEMENT TEAM

- What is your background and previous experience?
- Where did the idea for the company come from?
- How did you get involved with the company?
- Who is presently involved in managing the company? What are their credentials?
- Why will the management team be able to build a successful company?
- If not all management spots are filled, what is the plan for filling them?
- What kind of people are you seeking?
- If you do not expect to be the CEO that builds the business to $10 or 20 million, what kind of person would you bring in? When?
- How does the board function?

FINANCIALS

- Be prepared to explain "dramatic" numbers, such as:
    - "Hockey stick" growth
    - Unprecedented margins
    - Long periods of negative cash flow. ("Goodness" is positive cash flow in 6 to 12 months)
- What investment is required to carry the company to the next major level of valuation?
- When do you expect the next rounds of financing to take place?
    - What specific tasks need to be accomplished to do that?
    - How long will it take? (Try to identify a "next level" that can be achieved in less than 18 months.)
- What investment will be required beyond that?
- To the extent possible, explain key assumptions behind your forecast. And make sure the forecast relates in a logical way to the market forecasts you described previously.

REQUESTED FUNDING AND INTENDED USE OF FUNDS

- How much hard-money (cash) have the founders put in?
- How much cash have directors and advisory board members invested?
- What equity is available to recruit key executives?
- How did you arrive at your pre-money valuation for this round?

EXIT STRATEGY

- What comparables are you using for your proposed IPO/exit round?

SUMMARY AND GENERAL

- When did the company begin operations?
- What exactly does the company do? (This is different than the question: “What does the product do?”)
- What is your long-term vision for the company?
- How has it been funded to date?
- Where does it stand today?
- What are the important strategies for building the business?
- What kind of business will it be? (manufacturing, service, distribution, software, combination?)
- What is the business model? (i.e. what will produce the company’s revenue?)
- What kind of gross margins will the company have?
- What expense levels are required to run the business?
- Do you have any corporate partnerships in place?
- Do you plan to put any in place?
- What are the significant risks your business faces?

Style: Creating Understandable and Convincing Presentations

THE DELIVERY

1. The CEO should present so investors can size you up as well as your plan. This is your chance to show your erudition, command presence, and knowledge of your industry. You are the brand, the company.
2. Take bulging items out of your pockets.
3. Stand up, face the audience, not the screen.
4. Speak confidently.
5. Grab their attention. Lead with your strongest suit or a shocking statistic or a 15-second story that shows how much your product or service is needed.
6. Pause occasionally so your listeners can catch up.
7. Vary your voice, especially when you want to emphasize a point.
8. Avoid *salesman's talk*: "This is going to be the hottest selling product," "We're going to replace Google ," etc. Stick to what you can prove or you will lose credibility.
9. Avoid tech talk. Keep your language simple and accessible. Remember your audience.
10. Don't fall into the common trap of droning on about how wonderful your technology is and details of how it works. The investors don't care—at least not at this stage—how the watch works, just how they can make money by helping you make watches.

    What is the pain customers have; what is your solution; and how much can the investors make by exploiting this opportunity?
11. Practice – practice – practice. It does make a difference.
12. Videotape your rehearsal.
13. Be PASSIONATE!!! Show that you believe in your concept and that you are bound and determined for it to succeed, come hell or Katrina.
14. Make them believe in you and your vision, that you know where the land mines are, and that you will succeed.

Keith Camhi, CEO of FitLinxx, presenting at a venture fair.

THE SLIDES

So no one forgets who you are, put company name and logo on every slide. (This is especially important in a competitive environment with other presenters, as at a venture fair or business plan competition.)

1. ***List 5 or Fewer Points Per Slide***.

2. ***Don't waste real estate***. Use selling slide titles, like "Why 90% of our customers come back for more" instead of "Repeat cusomer data."

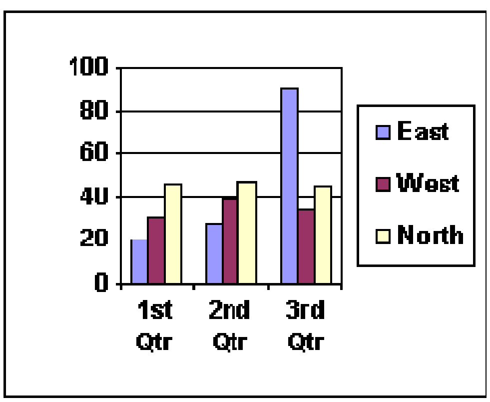
3. ***Use Large Type*** (24 points or larger).
    a. Limit slides to 7 lines and 7 words per line.
    b. Audience friendly font like Arial or Helvetica.
    c. Substitute symbols [=, %, >] for words.
    d. If the audience cannot read your material, you will lose their attention.
    e. Use phases instead of sentences.

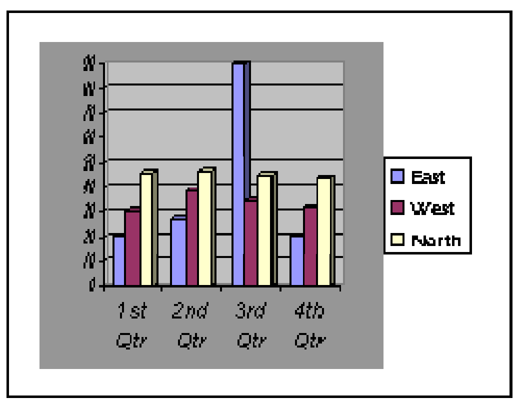
4. ***Use A High-Contrast Color Scheme***.

5. ***Keep The Show Moving***. One slide every 30 to 60 seconds is about right . Obviously, you will require more slides if you use a PowerPoint presentation and "uncover" points on your slides one at a time.

6. ***Use text on slides only to supplement, reinforce or offer examples of claims made in your talk***. (Don't put your speech on the slides. Nothing is more annoying and boring than having to listen to someone read a speech.)

7. ***Clarity***. Don't get clever. This is not a design competition. Which of the following charts is easier to read? Make sure labels are large and legible. Message of slide should be grasped in two seconds.





If you cannot read your PowerPoint or overhead slides from 15 feet away - without straining - your audience will not be able to read them when projected onto a screen.

Loan Applications

DEVELOPING YOUR LOAN PROPOSAL

Your loan proposal must answer the following questions:

- Who are you?
- How much do you need?
- How are you going to pay it back?
- What happens if you can't pay it back?

ELEMENTS OF YOUR LOAN PROPOSAL

Generally, the loan proposal is comprised of the following elements:

Summary: Comes first; written last.
This should be clear, concise, accurate and inviting. You want to summarize how the proposed loan will be used, how it will be repaid and how it will benefit your business. Remember, that you are competing with many others, so you'll also want to point out some of the distinguishing features of your business.

Top management profiles:
The key issue here is who are you? Be prepared to come under close scrutiny. You will need resumes as well as a summary of experience, qualifications and credentials for all owners and key members of your management team.

Business description:
You don't need to repeat all of the information contained in your business plan, but you do need to present a solid description of your business. Include a brief overview of the history of your business, plus a summary of current activities. Make sure you clearly demonstrate that you understand your markets and industry (current trends and risks). Include literature showing your products or services. It is also helpful to include letters from suppliers, customers and other business references.

Projections:
Include projected income statements and cash flow statements for two to three years. Your assumptions should be clearly stated and realistic. Generally, you don't need to show "best case" and "worst case" unless the banker asks you to do so. But do be prepared to answer questions (in quantifiable terms) about what happens if some of your assumptions don't come true. For example, if you anticipate obtaining a major new contract or customer as a result of newly expanded capacity, can you estimate the impact on your income statement if that customer decides to take her business elsewhere?

Financial Statements:
The loan package must include both business and personal financial statements. Make sure that you fully understand the "story" that your financial statements tell. Be assured that your banker will fully analyze your historical financial statements and calculate all the ratios. So, prepare in advance and point out any significant trends in an introductory paragraph.

Purpose of the loan:
Present a detailed statement of how you will use the loan proceeds.. Don't forget to include the proceeds of the loan in your cash flow projections (and the interest in your projected income statement).

Amount:
Remember, that you are offering the bank a deal that will make them money -- you are not asking for an "allowance". The attitude you should take is to ask, "how much money do you need, and how much will they lend?" and not, "will they lend it?"

Repayment plans:
You will have to make some assumptions about the terms of the loan in your proposal. (Obviously, this is necessary to prepare the initial financial projections.) In the first package, you will propose the terms that you want, but ultimately this will be a point that will be negotiated with the bank. The bank will consider a number of factors as they assess the overall risk of the loan and this will impact the repayment terms they are willing to give you.

Selecting the bank:
You may already have a relationship with a bank, and this is generally the logical first choice for borrowing money. But whether this is your first loan, or you are borrowing additional money, you should consider several points before selecting the bank.

Although you may need money, you should be in the driver's seat when it comes to choosing the bankers or partners you want to deal with. Make sure the bank is sincerely interested in your business and will provide you with the services you need. You should also look for a banker with whom you feel you can develop a good ongoing relationship and that has experience with similar businesses. Keep in mind the value of your business to the community and what its future deposits could mean for the bank.

Key questions to ask bankers include the following:

- Do they specialize in your industry?
- What is the average size of their borrowers?
- Does the banker make commercial loans or only consumer loans?
- Does the bank make loans in the same range as your capital requirements?

Whether you patronize a large commercial bank or a small community bank will depend on your needs. Major banks tend to offer a wider range of services and locations, which may be important if have the need for a variety of financial products and services. Community banks, on the other hand, are smaller, meaning that the banker you deal with daily might be able to make your financing decision personally or get it through the bank hierarchy quicker.

Presenting your loan proposal
Okay, now your loan package is prepared and its time to get ready to present your proposal. Before you go to the bank it is a good idea to role play with someone you trust. This is not the sort of presentation that you make every day, and this can help ensure that you are comfortable discussing all the material in your loan package, and have considered all the questions your banker might ask in the initial interview. If you have a question about how to present your loan, now might be a good time to visit the Info Exchange - discussion forum on lending and seek the advice of an expert or another business owner that has been through this before.

Before you approach a bank you should:

- Have comprehensive written documentation ready.
- Know your numbers inside and out.
- Know what collateral you can offer.
- Be prepared to sell yourself.

Handle the meeting professionally -- make an appointment, show up on time and have a business demeanor throughout the meeting. You should tell a prospective banker what benefit your business brings to the bank in terms of average balances in checking accounts, savings accounts, and present and future financial needs. You should also ask them questions to see if you think they are the right people to handle your account.

After you present your loan proposal, ask the banker what can be expected in terms of a response time, or when they will request additional information. Obviously, the request won't be approved in the initial meeting. But if you've done your homework, you will already have a good idea of whether or not your loan is likely to be approved.

If your loan is approved: (besides celebrate) make sure that you:
Thoroughly review all loan documents and understand before signing. Consult with your lawyer or accountant if you have any questions.

- Get documents in on time -- frequently there are a number of documents that cannot be finalized until after the loan is approved and closed. Keep up that good impression the bank has of you by promptly responding to requests for additional information, documents, signatures, etc.
- Maintain close contact with your loan officer. It is a good idea to give your banker progress reports -- the bank now has a vested interest in your success and will want to be kept current on your progress.
- Communicate problems. Bankers, don't like surprises, particularly if the news is bad. So, make sure they are one of the first contacted if you encounter any problems.

Once your banker makes a loan to you, he or she has a vested interest in your business success. If you prosper, the bank prospers. If you fail, the loan they approved is not going to be paid.

If your loan is not approved:

- Don't despair.
- A "no" today doesn't necessarily mean no forever.
- Don't take it personally.
- Be gracious.
- Ask the banker to explain "why" your loan was not approved.
- Don't get defensive, seek information so that your next proposal addresses and corrects any deficiencies in the current application

Where to turn for help:
There are a number of resources available to help you prepare your loan proposal, including SBA-affiliated Women's Business Development Centers, Small Business Development Corporations, and Service Corps of Retired Executives (SCORE).

Glossary

ACCREDITED INVESTOR. Potential investors who meet certain minimum net worth or income tests (as determined by the SEC) as they relate to certain exempt offerings. See also Sophisticated Investor, and consult with your legal counsel for further clarification.

ANGEL INVESTOR (ANGEL). Individuals who invest in businesses looking for a higher return than they would see from more traditional investments. In return for their investment they often are highly involved in the business. Usually they are the bridge from the self-funded stage of the business to the point that the business needs the level of funding that a venture capitalist would offer. Funding estimates vary, but usually range from $50,000 to $1.5 million.

BLUE SKY LAWS. The name applied to the securities laws of various states enacted to protect investors. While the SEC regulations are national in application, various states have securities laws that affect private and/or public offerings.

BROKER. A commonly used term applied to individuals or firms that trade securities. Brokers execute trades of securities between buyers and sellers in return for a fee or commission. Brokers do not own the securities in which they trade and, accordingly, do not share in the risks or rewards of ownership.

BUSINESS VALUATION. An estimate of the worth of a business entity and its assets.

CLOSELY HELD COMPANY. A company where the equity interests are held by a few shareholders.

DUE DILIGENCE. An investigation conducted by investors or others on their behalf that the assumptions are reasonable and that sales data, profit projections, listed assets, liabilities and other factors of a business plan contain no significant untrue or misleading information and that no material information has been omitted. For high-tech ventures, due diligence will include a feasibility review of critical technologies (will the gadget really do what the inventor claims and is the product or process superior to alternatives?) and whether the owner of the intellectual property hold an iron-clad patent protecting the companies exclusive rights to the technology.

EARLY STAGE. Seed Financing, Start-up Financing and First-Stage Financing

GOING PUBLIC. The process of a privately owned company selling its ownership shares to the investing public. See Initial Public Offering.

INITIAL PUBLIC OFFERING (IPO). The offering or sale of a company's securities to the investing public for the first time (i.e., converting a company from private to public ownership).

INSTITUTIONAL INVESTORS. Non-individual shareholders that invest on a regular basis. Institutional investors include pension funds, mutual funds, and trusts.

INTRASTATE OFFERING. A securities offering limited to investors residing in the state in which the issuer is doing a significant portion of its business. Such offerings are usually exempt from registration with the SEC.

INVESTMENT BANKER. A person or (usually) a firm that, among other things, underwrites securities, functions as a broker/dealer, and performs corporate finance and merger and acquisition advisory services. Investment bankers are usually full-service firms that perform a range of services, as opposed to an underwriter or broker/dealer, which only provides one specific service. Investment bankers typically are not direct investors but find investors for a fee. Usually a percentage of the amount raised. There may also be a fixed fee or minimum charge for their services.

JOINT VENTURE. An arrangement whereby two or more parties (the venturers) jointly control a specific business undertaking and contribute resources towards its accomplishment.

LEVERAGED BUYOUT. An acquisition of a company financed largely by debt.

LIMITED OFFERING. An offering of securities exempt from registration due to exemptions for the limited size of the offering and the limited number of purchasers.

MERGERS. A business combination where one entity becomes a part of another entity.

OFFERING CIRCULAR. Sometimes referred to as a private offering memorandum. A document used in certain securities offerings that are exempt from SEC registration requirements.

OPTIONS. A security giving its owner the right to purchase or sell a company's shares at a fixed date and agreed-upon price. (See also *Warrant*.)

PRIVATE PLACEMENT. An offering that is exempt from the requirements of registration and is limited in distribution.

PRO FORMA. Financial statements or financial tables prepared as though certain transactions had already occurred. For example, a registration statement might include a pro forma balance sheet that reflects the anticipated results of the offering.

PROSPECTUS. The primary selling document in an offering distributed to potential investors. The prospectus provides information about the company and the offering. See also Preliminary Prospectus and Final Prospectus.

ROAD SHOW. A presentation to potential investors, brokers, and dealers by the company's management and underwriters in order to facilitate a securities offering.

RULE 144A. An SEC exemption permitting the sale of certain restricted stock without registration.

RULE 504. A rule under Regulation D that permits an issuer to raise up to $1,000,000 within a 12-month period. Under Rule 504, a company may offer securities to an unlimited number of investors and need not provide an offering circular to them.

RULE 505. A rule under Regulation D that exempts from registration offers and sales of securities of up to $5,000,000 during any 12-month period. Rule 505 limits the number of non-accredited investors to 35; however, there can be an unlimited amount of accredited investors.

RULE 506. A rule under Regulation D that allows for the private placement of securities with an unlimited number of accredited investors and up to 35 "sophisticated" non-accredited investors regardless of the dollar amount of the offering.

S CORPORATIONS. Corporations that have 35 or fewer shareholders and meet certain other requirements of the Internal Revenue Code. An S corporation is taxed by the federal government and some states in a manner similar, but not identical, to a partnership.

SAFE HARBOR RULE. SEC provisions that protect issuers from legal action if specified requirements have been satisfied or, in certain cases, if a good-faith effort has been made to comply with specified requirements.

SECOND-STAGE FINANCING. Growth financing for market penetration following the initial financing round.

SECONDARY OFFERING. An offering by the company's shareholders to sell some or all of their stock to the public. The proceeds of a secondary offering are received by the selling shareholders, not by the company.

SECURITIES ACT OF 1933 (1933 ACT). Under the 1933 Act, a registration statement containing required disclosures must be filed with the SEC before securities can be offered for sale in interstate commerce or through the mail. The 1933 Act also contains antifraud provisions that apply to offerings of securities.

SECURITIES AND EXCHANGE COMMISSION (SEC). The SEC is the federal agency responsible for regulating sales and trading of securities through its administration of the federal securities laws, including the 1933 and 1934 Acts.

SECURITIES EXCHANGE ACT OF 1934 (1934 ACT). The 1934 Act requires companies registered under the 1933 Act to file periodic reports (e.g., Forms 10-K and 10-Q) with the SEC and to disclose certain information to shareholders. Companies traded over the counter with 500 or more shareholders and total assets of more than $10 million and companies that elect to be listed on a national stock exchange must file a registration statement to register under the Act.

SEED FINANCING. Second Stage Financing, Third Stage Financing and Going Public.

SOPHISTICATED INVESTOR. Potential investors who are capable of evaluating the merits of the investment venture as related to certain exempt offerings. See also Accredited Investor, and consult with your legal counsel for further clarification.

START-UP FINANCING. The product is prepared for opening up the market. The company is being built up or is newly in business and its product is not yet on the market.

VALUATION. An estimate of the worth of a business entity and its assets.

WARRANT. A security entitling its owner to purchase shares in a company under specified terms. An *option* is a form of warrant.