

RESOURCE REQUIREMENTS

It's almost like you see too much, because when it happens for real, everything flies at you so fast, you never get a sense of the ice and where everyone is at that one moment.

Steve Yzerman

RESULTS EXPECTED

Upon completion of this chapter, you will be able to:

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| <p>1. Describe the successful entrepreneur's unique attitudes about and approaches to resources—people, capital, and other assets.</p> <p>2. Identify the important issues in the selection and effective utilization of outside professionals, such as advisors, board of directors, lawyers, accountants, and consultants.</p> | <p>3. Articulate decisions about financial resources.</p> <p>4. Appreciate the ways in which entrepreneurs turn less into more (e.g., bootstrapping, lease not buy, control rather than own).</p> |
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RESULTS EXPECTED

THE ENTREPRENEURIAL APPROACH TO RESOURCES

Resources include (1) people, such as the management team, the board of directors, lawyers, accountants, and consultants; (2) financial resources; (3) assets, such as plant and equipment; and (4) a business plan and other intellectual property. Nick Bontis of McMaster University sees knowledge and know-how in people and processes as the key ingredient for a new venture to survive and ultimately thrive. Successful entrepreneurs view the need for and the ownership and management of these resources in the pursuit of opportunities differently from the way managers in many large organizations view them. This different way of looking at resources is reflected in a definition of entrepreneurship given in Chapter 1—the process of creating or seizing an opportunity and pursuing it regardless of the resources currently controlled.¹

Successful entrepreneurs have a unique approach to resources.² The decisions on what resources are needed, when they are needed, and how to acquire them are strategic decisions that fit with the other driving forces of entrepreneurship. Entrepreneurs seek to use the minimum possible amount of all types of resources at each stage in their ventures' growth. Rather than own the resources they need, they seek to control them.

Entrepreneurs with this approach reduce some of the risk in pursuing opportunities, including:

- **Less capital.** The amount of capital required is simply smaller due to the quest for prudence. The financial exposure is therefore reduced and the dilution of the founder's equity. As Michael Dunleavy with the business law firm LaBarge Weinstein in Kanata, Ontario, admonishes: don't give away too much equity too early—otherwise there is damage to be undone in order to capture the interest of later investors.
- **Staged capital commitments.** The capital infusions are staged to match critical objectives that will signal whether it is prudent to keep going, and thus infuse the second stage of capital, or abort the venture. Both the founder's and investor's financial exposure, and dilution of equity ownership, are thereby reduced.
- **More flexibility.** Entrepreneurs who do not own a resource are in a better position to commit and decommit quickly.³ One price of ownership of resources is an inherent inflexibility. With the rapidly fluctuating conditions and uncertainty with which most entrepreneurial ventures have to contend, inflexibility can be a curse. Response times to evaluate quick changes and take action need to be short if a firm is to be competitive. Decision windows are most often small and elusive. And it is extremely difficult to predict accurately the resources that will be necessary to execute the opportunity. The entrepreneurial approach to resources permits iterations or strategic experiments in the venture process—that is, ideas can be tried and tested without committing to the ownership of all assets and resources in the business, to markets and technology that change rapidly, and so forth. For example, Howard Head says that if he had raised all the money he needed at the outset, he would have failed by spending it all too early on the wrong version of his metal ski. Consider also, for example, the inflexibility of a company that commits permanently to a certain technology, software, or management system.
- **Low sunk cost.** In addition, sunk costs are lower if the firm exercises the option to abort the venture at any point. Consider, instead, the enormous upfront capital commitment of a nuclear power plant and the cost of abandoning such a project.
- **Lower costs.** Fixed costs are lowered, thus favourably affecting breakeven. Of course, the other side of the coin is that variable costs may rise. If the entrepreneur has found an opportunity with forgiving and rewarding economics, then there still will most likely be ample gross margins in the venture to absorb cost increases.
- **Reduced risk.** In addition to reducing total exposure, other risks, such as the risk of obsolescence of the resource, are also lower. For example, venture leasing has been used by biotechnology companies as a way to supplement sources of equity financing.

While some might scoff at the practice, assuming erroneously that the firm cannot afford to buy a resource, in fact not owning a resource can provide advantages and options. These decisions are often extremely complex, involving consideration of such details as the tax implications of leasing versus buying, and so forth.

Bootstrapping Strategies: Marshalling and Minimizing Resources

Minimizing resources is referred to in colloquial terms as bootstrapping or, more formally, as a lack of resource intensity, defined as a multistage commitment of resources with a minimum commitment at each stage or decision point.⁴ When discussing his philosophy on bootstrapping, Greg Gianforte (who retired at the age of 33 after he and his partners sold their software business, Brightwork Development, to McAfee Associates for more than \$10 million) stated, "A lot of entrepreneurs think they need money. . .when actually they haven't figured out the business equation."⁵ According to Gianforte, lack of money, employees, equipment—even lack of product—is actually a huge advantage because it forces the bootstrapper to concentrate on selling to bring cash into the business. Thus, to persevere, entrepreneurs ask at every step how they can accomplish a little more with a little less and pursue the opportunity (see for yourself by trying the online exercise "How Entrepreneurs Turn Less into More" at www.mcgrawhill.ca/olc/timmons).

As was outlined in Exhibit 1.3, the opposite attitude is often evident in large institutions that usually are characterized by a trustee or custodial viewpoint. Managers in larger institutions seek to have not only enough committed resources for the task at hand but also a cushion against the tough times.

Mustering Resources at Genuwine Cellars Inc.

Robb Denomme co-founded Genuwine Cellars with wood craftsman Lance Kingma. They have been building custom-made wine cellars for high-end hotels, business moguls, and celebrities worldwide. From their base in Winnipeg, Manitoba, they do their own manufacturing—something that sets them apart from competitors. Having necessary resources in-house settles well with clients and importing additional components from Asia cuts costs. Genuwine Cellars has set up a design office in Latin America for reasons of efficiency and access to skilled professionals. BDC awarded Robb a Young Entrepreneur of the Year Award and noted that in addition to lean manufacturing and an organizational structure that incorporates sales, design, and manufacturing functions: “Hiring an outside business consultant, who has become Robb’s mentor, also helped.”⁶ Robb gives much credit to a great team of talented people. But does note that the greatest challenge he has faced as proprietor came a few years ago when he had to lay off a handful of his 50-person team because they were not dedicated.⁷ Robb stated, “We always felt we needed every warm body, but after that, we were able to do more with less people. I was shocked to learn that.” Robb also acknowledges the value of learning vicariously through the experience of others.

Sources: BDC “2008 YEA Winners” *BDC etc.*, January 2009; Daryl-Lynn Carlson, “Outlook 2009: Gen Y Takes Recession in Stride,” *National Post*, December 29, 2008; Canadian Newswire, “Genuwine Cellars Captivates Discriminating Tastes—Robb Denomme Wins BDC’s Young Entrepreneur Award for Manitoba,” www.newswire.ca (accessed October 21, 2008).

Using Other People’s Resources

Obtaining the use of other people’s resources, particularly in the start-up and early growth stages of a venture, is an important approach for entrepreneurs. In contrast, large firms assume that virtually all resources have to be owned to control their use, and decisions centre around how these resources will be acquired and financed—not so with entrepreneurs.

Having the use of the resource and being able to control or influence the deployment of the resource are key. The quote at the beginning of the chapter illustrates being able to see everything unfolding quickly and sensing how it all comes together and fits into place. Scott Nichol founded 6N Silicon in September 2006 bringing his own expertise in metallurgy to tackle the purification of silicon for solar power. He located 6N Silicon “in the heart of Canada’s metal processing industry, surrounded by Canada’s extensive metal processing knowledge. 6N has benefited from access to considerable industry experience in processing other metals and applying collective skills to refine the 6N solution.”⁸

Other people’s resources can include, for example, money invested or lent by friends, relatives, business associates, or other investors. Or resources can include people, space, equipment, or other material loaned, provided inexpensively or free by customers or suppliers, or secured by bartering future services, opportunities, and the like. In fact, using other people’s resources can be as simple as benefiting from free booklets and pamphlets, such as those published by many of the Big Four accounting firms, or using low-cost educational programs or government-funded management assistance programs. Extending accounts payable is one of the primary sources of working capital for many start-ups and growing firms.

How can you as an entrepreneur begin to tap into these resources? Howard Stevenson and William Sahlman suggest that you have to do “two seemingly contradictory things: seek out the best advisors—specialists if you have to—and involve them more thoroughly, and at an earlier stage, than you have in the past. At the same time, be more skeptical of their credentials and their advice.”⁹ A recent study found that social capital, including having an established business network and encouragement from friends and family, is

strongly associated with entrepreneurial activity.¹⁰ In addition to networking with family, friends, classmates, and advisors, the human touch enhances the relationship between the entrepreneur and the venture’s advisors. Accuracy in social perception, skill at impression management, skill at persuasion and influence, and a high level of social adaptability may be relevant to the activities necessary for successful new ventures.¹¹ Paola Dubini of the University of Bocconi, Italy, and Howard Aldrich of the University of North Carolina have contributed to the growing body of knowledge about how these “social assets” may benefit the bottom line of a new venture; see Exhibit 8.1 for the strategic principles they have identified. However, a handful of studies have failed to demonstrate the effectiveness of networking activities on the performance of ventures.¹²

There are many examples of controlling people resources, rather than owning them. In real estate, even the largest firms do not employ top architects full-time but, rather, secure them on a project-by-project basis. Most smaller firms do not employ lawyers but obtain legal assistance as needed. Technical consultants, design engineers, and programmers are other examples. An illustration of this approach is a company that grew to \$20 million in sales in about 10 years with \$7,500 cash, a liberal use of credit cards, reduced income for the founders, and hard work and long hours. This company has not had to raise any additional equity capital.

bitHeads—Resources for Hire

Founded by three Bachelor of Computer Science graduates (two from the University of New Brunswick and one from the University of Windsor), the company provides software product development for large and small organizations in Canada, the U.S., and Europe. bitHeads today has 50 employees, many of whom have learned programming skills at technical college. For organizations large or small, bitHeads provides a flexible solution—immediate help with software programming, project management, or even development mentorship. It allows an organization on-demand access to resources they might not need again in the future. bitHeads specializes in VoIP, wireless, Internet, enterprise software, and more recently game development with the acquisition of a RndLabs, an independent game studio added to HeadGames, a division of bitHeads.

Source: www.bitheads.com.

An example of the opposite point of view is a proposed new venture in the iPhone applications software industry. The business plan called for about \$300,000, an amount that would pay for only the development of the first products. The first priority in the deployment of the company’s financial resources outlined in the business plan was to buy outright office equipment and sign a one-year lease on space costing approximately \$150,000. The founders refused to consider other options, such as renting the equipment

EXHIBIT 8.1 Hypotheses Concerning Networks and Entrepreneurial Effectiveness

Effective entrepreneurs are more likely than others to systematically plan and monitor network activities.

- Effective entrepreneurs are able to chart their present network and to discriminate between production and symbolic ties.
- Effective entrepreneurs are able to view effective networks as a crucial aspect for ensuring the success of their company.
- Effective entrepreneurs are able to stabilize and maintain networks to increase their effectiveness and their efficiency.

Effective entrepreneurs are more likely than others to undertake actions toward increasing their network density and diversity.

- Effective entrepreneurs set aside time for purely random activities—things done with no specific problem in mind.
- Effective entrepreneurs are able to check network density, so as to avoid too many overlaps (because they affect network efficiency) while still attaining solidarity and cohesiveness.
- Effective entrepreneurs multiply, through extending the reachability of their networks, the stimuli for better and faster adaptation to change.

Source: Adapted from Paola Dubini and Howard Aldrich, “Personal and Extended Networks Are Central to the Entrepreneurial Process,” *Journal of Business Venturing* 6, no. 5 (1991): 305–313.

or working from home with what they had. The company was unable to attract venture capital, even though, otherwise, it had excellent prospects. The \$150,000 raised from informal private investors was not enough money to execute the opportunity, and the founders decided to give it back and abandon the venture. A more entrepreneurial team would have figured out a way to keep going under these circumstances.

The Right Stuff—Does Canada Have What It Takes?

Some contend that Canada is too conservative, resistant to innovation and risk, and stuck on its history of natural resources for competitive advantage. Michael Treacy, serial entrepreneur and strategy expert, knows that **trade-offs have to be made to catch up and pursue things in a knowledge-based economy.** “The only way to keep attracting work without suppressing wages,” Treacy reasons, “is to improve productivity, and that means investing in innovation. Knowledge talent will be the only basis of real, sustainable competitive advantage over time.”¹³ According to Treacy, Canada is not prepared for a world where knowledge rules. This he finds in sizeable contrast to the U.S. where innovation thrives. “That massive, consumer-driven culture opens up a world of opportunity for new ventures, because the market recognizes and warmly receives the value of a new product or service. And the people who can provide early-stage financing are willing to back it.”¹⁴

Some have questioned whether or not entrepreneurship is the same everywhere. In France, entrepreneurs are more often part of the “corporate” establishment, whereas in Japan “network” entrepreneurs rely on the organization of industry. The “informal” entrepreneur characterizes the entrepreneur in Africa and parts of Asia. The western notion of the entrepreneur is that of an individualist with competitive instincts not part of a collective, as in other regions where trust may be more prominent.¹⁵

Most contend that entrepreneurial attributes are more universal than idiosyncratic; it is the institutional environment that drives economic activity and latent behaviours. For example, recent research has shown that Labour Sponsored Venture Capital Corporations “crowd out” other types of venture capital funds, clearly frustrating one of the key governmental goals of this program.¹⁶ These vehicles for new venture creation were supposed to foster additional financing (expand the aggregate pool of risk capital) not displace it! It is most probable that it is the incentive structures that arise from institutional arrangements that produce entrepreneurs. Finally, it should be noted that differences in entrepreneurial activity are often greater within a country (e.g., Québec vs. Saskatchewan) than between countries (e.g., Texas vs. Alberta).

Treacy concludes with that critical question about the future supply of Canadian entrepreneurs: “What are we doing to nurture them, and what are we doing to keep them here?”

OUTSIDE PEOPLE RESOURCES

Build Your Brain Trust

Building a **brain trust—a group of close advisors selected for their various expertises—for your venture is a huge part of improving the “fit” vis-à-vis the Timmons Model, and managing risk and reward.** The adage “it’s not just what you know, it’s who you know that matters” conveys the message. While networking for its own sake is ill-advised, making connections pays dividends—some of these payoffs may be delayed, options to be exercised in the future.

After assessing the venture and entrepreneur’s background through a basic “Gap Analysis” and applying the Timmons Model to the venture, it becomes clear what is missing and where value can be added in during the creation, launch, and building of the enterprise. Aydin Mirzaee, founder of bOK Systems and author of the business plan in Chapter 4, was able to add Michael Cowpland of Corel and a Toronto VC to his brain trust. Aydin gained access to their knowledge, their relevant and extensive experience, and their contacts with other talent pools and capital. It was then up to Aydin, through his entrepreneurial energy,

promise, and salesmanship, to capture their interest, gain their confidence, and tap into their talent. When this all comes together, drawing on the considerable strength of others, a better venture opportunity can be realized. The key is getting investors and directors to recognize high potential and see how they could personally make a large impact on the odds of success *because* they know what to do and how to do it in order to add value to this specific opportunity. The “Build Your Brain Trust,” exercise at the end of this chapter will walk you through the key issues and tasks necessary to assemble a brain trust that can add maximum value to your venture.

The right advisors and brain trust members are very important parts of your extended team and provide critical value to your venture. The most successful entrepreneurs think this through before they launch. They know what they need to fill in the gaps that exist on the team, and they ask themselves what they don’t know. They focus on identifying individuals with the know-how, experience, and networks who have access to critical talent, experience, and resources that can make the difference between success and failure. Spend enough—but not too much—time planning and looking before you leap. James Chrisman of Mississippi State University, and Ed McMullan and Jeremy Hall both of the University of Calgary studied new ventures that had outside advisors; their research showed that start-up counselling assistance was positively related to a ventures growth up to a point where more help adds less and less value (marginal returns to outside assistance), eventually adding no value and ultimately reaching a point where guided preparation was actually detrimental.¹⁷ Jean Lorrain of the Université du Québec à Trois-Rivières and Sylvie Laferté of Télé-université du Québec find that the support needs of young entrepreneurs are unique: **“young entrepreneurs experience serious personal problems. . . feel at a particular loss with respect to self-management issues, including stress and time management.”**¹⁸

Board of Directors

Initial work in evaluating the need for people resources is done when forming a new venture team (see Chapter 6). Once resource needs have been determined and a team has been selected, it will usually be necessary to obtain additional resources from outside the venture in the start-up stage and during other stages of growth as well.

The decision of whether to have a board of directors and, if the answer is yes, the process of choosing and finding the people who will sit on the board are troublesome for new ventures.¹⁹

The Decision The decision of whether to have a board of directors is influenced first by the form of organization chosen for the firm. **If the new venture is organized as a corporation, it must have a board of directors, which must be elected by the shareholders.** There is flexibility regarding a board with other forms of organization.

In addition, certain investors will require a board of directors. **Venture capitalists almost always require boards of directors and that they be represented on the boards.**

Beyond that, deciding whether to involve outsiders is worth careful thought. This decision making starts with identifying missing relevant experience, know-how, and networks, and **determining if the venture has current needs that can be provided by outside directors.** Their probable contributions then can be balanced against the resultant greater disclosure to outsiders of plans for operating and financing the business. Also, since one responsibility of a board of directors is to appoint officers for the firm, the decision whether to have a board also is tied to financing decisions and ownership of the voting shares in the company.

Boards are dominated by company executives and venture capitalists.²⁰ At least half of a board’s members should be outside directors in order to provide independent, outside viewpoints. When Art Spinner of Hambro International was interviewed by *INC.*, he explained:

Entrepreneurs worry about the wrong thing. . . that the boards are going to steal their companies or take them over. Though entrepreneurs have many reasons to worry, that’s not one of them. It almost never happens. In truth, boards don’t even have much power. They are less well equipped to police entrepreneurs than to advise them.²¹

The expertise that members of a board can bring to a venture, at a price it can afford, can far outweigh any of the negative factors. A board can play a crucial role, so it is impor-

tant to intentionally choose a board by focusing on “holes” that need to be filled. According to noted business writer, David Gumpert, “The board continually challenged us—in terms of tactics, strategy and overall business philosophy.” These challenges benefited the venture by (1) preventing dumb mistakes, (2) keeping us focused on what really mattered, and (3) stopping us from getting gloomy.²²

Selection Criteria: Add Value with Know-How and Contacts Once the decision to have a board of directors has been made—and remember that it may not be optional, it may be a legal requirement—finding the appropriate people for the board is a challenge. It is important to be objective and to select trustworthy people. Most ventures typically look to personal acquaintances of the lead entrepreneur or the team or to their lawyers, bankers, accountants, or consultants for their first outside directors. While such a choice might be the right one for a venture, the process also involves finding the right people to fill the gaps discovered in the process of forming the management team.

This issue of filling in the gaps relates to one criteria of a successful management team, intellectual honesty; that is, knowing what you know and what you need to know. In a study of boards and specifically venture capitalists’ contribution to them, entrepreneurs seemed to value operating experience over financial expertise.²³

Defining expectations and minimum requirements for board members might be a good way to get the most out of a board of directors. A “wish list” of attributes and areas of knowledge may be constructed or alternatively if a list of candidates is identified, pros and cons for each individual may be tallied. Again, one must be mindful that the whole, the sum of the individuals, is the goal. These individuals must work together.

A top-notch outside director usually spends at least 9 to 10 days per year on his or her responsibilities. Four days per year are spent for quarterly meetings, a day of preparation for each meeting, a day for another meeting to cope with an unanticipated issue, plus up to a day or more for various phone calls. Yearly fees are usually paid for such a commitment.

Quality directors most often become involved for the learning and professional development opportunities, rather than for the money. Compensation to board members varies widely. Fees can range from as little as \$500 to \$1,000 for a half- or full-day meeting to \$10,000 to \$30,000 per year for four to six full-day to day-and-a-half meetings, plus accessibility on a continuous basis. Directors are also usually reimbursed for their expenses incurred in preparing for and attending meetings. Shares in a start-up company, often 2 to 5 percent, or options, for 5,000 to 50,000 shares, are common incentives to attract and reward directors.

As a director of 11 companies and an advisor to two other companies, Art Spinner suggested the following as a simple set of rules to guide you toward a productive relationship with your board:

- ✓ Treat your directors as individual resources.
- ✓ Always be honest with your directors.
- ✓ Set up a compensation committee.
- ✓ Set up an audit committee.
- ✓ Never set up an executive committee.²⁴

New ventures are finding that, for a variety of reasons, people who could be potential board members are increasingly cautious about getting involved.

Liability Motivated by an apparent wave of corporate fraud scandals that many felt could lead to a crisis of confidence in the capital marketplace, in 2002 the U.S. government passed the Sarbanes-Oxley Act (SOX). SOX requires companies to file paperwork with the Securities and Exchange Commission faster, create a more transparent means of collecting and posting financial data, maintain volumes of data, and test their procedures for posting accurate, timely information. The potential consequences of running afoul of this law are ominous, including prison time and huge fines for the company’s chief officers. According to Tara Gray, of the Economics Division of the Parliamentary Research Information and Research Service, Canada’s response to SOX has been to emulate it. Particularly given that many Canadian firms are listed on U.S. exchanges and must comply with SOX even when

it conflicts with Canadian regulations. “Canadian firms make up the single largest group of foreign firms listed on U.S. stock exchanges.”²⁵ But there are some stark differences between Canada and the U.S.:

- ✓ Securities regulation is not under federal control in Canada.
- ✓ A greater proportion of Canadian firms have a controlling shareholder.
- ✓ Many Canadian public corporations have relatively low market capitalizations.

While start-ups are usually not subject to the technical requirements of the act, the spirit of the law and emerging case law create higher disclosure standards for even small and growing firms. Audit committees sitting on start-up boards, for example, could have real SOX-like exposure.

As well, directors of a company can be held personally liable for its actions and those of its officers. A climate of litigation exists in many areas. For example, some specific grounds for liability of a director have included voting a dividend that renders the corporation insolvent, voting to authorize a loan out of corporate assets to a director or an officer who ultimately defaults, and signing a false corporate document or report. Courts have held that if a director acts in good faith, he or she can be excused from liability. However, it can be difficult for a director to *prove* that he or she has acted in good faith, especially in a start-up situation. This proof is complicated by several factors, including possibly an inexperienced management team, the financial weaknesses and cash crises that occur and demand solution, and the lack of good and complete information and records, which are necessary as the basis for action.

One solution to liability concerns is for the firm to purchase indemnity insurance for its directors. But this insurance is expensive. Despite the liability problems noted above, few enterprises report difficulty in recruiting board members. In dealing with this issue, new ventures will want to examine a possible director’s attitude toward risk in general and evaluate whether this is the type of attitude the team needs to have represented.

Harassment Outside shareholders, who may have acquired shares through a private placement or through the over-the-counter market, can have unrealistic expectations about the risk involved in a new venture, the speed at which a return can be realized, as well as the size of the return. Such shareholders are a source of continual annoyance for boards and for their companies.

Time and Risk Experienced directors know that often it takes more time and intense involvement to work with an early-stage venture with sales of \$5 million or less than with one having sales of \$25 million or more, and the former is riskier. But the rewards—which may never be measured financially—are often substantial. The thrill of seeing others succeed or even simply navigate away from catastrophe can be satisfying. And we know that the initial break-in period for a start-up is crucial. Monica Diochon of St. Francis Xavier University, Teresa Menzies of Brock University, and Yvon Gasse of the Université Laval report that “sustainable operating ventures can be distinguished from others according to the activities undertaken during start-up.”²⁶ “Outsider assistance during the early stages of a venture’s development can influence its subsequent development.”²⁷ James Chrisman and Ed McMullan both of the University of Calgary found that ventures receiving such help “had higher than expected rates of survival, growth, and innovation.” The online exercise “How Entrepreneurs Turn Less into More,” on the Online Learning Centre at www.mcgrawhill.ca/olc/timmons, is a great place to start.

Alternatives to a Formal Board

The use of advisors and quasi-boards can be a useful alternative to having a formal board of directors—assuming a board is not legally required.²⁸ A board of advisors—which may complement a board of directors—is designed to dispense advice, rather than make decisions, and therefore advisors are not exposed to personal liability. A firm can solicit objective observations and feedback from these advisors. Such informal boards can bring needed

expertise, without the legal entanglements and formalities of a regular board. Also, the possible embarrassment of having to remove someone who is not serving a useful role can be avoided. Informal advisors are usually much less expensive, with honorariums of \$500 to \$1,000 per meeting common. Remember, however, the level of involvement of these advisors probably will be less than that of members of a formal board. The firm also does not enjoy the protection of law, which defines the obligations and responsibilities of members of a formal board.

An informal group of advisors can also be a good mechanism through which a new venture can observe a number of people in action and select one or two as regular directors. The entrepreneur gains the advantages of counsel and advice from outsiders without being legally bound by their decisions.

Legal Counsel

The Decision Nearly all companies need and use the services of lawyers, and newly created ventures perhaps more than most. Since it is critical that entrepreneurs fully understand the legal aspects of any decisions and agreements they make, they should never completely outsource that responsibility to their lawyer. Leslie Charm, a partner in the firm Youngman & Charm, put it this way, "You must understand the meaning of any document you're considering as well as your attorneys do. That's because at the end of the day, when you close that deal, you are the one who has to live with it, not your lawyers." In addition, Charm noted that lawyers should be viewed as teachers and advisors; use them to explain legalese, articulate risk and ramifications; and in negotiations, use them to push to close the deal.

Various authors describe the importance of choosing and managing legal counsel. By following some legal basics and acquiring appropriate legal services, companies can achieve better legal health, including fewer problems and lower costs over the long term.²⁹ Some of the legal work can be done by entrepreneurs who do not have law degrees by using self-help legal guides and pre-printed forms. However, one should not rely exclusively on these materials. Factors to consider in choosing a lawyer include availability, comfort level with the lawyer, experience level and appropriateness to the task, cost, and whether or not the lawyer knows the industry and has connections to investors and venture capital.

Just how lawyers are used by entrepreneurial ventures depends on the needs of the venture at its particular stage. Size is also a factor. As company size increases, so does the need for advice in such areas as liability, mergers, and benefit plans. Contracts and agreements were almost uniformly the predominant use by entrepreneurs, regardless of the venture's size.

Entrepreneurs will most likely need to get assistance with the following areas of the law:

- **Incorporation.** Issues such as the forgivable and non-forgivable liabilities of founders, officers, and directors or the form of organization chosen for a new venture are important. As tax laws and other circumstances change, they are important for more established firms as well. How important this area can be is illustrated by the case of a founder who nearly lost control of his company as a result of the legal manoeuvring of the clerk and another shareholder. The clerk and the shareholder controlled votes on the board of directors, while the founder had controlling interest in the shares of the company. The shareholder tried to call a directors' meeting and not re-elect the founder president. The founder found out about the plot and adroitly managed to call a shareholders' meeting to remove the directors first.
- **Franchising and licensing.** Innumerable issues concerning future rights, obligations, and what happens in the event of non-performance by either a franchisee or lessee or a franchisor or lessor require specialized legal advice.
- **Contracts and agreements.** Firms need assistance with contracts, licences, leases, and other such agreements such as non-compete employment agreements and those governing the vesting rights of shareholders.
- **Formal litigation, liability protection, and so on.** In today's litigious climate, sooner or later most entrepreneurs will find themselves as defendants in lawsuits and require counsel.

- **Real estate, insurance, and other matters.** It is hard to imagine an entrepreneur who, at one time or another, will not be involved in various kinds of real estate transactions, from rentals to the purchase and sale of property, which require the services of a lawyer.
- **Copyrights, trademarks, patents, and intellectual property protection.** Products are hard to protect. But pushing ahead with product development before ample protection from the law is provided can be expedient in the short term but disastrous in the long term. For example, an entrepreneur—facing the loss of a \$2.5-million sale of his business and uncollected fees of over \$200,000 if his software was not protected—obtained an expert on the sale, leasing, and licensing of software products. The lawyer devised subtle but powerful protections, such as internal clocks in the software that shut down the software if they were not changed.
- **Employee plans.** Benefit and share ownership plans have become complicated to use effectively and to administer. They require the special know-how of lawyers to avoid common pitfalls.
- **Tax planning and review.** Too frequently the tail of the accountant's tax avoidance advice wags the dog of good business sense. Entrepreneurs who worry more about finding good opportunities to make money, rather than tax shelters, are infinitely better off.
- **Federal, provincial, and other regulations and reports.** Understanding the impact of and complying with regulations often is not easy. Violations of federal, provincial, and other regulations often can have serious consequences.
- **Mergers and acquisitions.** Specialized legal knowledge is required when buying or selling a company. Unless an entrepreneur is highly experienced and has highly qualified legal advisors in these transactions, he or she can either lose the deal or end up having to live with legal obligations that can be costly.
- **Bankruptcy law.** Many people have heard tales of entrepreneurs who did not make deposits to pay various federal and provincial taxes in order to use that cash in their business. These entrepreneurs perhaps falsely assumed that if their companies went bankrupt, the government was out of luck, just like the banks and other creditors. They were wrong. The owners, officers, and often the directors are held personally liable for those obligations.
- **Other matters.** These matters can range from assistance with collecting delinquent accounts to labour relations.
- **Personal needs.** As entrepreneurs accumulate net worth (i.e., property and other assets), legal advice in estate, tax, and financial planning is important.

Selection Criteria: Add Value with Know-How and Contacts In a survey of the factors that enter into the selection of a law firm or a lawyer, 54 percent of the respondents said personal contact with a member of the firm was the main factor.³⁰ Reputation was a factor for 40 percent, and a prior relationship with the firm for 26 percent. Equally revealing was the fact that fees were mentioned by only 3 percent.

Many areas of the country have lawyers who specialize in new ventures and in firms with higher growth potential. The best place to start in selecting a lawyer is with acquaintances of the lead entrepreneur, of members of the management team, or of directors. Recommendations from accountants, bankers, and associates also are useful. Other sources are partners in venture capital firms, partners of a leading accounting firm (those who have privately owned and emerging company groups), or a provincial bar association. To be effective, a lawyer needs to have the experience and expertise to deal with specific issues facing a new venture. Hooking up with the vast resources of a large law firm or national accounting firm may be very beneficial, but we do not necessarily advise that strategy. You can usually get reasonable tax or estate-planning advice from a big law firm merely by picking up a telephone. The trade-off is that, if you are a small company and they have a dozen General Electrics as clients, you may get short shrift. One- or two-person firms can have an excellent network of specialists to refer to for problems outside their bailiwick. Use the specialist when you have to.³¹

As with members of the management team, directors, and investors, the chemistry also is important. Finally, advice to be highly selective and to expect to get what you pay for is

sound. It is also important to realize that lawyers are not leaders of entrepreneurial enterprises and that they do not usually make business judgments. Rather, they seek to provide perfect or fail-safe legal protection.

Most lawyers are paid on an hourly basis. Retainers and flat fees are sometimes paid, usually by larger ventures. **The amount an enterprise pays for legal services expectedly rises as the firm grows.** Many law firms will agree to defer charges or initially to provide services at a lower than normal rate to obtain a firm's business. According to Michael Dunleavy of LaBarge Weinstein, it's a good sign if your lawyer will defer payment until the venture is thriving. **If your lawyer wants fees paid up front or charges market rates, it's a sign that she's less confident in your start-up's viability.**

Bankers and Other Lenders

The Decision Deciding whether to have a banker or another lender usually involves decisions about how to finance certain needs. Most companies will need the services of a banker or other lender at some time. The decision also can involve how a banker or other lender can serve as an advisor.

As with other advisors, the banker or other lender needs to be a partner, not a difficult minority shareholder. First and foremost, therefore, **an entrepreneur should carefully pick the right banker or lender rather than just pick a bank or a financial institution,** although picking the bank or institution is also important. Different bankers and lenders have reputations ranging from "excellent" to "just OK" to "not OK" in how they work with start-ups and growing enterprises. Their institutions also have reputations for how well they work with entrepreneurial companies. Ideally, an entrepreneur needs an excellent banker or lender with an excellent financial institution, although an excellent banker or lender with a just OK institution is preferable to a just OK banker or lender with an excellent institution.

For an entrepreneur to know clearly what he or she needs from a lender is an important starting point. Some will have needs that are asset-based, such as money for equipment, facilities, or inventory. Others may need working capital to fund short-term operations.

Having a business plan is invaluable preparation for selecting and working with a lender. Also, because a banker or other lender is a "partner," it is important to invite him or her to see the company in operation, to avoid late financial statements (as well as late payments and overdrafts), and to be honest and straightforward in sharing information—even if it's bad news.

Selection Criteria: Add Value with Know-How and Contracts Bankers and other lenders are known to other entrepreneurs, lawyers, accountants, and venture capitalists. **Starting with their recommendations is ideal.** From among four to seven or so possibilities, an entrepreneur will find the right lender and the right institution.

Today's banking and financial services marketplace is much more competitive than in the past. There are more choices, and it is worth the time and effort to shop around.

Accountants

The Decision The accounting profession has come a long way from the "green eyeshades" stereotype one hears reference to occasionally. **Today, virtually all the larger accounting firms have discovered the enormous client potential of new and entrepreneurial ventures, and a significant part of their business strategy is to cater specifically to these firms.**

Accountants often are maligned, especially after the fallout of ethical scandals. The activities that accountants engage in have grown and no longer consist of solely counting numbers.³² Accountants who are experienced as advisors to emerging companies can provide valuable services in addition to audits and taxation advice. An experienced general business advisor can be invaluable in helping to evaluate strategy, raising debt and equity capital, facilitating mergers and acquisitions, locating directors, and even balancing business decisions with important personal needs and goals. In fact, when Prescott Ensign's wife was launching a venture her accountant advised her on much more than the simple tax

questions she initially inquired about. She was given advice on partnership arrangements (and why they often don't work), incorporation, cross-border shipping, and monitoring expenses and cash flow. Accountants and others may not have "lived it"—but their second-hand experience relayed by a multitude of clients may cut across industries and stages of the venture's lifecycle.

Selection Criteria: Add Value with Know-How and Contacts In selecting accountants, **the first step is for the venture to decide whether to go with a smaller local firm, a regional firm, or one of the major accounting firms.** Although each company should make its own decision, many entrepreneurs prefer working with smaller regional accounting firms, because of lower costs and better personal attention.³³ In deciding on an accountant, you will need to address several factors:³⁴

- **Service.** Levels of service offered and the attention likely to be provided need to be evaluated. Chances are, for most start-ups, both will be higher in a small firm than a large one. But if an entrepreneur of a higher potential firm seeking venture capital or a strategic partner has aspirations to go public, a national firm is a good place to start.
- **Needs.** Needs, **both current and future,** have to be weighed against the capabilities of the firm. Larger firms are more equipped to handle highly complex or technical problems, while smaller firms may be preferable for general management advice and assistance because the principals are more likely to be involved in handling the account. In most instances, those companies in the early stages of planning or that do not plan to go public do not require a top-tier accounting firm. However, one exception to this might be those start-ups that are able to attract formal venture-capital funds from day one.³⁵
- **Cost.** Most major firms will offer **very cost-competitive services to start-ups with significant growth and profit potential.** If a venture needs the attention of a partner in a larger firm, services of the larger firm are more expensive. However, if the firm requires extensive technical knowledge, a larger firm may have more experience and therefore be cheaper. Many early-growth phase companies are not able to afford to hire a leading national accounting firm and therefore a smaller local firm is best. However, these firms should tell you when you are ready to move on to a larger firm that provides more extensive services.³⁶
- **Chemistry.** Rapport and personal interaction always is an important consideration.

The recent trend in the accounting market has led to increased competition, spiralling capital costs, declining profit margins, and an increase in lawsuits.³⁷ Entrepreneurs should shop around in such a buyer's market for competent accountants who provide the most suitable and appropriate services. Sources of reference for good lawyers are also sources of reference for accountants; trade groups may also provide recommendations.

Once a firm has reached any significant size, it will have many choices. The founders of one firm, which had grown to about \$5 million in sales and had a strong potential to reach \$20 million in sales in the next five years and eventually go public, put together a brief summary of the firm, including its background and track record, and a statement of needs for both banking and accounting services. The founders were startled by the aggressive response they received from several banks and major accounting firms.

The accounting profession is straightforward enough. Whether the accounting firm is small or large, it sells time, usually by the hour.

Consultants

The Decision³⁸ **Consultants are hired to solve particular problems and to fill gaps not filled by the venture team.** There are many skilled consultants who can be of invaluable assistance and are a great source of "other people's resources." Advice needed can be quite technical and specific or general and far-ranging. Problems and needs also vary widely, depending upon whether the venture is just starting or is an existing business.

Start-ups usually require help with critical onetime tasks and decisions that will have lasting impact on the business. Consultants are employed by start-ups for the following reasons:

- ✓ To compensate for a lower level of professional experience.
- ✓ To target a wide market segment (possibly to do market research).
- ✓ To undertake projects that require a large start-up investment in equipment.³⁹

These tasks and decisions might include assessing business sites, evaluating lease and rental agreements, setting up record and bookkeeping systems, finding business partners, obtaining start-up capital, and formulating initial marketing plans.

Existing businesses face ongoing issues resulting from growth. Many of these issues are so specialized that rarely is this expertise available within the venture team. Issues of obtaining market research, evaluating when and how to go about computerizing business tasks, deciding whether to lease or buy major pieces of equipment, and determining whether to change inventory valuation methods can be involved.

While it is not always possible to pinpoint the exact nature of a problem, sometimes a fresh, outside view helps when a new venture tries to determine the broad nature of its concern, such as whether it involves a personnel problem, manufacturing problem, or marketing problem, for example.

Karl Bayer, of Germany's Institute for Systems and Innovation Research, reported that the use of consultants had a negative effect on sales three to five years later. Additionally, his research found that "the work delivered by the consultants. . . [was] inadequate for the task."⁴⁰ He suggests that the entrepreneur can most likely find and adequately prepare a consultant so that gaps are filled and the firm benefits in the long run, but it takes diligence.

Selection Criteria: Add Value with Know-How and Contacts Unfortunately, nowhere are the options so numerous, the quality so variable, and the costs so unpredictable as in the area of consulting. The number of people calling themselves management consultants is large and growing steadily. More than half the consultants were found to work on their own, while the remainder work for firms. In addition, government agencies employ consultants to work with businesses; various private and non-profit organizations provide management assistance to help entrepreneurs; and others, such as professors, engineers, and so forth, provide consulting services part time. Such assistance also may be provided by other professionals, such as accountants and bankers. A new and vital arena concerns Web presence. For example, Couple of Chicks e-marketing provides Internet marketing, distribution, and revenue measurement. The "chicks," Alicia Whalen of St. Catharines, Ontario, and Patricia Brusha of Mississauga, Ontario, use their expertise in search engine strategies and online metrics to boost Web site performance (www.acoupleofchicks.com).

Again, the right chemistry is critical in selecting consultants. One company president who was asked what he had learned from talking to clients of the consultant he finally hired said, "They couldn't really pinpoint one thing, but they all said they would not consider starting and growing a company without him!"

As unwieldy and risky as the consulting situation might appear, there are ways of limiting the choices. Consultants tend to have specialties; while some consultants claim wide expertise, most will indicate the kinds of situations they feel most comfortable with and skillful in handling. In seeking a consultant, consider the following:⁴¹

- ✓ Good consultants are not geographically bound; they will travel and can work via electronic means.
- ✓ The best referral system is word of mouth. This point cannot be stressed enough.
- ✓ Always check references carefully. It is important to look at the past solutions consultants have utilized.
- ✓ People skills are essential and therefore should be assessed when interviewing a consultant.
- ✓ Ask about professional affiliations and call them to verify the person is in good standing.

Three or more potential consultants can be interviewed about their expertise and approach and their references checked. Candidates who pass this initial screening then can be asked to prepare specific proposals.

A written agreement, specifying the consultant's responsibilities and objectives of the assignment, the length of time the project will take, and the type and amount of compensation, is highly recommended. Some consultants work on an hourly basis, some on a

fixed-fee basis, and some on a retainer-fee basis. Huge variations in consulting costs for the same services exist. At one end of the spectrum are government agencies, which provide consultants to small businesses without charge. At the other end of the spectrum are well-known consulting firms that may charge large amounts for minimal marketing studies or technical feasibility analysis.

While the quality of many products roughly correlates with their price, this is not so with consulting services. It is difficult to judge consultants solely on the basis of the fees they charge.

FINANCIAL RESOURCES

Analyzing Financial Requirements

Once the opportunity has been assessed, once a new venture team has been formed, and once all resource needs have been identified, then is the time for a new venture to evaluate what financial resources are required and when. 6N Silicon Inc., which "makes silicon that can be combined with scrap from the chip manufacturing industry to make crystalline silicon,"⁴² was able to obtain federal funding from Sustainable Development Technology Canada and get money from Ontario's Innovation Demonstration Fund. 6N raised \$6 million in its first round of venture funding in July 2007, \$20 million in second-round funding in April 2008, and in early 2009 another \$5 million was found for equipment lease financing.

As has been noted before, there is a temptation to place the cart before the horse. Entrepreneurs are tempted to begin their evaluation of business opportunities—and particularly their thinking about formal business plans—by analyzing spreadsheets, rather than focusing first on defining the opportunity, deciding how to seize it, and then preparing the financial estimates of what is required.

However, when the time comes to analyze financial requirements, it is important to realize that **cash is the lifeblood of a venture**. As James Stancill, of the University of Southern California, has said: "Any company, no matter how big or small, moves on cash, not profits. You can't pay bills with profits, only cash. You can't pay employees with profits, only cash."⁴³ Financial resources are almost always limited, and important and significant trade-offs need to be made in evaluating a company's needs and the timing of those needs.

Spreadsheets Computers and spreadsheet programs are tools that save time and increase productivity and creativity enormously. Spreadsheets are nothing more than pieces of accounting paper adapted for use with a computer.

The origins of the first spreadsheet program, VisiCalc, reveal its relevance for entrepreneurs. It was devised by business school student Dan Bricklin. Faced with analyzing pro forma income statements and balance sheets, cash flows, and breakevens for his cases, he was asked the question: "What if you assumed such and such?"

The major advantage of using spreadsheets to analyze capital requirements is having the **ability to quickly examine different scenarios**. This takes on particular relevance also when one considers, as James Stancill points out, "Usual measures of cash flow—net income plus depreciation (NIPD) or earnings before interest and taxes (EBIT) give a realistic indication of a company's cash position only during a period of steady sales."⁴⁴

Take cash flow projections, for example. An entrepreneur could answer a question such as, What if sales grow at just 5 percent, instead of 15 percent, and what if only 50 percent, instead of 65 percent, of amounts billed are paid in 30 days? The impact on cash flow of changes in these projections can be seen.

The same what-if process also can be applied to pro forma income statements and balance sheets, budgeting, and breakeven calculations. To illustrate, by altering assumptions about revenues and costs such that cash reaches zero, breakeven can be analyzed. Thus, for example, return merchandise authorization (RMA) assumptions could be used as comparative boundaries for testing assumptions about a venture.

An example of how computer-based analysis can be of enormous value is the experience of a colleague who was seriously considering starting a new publishing venture. His analysis

of the opportunity was encouraging, and important factors such as relevant experience and commitment by the lead entrepreneur were there. Assumptions about fixed and variable costs, market estimates, and probable start-up resource requirements had also been assembled. What needed to be done next was to generate detailed monthly cash flows to determine more precisely the economic character of the venture, including the impact of the quite seasonal nature of the business, and to determine the amount of money needed to launch the business and the amount and timing of potential rewards. In less than three hours, the assumptions about revenues and expenditures associated with the start-up were entered into a computer model. Within another two hours, he was able to see what the venture would look like financially over the first 18 months and then to see the impact of several different what-if scenarios. The net result was that the new venture idea was abandoned because the amount of money required appeared to outweigh the potential.

The strength of computer-based analysis is also a source of problems for entrepreneurs who place the "druther" before the fact. As the quote from Yzerman at the start of the chapter makes clear, with so many moving parts, analysis that is not grounded in sound perceptions about an opportunity is most likely to be confused.

INTERNET IMPACT: RESOURCES

Extending Your Network

An entrepreneur can greatly increase his or her reach for resources via the Internet. The Web offers a platform for which many tools are available (e.g., LinkedIn, Xing, Yahoo! Kickstart, Plaxo, Jigsaw, and Spoke). Nick Bontis is the Chief Knowledge Officer of Knexa, founded in 1999 as an online auction for knowledge. Knexa evolved to provide knowledge exchange tools. Online groups and bulletin boards might also be a source for answers to challenges new ventures and their leaders face (e.g., Brightspark and Innovation Resource Centre). And if you are short of ideas, check out Springwise.com, which "scans the globe for the most promising business ventures, ideas, and concepts."⁴⁵ Springwise is the brainchild of Reiner Evers, the creator of Trendwatching.com, a site devoted to spotting and tracking "the most promising consumer trends, insights, and related hands-on business ideas."⁴⁶

In addition to intellectual resources the Web provides access to physical and financial assets (e.g., VenCorps, Alibaba, and Tradekey). Whether sourcing capital or equipment, just about anything can be found with some patience and a systematic search. Whether opening a restaurant or a carwash, used appliances and tools can readily be found. It is now even possible to pitch your idea and broadcast it on the Internet (e.g., Under the Radar).

Fund-raising for Nonprofits

A dynamic online service model has emerged that is changing the way nonprofits conduct their fund-raising auctions. Charity auctions, which account for millions of dollars in charitable giving in Canada, often attract high-income individuals and freely donated, high-quality items. But coordinating and staffing those venues has always been a challenge, particularly since volunteer turnover requires the retraining of a majority of the workforce each time an auction is held. In addition, physical auctions are typically catered affairs that are attended by only a small percentage of an organization's support base. Tom Williams of Victoria, British Columbia, has started GiveMeaning.com, a site that hosts fund-raising pages and serves as a system for charities seeking support and those wishing to make online donations. CanadaHelps.org is a donation portal for 83,000 charities that can be browsed under a number of categories. It was created in 2000 by Queen's University students Matthew Choi, Ryan Little, and Aaron Pereira to help charities reduce overhead costs and since its inception, it has facilitated \$60 million in donations.

Chapter Summary

1. Successful entrepreneurs use ingenious bootstrapping approaches to marshalling and minimizing resources.
2. Control of resources rather than ownership of resources is the key to a "less is more" resource strategy.
3. Entrepreneurs are also creative in identifying other people's money and resources, thereby spreading and sharing the risks.
4. Building a brain trust of the right mentors, advisors, and coaches is one of the entrepreneur's most valuable "secret weapons."
5. Selecting outside advisors, directors, and other professionals boils down to one key criterion: Do they add value through their know-how and networks?
6. Today, access to financial and non-financial resources is greater than ever before and is increasing because of the Internet.

Study Questions

1. Entrepreneurs think and act ingeniously when it comes to resources. What does this mean and why is it so important?
2. Describe at least two creative bootstrapping examples you know of.
3. In selecting outside advisors, a board, consultants, and others, what are the most important criteria, and why?

Mind Stretchers Have you considered?

1. Many successful entrepreneurs and private investors say it is just as bad to start out with too much money as it is too little. Why is this so? Can you find some examples?
2. It is said that money is the least important part of the resource equation and of the entrepreneurial process. Why is this so?
3. Within the first six months of start-up, which strategies will enable the entrepreneur to conserve cash and stretch resources?

EXERCISE Build Your Brain Trust

Building a cadre of mentors, advisors, coaches, and directors can be the difference between success and failure in a venture. Building this brain trust will require your professionalism, thoroughness, salesmanship, and tenacity. You gain the trust and confidence of these mentors through your performance and integrity.

This exercise is intended to provide a framework and key steps in thinking through your requirements and developing a brain trust for your ventures.

Part I: Gap and Fit Analysis vis-à-vis the Timmons Model

1. At each phase of development of a venture, different know-how and access to experience, expertise, and judgment external to the founding team are often required. A key risk-reward management tool is the gap and fit analysis using the model.
 - Who has access to key know-how and resources that we do not?
 - What is missing that we have to have to obtain a very good chance?
 - Who can add the most value, insights, and solid experience to the venture now, in the next two years; and how?
2. Break down the Timmons Model to focus on each dimension.
 - Who are the smartest, most insightful people given what we are trying to do?
 - Who has the most valuable perspective and networks that could help the venture or in an area that you know least about?

- Resources: Who can help you get the necessary knowledge of and access to people, networks, money, and key talent?
- Team: Who has 10 to 20 years more experience and scar tissue than you do in building a venture from ground zero?

- Context: Who understands the context, changes, and timing of the venture in terms of the capital markets, any key regulatory requirements, and the internal drivers of the industry/technology/market?
3. Conclusions: What and who can make the biggest difference in the venture? Usually just one to three key people or resources can make a huge difference.

Part II: Identify and Build the Brain Trust

1. Once you've figured out what and who can make the greatest difference, you need to arrange for an introduction. Faculty, family, friends, roommates, and the like are good places to start.
2. If you can't get the introductions, then you have to go with your wits and creativity to get a personal meeting.
 - Be highly prepared and articulate.
 - Send an executive summary and advance agenda.
 - Know the reasons and benefits that will be most appealing to this person.
 - Follow up and follow through: send a handwritten note, not just another email.
3. Ask for blunt and direct feedback to such questions as:
 - What have we missed here? What flaws do you see in our team, our marketing plan, our financial requirements, our strategy, etc.?

- Are there competitors we don't know about?
- How would you compete with me?
- Who would reject and accept us for an investment? Why?
- Who have we missed?
- Who else should we talk with?

You will gain significant insight into yourself and your venture, as well as how knowledgeable and insightful the potential brain trust member is about your business, from the questions he or she asks, and from your own. You will soon know whether the person is interested and can add value.

4. Grow the brain trust to grow the venture. Think two years ahead and add to the brain trust people who have already navigated the difficult waters you expect to travel.

CASE WANT BEVERAGES

LAURIER
Business & Economics

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Preparation Questions

1. In terms of resources, what are Want Beverages' strengths? What resources are missing?
2. Evaluate the financial situation of Want Beverages.
3. What goals do Bill and Angela Moffat have for Want Beverages? Can they go after competitors like Red Bull? If so, how?

In July 2006, as Bill and Angela Moffat looked back at the first year of operations for Want Beverages (www.wantbeverages.com) and looked ahead to their plans for the coming year, they realized that there were many decisions that needed to be made. The owners of the Burlington, Ontario-based beverage company could clearly picture where they wanted the company to be several years in the future, but the path to get there was not as clear. What should they do in the upcoming year to increase sales to a level that would ensure success in achieving their long-term goals? Due to the dynamics of the industry they felt they needed to move quickly but a lack of resources, both people and money, was limiting their growth potential. So far they had financed Want from personal savings and lines of credit but they now needed more secure financing arrangements. They were

not sure what would be the best source of funds but they were sure that any lender or investor would want to see a detailed marketing plan for the next two or three years.

Background

For years the Moffats had represented a number of clothing and shoe companies, calling on stores throughout Ontario. They called their business Spellbound. While Spellbound was very successful, Bill and Angela felt there was an opportunity for them to build a company of their own. The companies they represented sold some of the most popular lines of clothing and footwear targeted at the action sports market but the Moffats realized that their personal chances for long-term success were dependent on those companies. This had become more obvious

This case was written by David Rose, Hugh Munro, and Lisa Giguere of Wilfrid Laurier University, Business & Economics, for purposes of classroom discussion.

to them in a few cases where a manufacturer had made decisions that might have been best for the company but were not in the best interests of Spellbound. The Moffats' goal was to have Want become a strong, profitable business that could support them and their young family without depending on Spellbound.

Since Spellbound's target market was young, action sports lovers Bill and Angela had developed a strong relationship with retailers across Ontario who served this market. They could see an opportunity to develop a beverage brand to appeal to this market. According to Bill:

The average teenager only buys two or three shirts a year, but the same person buys 24 beverages per month. If we can become the beverage company that the young action sports crowd can call their own, we have an opportunity to build a very large market.

Using the insights that they had gained from their Spellbound experience, the Moffats launched their new company, Want Beverages, in June 2005. Their first product was a Berry-flavoured energy drink but they were determined to be a beverage company that targeted the 14 to 24-year-old, action sports crowd, rather than an energy drink company. In May 2006 they launched two new energy drink flavours, Lemonade and Lemonade Lite, as well as bottled water. Retailing for \$1.00 per bottle, including tax, the bottled water would not provide the same profit margins for Want or the retailers, but the Moffats thought it was important to have it as part of their product offering. Now, loyal consumers in the target market could drink Want products more often than just the one or two energy drinks they would consume in a day. In the future they still planned to add an electrolyte drink and perhaps other beverages that would appeal to the target audience, for example, iced tea. They dreamed of becoming the brand that the target audience, throughout North America, would think of whenever they reached for a beverage. A critical component of the Want brand would be the commitment to give 15 cents from every bottle Want sold¹ to support action sports, for example, local skateparks, snowboard hills, and BMX trails.

Sales to early July were encouraging, with revenue of \$35,000 so far in 2006, representing sales of 1,200 cases of energy drinks and water. These sales occurred mainly in a six-week period, as sales had been minimal in March and April due to a lack of inventory while Want was getting production underway for the launch of Lemonade and Lemonade Lite.

The Energy Drink Market

DISTRIBUTION The first retailers to carry Want Beverages were stores that catered to the action sports crowd. Skateboard and snowboard shops were the primary targets in the first year. Want provided these retailers with a Want branded counter-top refrigerator along with promotional materials. Since this was the only beverage carried in most of these stores, the store employees were frequent buyers of Want products and in many cases became advocates for the brand.

Selling through outlets that did not traditionally sell beverages was not without problems. Some retailers would not carry the Want product because they did not feel they could control the 'disappearance' of the product. As one store owner remarked:

If I put a Want refrigerator on the counter, I know that each of my staff will have one bottle each day. At the end of the week I will have no product left in the refrigerator, but I am pretty

¹ In order to keep the retail price at \$1.00, Want was only able to donate five cents per bottle of water sold.

sure I won't have as much money as I should. It will be a big job to figure out who is paying and who isn't.

Another issue that resulted from distributing through these non-traditional outlets was the different markups and payment terms that were common in the snowboard and skateboard accessory business. While convenience stores were accustomed to paying for their beverages on short terms or even COD, other retailers were used to receiving 30 or 60-day terms. As well, 50-percent margins were not uncommon in clothing and shoe stores while convenience stores were accustomed to 20 to 35 percent margins.

West 49, the largest Canadian action sports retail chain with close to 100 stores located in malls across the country, had just recently decided to carry Want beverages in all locations, instantly giving Want national distribution. Want beverages had been available at 16 West 49 locations in 2005 on a trial basis. Based on the results at these test locations, they had decided to stock Want in all of their stores in 2006. While Want had to provide a refrigerator for each West 49 location, the retailer committed to an initial order of 10 cases per store and West 49 looked after distribution. Want only had to deliver the refrigerators and product to West 49's warehouse in Burlington, Ontario, just minutes from Want's Burlington warehouse.

Bars were also becoming an important part of Want's distribution, given the popularity of energy drinks mixed with alcohol, usually vodka. In busy bars, where the staff was actively promoting Want, sales could be in the seven or eight cases per week range. Bill attributed Want's success in bars to the unique flavour, a much lower price than for other energy drinks, and a good relationship with bar staff. This last point was important, according to Bill:

If the staff isn't pushing our product, it hurts both Want and the bar. If a customer asks for a 'Red Bull and Vodka' and the bartender says 'We only have Want' the customer will likely switch to another drink, for example beer or wine. But if the bartender is positive about Want, there is a good chance the customer will be very pleased to pay a lower price for Want.

For all of the Ontario stores, Bill personally delivered the product, often in conjunction with calling on Spellbound's accounts. So far, the vehicle expenses were paid through Spellbound rather than Want, unless the trip was only for Want business. This arrangement was very convenient in the beginning but Want would eventually have to start paying the distribution costs as the Want business increased and Spellbound stayed the same or declined.

MANUFACTURING Want's products were bottled by a contract manufacturer, based on a recipe developed and strictly controlled by the Moffats. This bottler had been selected because they were willing to produce batches of as few as five pallets (585 cases) and they had a flexible production schedule so an order could be produced with as little as two weeks lead time. However, in exchange for the low volume requirement, the bottler charged \$7.25 per case and insisted on being paid in advance. Since the Moffats were 'bootstrapping' the Want operation, attempting to operate without any external financing, the lack of credit terms created cash flow issues, particularly since most retailers were demanding 30 or 60-day terms.

There were other, cheaper manufacturing options. The Moffats knew of several bottlers who would produce the

product for \$2.50 per case, and would probably give at least 30-day terms, but their minimum quantity was usually 40,000 cases per batch. That was a lot of product to commit to buying, considering that total Want sales in 2005 were only 750 cases. There were also storage constraints given the 6,000 case capacity of the new Want warehouse. Finally, there was also a question of reliability. As Bill pointed out:

The other bottlers are all reputable companies but we have never dealt with them. When I place an order with our current supplier I am very confident that the order will arrive on time. Right now I am focusing on building brand awareness and increasing distribution. Sure, it would be cheaper to deal with other bottlers, but right now I just don't have time to be worrying about whether the order will arrive on time or not.

(See Exhibits 1 and 2 for Want Beverages Inc. financial information.)

Promotion

The Moffats felt that Want's market strength would come from the fact that they focused on the Canadian action sports industry. They were convinced that action and extreme sports in Canada had only been slightly targeted by other beverage companies, all of which were U.S. based, and none of those companies were 'giving back' to the industry in the way that Want was doing with the 15 cent per bottle donation. Want was very grassroots, sponsoring up-and-coming athletes and participating in small, community events. Much of Want's advertising and promotion activity involved participating in sporting events including wakeboarding, skateboarding, and snowboarding functions. In 2006 more emphasis was also being placed on mountain biking, with Want sponsoring the Ontario Cup Downhill Mountain Bike Race series as well as sponsoring one of the downhill racing teams. By being present at local events, Bill and Angela felt they had direct access to their target market and could get a good grasp on what their ultimate consumer liked and disliked. As Bill and Angela explained:

A number of bar promotions had been held and more were planned. At these events, Bill and/or Angela would set up a sampling area in the bar. They would bring their own Want product but had to buy vodka from the bar, at a cost of anywhere from \$80 to \$150 per bottle, depending on the bar. Using 15 ml. (one-half ounce) shots of vodka allowed them to serve 80 samples from an 1140-ml (40-ounce) bottle of vodka.

Staffing

The Moffats felt that a big part of building the Want brand involved getting out to places where the target market could be found. In summer 2005 they participated in 15 large, action sports events where they would set up a tent and spend an entire day. At the events, the Moffats were careful to control costs as much as possible. Rather than give away full bottles of product, they only gave one or two-ounce samples. They knew that other companies had teams of samplers who were hired specifically to attend events, but they often saw them putting little effort into their sampling and giving away far too much free product. Bill was certain that he needed to be at each event to control costs and to make sure that maximum value was reaped from the event, even if it meant limiting the number of events that could be sponsored. At many of these events they also met retailers who were interested in carrying their product.

The Moffats were considering whether they should hire additional sales staff and how they should pay them. They were con-

sidering hiring a full-time sales representative with knowledge of the industry, who they felt might cost about \$50,000 per year including salary, a small commission based on sales and travel expenses. The new sales representative would be expected to attend sporting events and bar promotions either with or instead of the Moffats. This would allow Bill and Angela to focus more on other areas of the business including manufacturing, distribution, finance, and strategic planning. They also wondered if a better plan would be to have a number of sales representatives working on a straight commission basis. For example, they might get \$50 for setting up a new retail account with a refrigerator and an initial order of five cases of product, and then \$3.00 per case for all subsequent orders that they sold and delivered. Bill and Angela wondered if there were more people operating Spellbound-type businesses who would be interested in selling Want beverages in addition to their other product lines.

Finance

Since the Moffats were still operating Spellbound, they had not taken a salary from Want yet and had used their personal savings to pay for Want expenses that were over and above sales revenues. They were now at the point where a lack of cash was limiting their growth opportunities. Each time a new store agreed to begin selling Want products, except for convenience stores and bars, the store was given a counter-top refrigerator at no charge, provided they purchased at least 10 cases of product. The refrigerators originally cost \$250 each, including Want logos, and the Moffats had to pay for the refrigerators six weeks before they were scheduled for production. For 2006, they had modified the design of the refrigerator and logos, and they had negotiated a better arrangement with the manufacturer so they were now paying only \$150 per refrigerator with payment due on delivery.

The Moffats were uncertain about what the best financing source might be. Securing a bank loan would be an attractive option. However, the company had few assets that could be used to secure a loan and no track record of profitability so it would be difficult to convince a bank to lend Want the necessary money. The interest on a loan would also increase the company's breakeven point. An equity investor might be a better idea, but Bill and Angela were reluctant to have a partner who might not share their vision for the company. If they did decide to look for an equity investor they wondered what sort of investor they should be looking for and how much of the company they would need to give up. It was difficult to calculate a value for a start-up with limited revenues and no profits, as the value of the firm was really dependent on future activities. One approach could be to estimate the value of the firm at some point in the future and then calculate the net present value (NPV) of that figure at the time the investment was received. The amount of the required investment could then be converted to a percent ownership. The discount rate used to calculate the NPV would depend on the return that the investor wanted to achieve. In the end, the value would depend on negotiations between what the investor would be willing to offer and what the Moffats would be willing to accept.

The Future

Bill and Angela were concerned about the future of Want Beverages. Although they were still operating Spellbound and did not currently need to take a salary from Want, they hoped to be able to do so in the future. As they considered all that had happened so far, they wondered what the best plan would be to build Want into the profitable business that they knew it could be.

EXHIBIT 1 Want Beverages Inc.

INCOME STATEMENT		(Canadian Dollars)
4/12/05-12/31/05		
Gross Sales		18,610.46
Cost of Goods Sold		13,042.19
Gross Profit		5,568.27
Expenses		500.00
Advertising		1,847.00
Amortization		1,145.68
Bank Charges & Interest		10,162.01
Event Fees & Equipment incl. trailer		846.72
Miscellaneous		2,689.77
Promotional Supplies		5,087.62
Promotional Cases for Events (used as event admission)		3,963.74
Promotional Cases for Team Riders		2,123.18
Promotional Cases for Sampling		4,565.16
Rent		1,274.97
Supplies		2,069.07
Telephone & Utilities		2,597.59
Travel, Meals & Entertainment		38,872.51
Total Expenses		- 33,304.24
Net Income (Loss)		
BALANCE SHEET		(Canadian Dollars)
As at 12/31/05		
ASSETS		
Current Assets		
Accounts Receivable		7,930.20
Inventory		11,133.90
GST		2,865.04
		21,929.14
Capital Assets		
Refrigerators (Less accum. amortization)		15,005.52
TOTAL ASSETS		36,934.66
Current Liabilities		
Demand Loan and Overdraft		40,996.53
Accounts Payable: Spellbound		15,617.03
Accounts Payable: Suppliers		13,625.34
TOTAL LIABILITIES		70,238.90
EQUITY		
Capital Stock		2.00
Retained Earnings		-33,304.24
TOTAL LIABILITIES & EQUITY		36,934.66

Source: Want company records. Figures may have been disguised for confidentiality.

EXHIBIT 2 Want Beverages Inc.'s Price and Cost Information

	Per 24 Bottle Case	Per Bottle
Suggested Retail Price (including tax)		\$2.50
Selling Price to Retailer	\$30.00	\$1.25
Production Costs:		
Bottling Fee	\$7.25	\$0.30
Bottles	\$3.84	\$0.16
Labels	\$1.77	\$0.07
Ingredients	\$1.21	\$0.05
Donations	\$3.60	\$0.15
Total Production Costs	\$17.67	\$0.73
Gross Margin	\$12.33	\$0.52

Source: Want company records. Figures may have been disguised for confidentiality.



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C·H·A·P·T·E·R

9

FINANCING THE VENTURE

Happiness to an entrepreneur is a positive cash flow.

Fred Adler
Venture Capitalist

Upon completion of this chapter, you will be able to:

- | | | | |
|-------------------------|--|---|-------------------------|
| RESULTS EXPECTED | 1. Describe critical issues in financing new ventures. | 4. Understand the capital markets food chain and its implications. | RESULTS EXPECTED |
| | 2. Discuss the difference between entrepreneurial finance and conventional managerial or corporate finance. | 5. Identify informal and formal investment sources of equity capital. | |
| | 3. Appreciate the process of crafting financial and fund-raising strategies and the critical variables involved, including identifying the financial life cycles of new ventures, a financial strategy framework, and investor preferences. | 6. Learn how to be vigilant in finding, contacting, and dealing with equity investors. | |
| | | 7. See how venture capital investors make decisions. | |

VENTURE FINANCING: THE ENTREPRENEUR'S ACHILLES' HEEL

There are three core principles of entrepreneurial finance: (1) more cash is preferred to less cash, (2) cash sooner is preferred to cash later, and (3) less-risky cash is preferred to more-risky cash. While these principles seem simple enough, entrepreneurs, chief executive officers, and division managers often seem to ignore them. To these individuals, financial analysis seems intimidating, regardless of the size of the company. Even management teams, comfortable with the financial issues, may not be adept at linking strategic and financial decisions to their companies' challenges and choices.

Financial Management Myopia: It Can't Happen to Me

Financial management myopia is a combination of self-delusion and just plain not understanding the complex dynamics and interplay between financial management and business strategy. Why is this so?