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FastTrac® TechVenture™

FOR ASPIRING TECHNOLOGY AND LIFE SCIENCE ENTREPRENEURS

FastTrac® TechVenture™

ENTREPRENEUR MANUAL

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About Kauffman FastTrac®

Kauffman FastTrac, a not-for-profit educational organization, is the leading provider of learning curricula that equip aspiring and existing entrepreneurs with the business skills and insights, tools, resources, and networks to start and grow successful businesses. Kauffman FastTrac was created by the Ewing Marion Kauffman Foundation, the largest foundation in the United States devoted to entrepreneurship. For more information about Kauffman FastTrac, visit **fasttrac.org** or follow us on Twitter @fasttrac.

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On a bitterly cold day in January 1993, Ewing Marion Kauffman scheduled to launch a new program for entrepreneurs called FastTrac®. Kauffman was legendary in Kansas City because his company, Marion Merrell Dow, provided more than 3,000 high-paying jobs, he was the owner of the Kansas City Royals baseball team, and through his foundation, he helped families in disadvantaged areas get an education – even paying for college for many.

On that same morning, however, nature decided to dump on Kansas City one of the worst snowstorms in its history. Kauffman's staff debated whether to cancel the event, since people were being asked to stay off the roads, and Kauffman was extremely ill. He wanted to hold the event just in case someone did go to the trouble to get there. That day, 900 people showed up. Yes, some came because it was sponsored by "Mr. K" as he was affectionately called; but most came because they had a hunger to learn how to start and grow a business. They wanted to invest in themselves even if that meant braving the storm.

That Kansas City FastTrac® kickoff was one of the last public appearances for Kauffman, who passed away later that year at the age of 76. He was grateful for the opportunity to build a company and to share his abundance with others. He loved entrepreneurs and all they stood for – self-reliance, innovation, hard work, and providing good paying jobs and benefits. He was proud that his foundation was championing entrepreneurship.

The Ewing Marion Kauffman Foundation is proud to have played some small part in the decision-making process, skill development, and network building of hundreds of thousands of people engaged in the entrepreneurial process.

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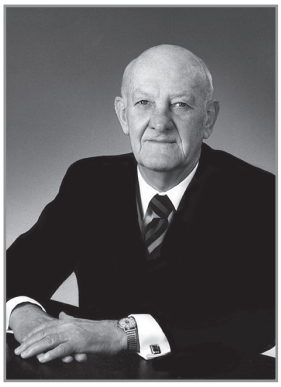
The Story of Ewing Marion Kauffman



The late entrepreneur and philanthropist Ewing Kauffman established the Ewing Marion Kauffman Foundation as the first foundation to focus on entrepreneurship as one of its primary areas of interest.

There is more to Ewing Kauffman's beneficence than his fortune. He had an instinct for the future. He understood how to bring organizations to life to be productive and vital. Above all, he had a zest for life and a social awareness that was grounded in his belief in people. The Kauffman Foundation of Kansas City develops and advances innovative ideas that set the groundwork for institutional change, advance entrepreneurship, and improve the academic achievement of children and youth.

One of America's most successful entrepreneurs, Kauffman was born on a farm in Garden City, Mo., in 1916. His family moved to Kansas City when he was a boy. He started his business in 1950 from modest beginnings. Working out of the basement of his Kansas City home, he built Marion Laboratories into a billion-dollar pharmaceutical giant. Kauffman set a high standard for his associates, inspiring them to work hard, and promising to share the rewards of the company's success with those that produced.

Kauffman established the Kansas City Royals, bringing major league baseball back to Kansas City. He hired mavericks and encouraged them to bring new thinking to transform the hidebound culture of the baseball establishment. Following their owner's unconventional path, the Royals built a model baseball franchise, developing talented young players into major league stars. Ewing Kauffman's Royals were perennial playoff contenders, winning six division championships, two American League pennants and a world championship.

With his business succeeding beyond his wildest dreams, Kauffman turned his vigor, intellect, and wealth to a new style of philanthropy. He lost patience with charity work that never seemed to attack the core problem it sought to remedy. He wanted to dig deep and get at the roots of issues rather than talk about addressing the symptoms. Undaunted by the size of the challenge or the lack of resources, Kauffman encouraged his staff to become immersed in research, consult with the best minds, and devise bold approaches to address complex social problems. He told friends he was having more fun giving money away than he had earning it. He told associates he expected his foundation to be exemplary.

An epitome of American entrepreneurship, Kauffman saw business enterprise as one of the most effective ways to unleash human potential and stir the economy to life. He viewed entrepreneurship as the most powerful strategy to help individuals gain economic independence and serve as a catalyst for creating jobs and wealth in society.

Today the Kauffman Foundation is devoted to advancing entrepreneurship as one of the fundamental aspects of life in the United States. Focusing on research, education, technical assistance, and policy, we work to increase the number and success rate of individuals engaged in the process of starting or growing their own business or idea. We work with partners to design programs based on the proven principles, techniques, and leadership tactics that make starting and growing a business a more common choice for Americans of all walks of life.

To that end, the Kauffman Foundation's FastTrac programs are part of a wide range of learning resources developed by and with hundreds of successful entrepreneurs who have shared their knowledge, insights, and stories so that others might learn from them. It is hoped that all entrepreneurs will find them useful as they work to write their own entrepreneurial success stories.

For more information on FastTrac, the nation's leading, award-winning business training program for entrepreneurs, go to **fasttrac.org** or call 800.689.1740. For more information about the Kauffman Foundation and entrepreneurship, go to **entrepreneurship.org**, **kauffman.org**, or call 800.489.4900.

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Introduction

Program Overview

The goal of FastTrac® TechVenture™ is to enable you to develop your Elevator Pitch, Investor Presentation and other important aspects of your business concept. Through a series of educational experiences, products, and services, FastTrac provides comprehensive training in all aspects of growing and managing a business.

FastTrac® TechVenture™ is a program designed for entrepreneurs in the fields of technology or life sciences. It focuses on the specific needs of entrepreneurs with businesses based on:

- Developing and marketing technology.
- Developing technology that enables creation or enhancement of a non-technology business.
- Developing health-tech and life sciences products and/or services.

FastTrac® TechVenture™ sessions are led by experienced facilitators and business coaches who make tech entrepreneurship come alive by sharing real-world expertise, practical tips, and success stories. Expert guest speakers from the entrepreneurial, corporate, investment, legal, and financial communities are frequent contributors to the program.

Program Goal

The goal of FastTrac® TechVenture™ is to enable you to develop your Elevator Pitch, Business Plan, and Investor Presentation in order to effectively communicate your:

- Market opportunities.
- Business concept.
- Financial plan.
- Investment potential.

Confidentiality

It's essential that you share your ideas with the facilitator, your business coach, and the other participants if you're to get as much benefit as possible from this program. To alleviate any worry you might have about the proprietary nature of your ideas, that is, your intellectual property, be assured that everyone involved with the program – whether facilitator, business

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coach, guest speaker, or participant – understands that confidentiality is a must. Each person connected with this program is expected to respect the proprietary nature of each participant's ideas. It is essential that you feel free to participate in the intellectual give-and-take that's necessary for you to get optimal results from this program, confident that your ideas are safe.

Resources for Learning

The FastTrac® TechVenture™ program provides you with numerous resources to learn from both during and after the program:

Entrepreneur Manual – Addresses the program topics more broadly and in greater depth than the time constraints of face-to-face sessions allow, and serves as an invaluable reference after you complete the program.

Facilitator and business coaches – Entrepreneurs or professional service providers who have extensive experience in starting, funding, growing, and managing businesses.

Guest speakers – Experts in the specific topics for a given module.

Online tools – Downloadable resources accessed through the FastTrac website. These tools include templates, assessments, action files, guidelines, and sample documents, many of which you'll customize to your business. You can access these tools at **fasttrac.org**.

Other participants – Their experience, skills, and knowledge may be very different from yours, allowing them to offer you fresh perspectives on problems you need to solve.

Entrepreneurial network – You can form a network to call on from among your facilitator and business coaches, the guest speakers, and the other program participants.

How the Program is Structured

This program is usually offered in sessions that follow the order of the modules in this Entrepreneur Manual. The program is flexible and may be conducted using a variety of timeframes. The manual and the program are divided into two sections, Concept Analysis and Business Planning.

Before each session, you should read the module(s) in this manual that pertains to the topic of the session. The reading will lay the groundwork for the topic. Although not every detail contained in the manual might be addressed during the program session, you'll find that the reading provides a thought structure that will help you get optimal benefit from the session. The manual will also be an invaluable reference for use after you complete the program.

During a typical session, you'll hear more about the topics from your reading and you'll work on specific assignments for those topics. The program facilitator usually introduces and provides overview information on the module topics. The facilitator, a business coach, or a guest speaker who is an expert on the topics then delves more deeply into issues relating to the session content.

Each session will include a networking interlude during which you'll get the chance to interact with other participants, the facilitator, business coaches, and guest speakers. During this time, you'll learn more about each other's ideas and, ideally, help each other address the challenges of running your business. You'll also build professional relationships that will continue after you complete this program.

A significant amount of time is devoted to business coaching sessions, during which you will meet in small peer groups with a business coach or your facilitator to address your specific business, marketplace, or personal and professional goals. The business coaching

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sessions not only provide you with customized counseling and guidance, but also offer the opportunity to develop mentoring relationships with experts in your field.

Throughout the program, you'll use the online tools for each module. You'll probably spend the most time working with the templates for creating your Business Plan and Financial Plan.

Finally, FastTrac® TechVenture™ facilitators may direct you to follow-on programs that take your business concepts beyond the program, both into the real world of presenting to prospective investors and into the actual operational or growth stages of business.

Many FastTrac® entrepreneurs successfully launch or grow their businesses and return as guest speakers, facilitators, and business coaches, building an expanding community of entrepreneurs helping and giving back to entrepreneurs.

Concept Analysis Section

Purpose

For those starting a business, the purpose of the Concept Analysis section is to help test your personal vision and the feasibility of your business concept through personal introspection, market definition, research and analysis, and development of a business concept statement. If you are already in business, this section provides an opportunity for critical review of your existing concept and can lead to enhancing or changing your concept. Upon completion of this critical step for both start-up and existing businesses, you will have created a Business Concept Statement and started practicing an elevator pitch to effectively communicate your market opportunity and business strategy.

Time Frame

The Concept Analysis section encompasses the first four modules of the program. In the first three modules, you will gain a greater understanding of the features and benefits, or value proposition, of your product and its unique position in the marketplace. Then, in the fourth module, after you have tested the feasibility of your business concept and technology, your facilitator will guide you in determining the appropriate next steps.

What Will You Gain from the Concept Analysis Section?

This section of the program will guide you through the following means of analyzing your business concept and its likelihood of success:

Personal Vision Statement – You will examine your entrepreneurial characteristics. You will also define your personal vision, which includes lifestyle, professional, and financial objectives.

Business Concept Statement – A Business Concept Statement expresses the precise nature of your venture. You will write a Business Concept Statement to communicate your business concisely to advisors, customers, potential investors, vendors, and employees.

Elevator Pitch – You will begin to compose and practice your elevator pitch, a verbal commercial for your business that can be stated in one or two minutes.

Business Concept Feasibility Assessment – You will test the concept's feasibility to determine whether it should be pursued. Feasibility means that a product or service can be sold to an identifiable market at a profit sufficient to support your personal vision and business goals. You will research and define the target market for your product or service as part of testing its feasibility. You will also compare the business concept against a model, or ideal, business.

Next Steps – If your business concept tests favorably against a model business and is compatible with your personal vision, you will proceed to the second part of this program, Business Planning. If the market definition and feasibility tests reveal a weakness, then you can work with your facilitator to discuss modifying or abandoning the concept.

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Business Planning Section

Purpose

The purpose of the Business Planning section is for you to develop your business concept. You will consider management, financial, and operations issues that will affect the future success of your enterprise. Upon completion of the Business Planning section, you will be able to create a full business plan with the goal of obtaining outside financing. Your work in the Business Planning section will also enable you to create an investor presentation geared toward effectively communicating:

- Market opportunity.
- Business strategy.
- Value proposition.
- Financial plan.
- Investment potential.

Time Frame

The Business Planning section encompasses six modules that focus on developing, growing, and managing your business. Within these six modules, you will work on your Business Plan and Investor Presentation with assistance from the program facilitator.

What Will You Gain from the Business Planning Section?

With a Business Plan Template as a guide, you will create a business plan that captures all the key details about your business. You will also work on an investor presentation designed to inform potential investors about your business and convince them to fund your enterprise.

Potential funding sources will want to investigate all aspects of your business. They want to see that you have proven your concept, organized day-to-day operations, and considered future growth. In short, they want to see that you have planned for your success. Your Business Plan and Investor Presentation will demonstrate your efforts.

The modules of the Business Planning section cover topics you will need to know about in order to secure funding and lead a thriving enterprise. You will work with your business coach on:

- Entering and Capturing the Market.
- Planning for Financial Success.
- Building and Compensating Your Organizational Team.
- Protecting the Business and Your Intellectual Property.
- Identifying Funding and Working with Investors.
- Managing Cash and Operating Your Business.

Conclusion

By the time you complete the FastTrac® TechVenture™ program, your accomplishments will be many. You will have:

- Connected with excellent resources from the entrepreneurial, corporate, investment, legal, and financial communities to help your business succeed.
- Learned how to start, fund, grow, and manage your business.
- Created an Elevator Pitch, a Business Plan, and an Investor Presentation to communicate your business concept.

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Exploring Entrepreneurship

Starting and growing a company can be both the most rewarding and the most frustrating experience of your life. It's rewarding to open yourself to a new world of experiences, learning, and accomplishment that cannot be encountered working for someone else. It's frustrating when nothing happens the way you planned and you have to deal with obstacles – negative employees, demanding investors, distracted partners, and unpredictable market forces, just to name a few.

Since growing a company is a challenging task, it's important to minimize risk at every stage of the process. This module gives you an overview of the reality of starting and growing a company and will help you minimize risk by:

- Making you aware of critical issues.
- Encouraging you to construct and examine your business concept in a critical and objective manner.
- Introducing you to resources that will allow you to expand your knowledge base.
- Providing access to experienced entrepreneurs and professionals who can provide valuable practical advice.

Outcomes

- Compare your own characteristics to those of successful entrepreneurs.
- Consider issues specific to entrepreneurship in the technology and life sciences markets.
- Consider your own criteria for successfully starting and operating a business.
- Identify the features, benefits, and uniqueness of your business concept.
- Learn how to quickly express the key things you want people to remember about your business.

Action Steps (Find online tools at **fasttrac.org/resources**.)

- ❑ Complete the Entrepreneurial Readiness Assessment (Assessments tab).
- ❑ Compose your Personal Vision Statement (Action Files tab).
- ❑ Write the first draft of your Business Concept Statement (Action Files tab).
- ❑ Write the first draft of your Elevator Pitch (Action Files tab).
- ❑ Review the Business Plan Template, the Financial Templates, the instructions for the 6-Year Financial Template, and the FastTrac® Glossary (Templates and Glossary tab).
- ❑ Review the Investor Presentation (Action Files tab).
- ❑ Review the Sample Business Plan (Guidelines and Sample Documents tab).
- ❑ Read Module 2: Understanding Customer Development and the Business Model.

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What is Entrepreneurship?

Entrepreneurship is a process through which people and teams pursue opportunity, use resources, and initiate change to create value. Starting a business takes time and effort. It requires balancing commitments. It costs money, and it involves taking risks.

As you pursue entrepreneurship, you may soon realize the following:

- Entrepreneurs do not need to base their enterprise on a *fantastic* idea. Successful entrepreneurs turn *feasible* ideas into profitable businesses.
- It is wise to select good people who will help the business succeed. Don't be afraid to hire people who are brighter or more knowledgeable than you. And, recognize when you need others to take over – many businesses have been taken over by new management that pushes the company to the next growth stage.
- Experience within the industry or market provides a distinct advantage in creating and growing a business.
- It is important to find creative ways to finance a business. If you're just starting out, you'll find that your most important job may be selling your concept to prospective investors or searching for other avenues to fund your enterprise.

Characteristics of Entrepreneurs

Entrepreneurs are people who interpret problems as opportunities, take action in response to needs, and accept calculated risk in the hope of creating value. Most entrepreneurs believe that solving problems for a business they own is more rewarding than solving problems for a business where they are employees.

Tip

"Genius is one percent inspiration and ninety-nine percent perspiration."

– Thomas A. Edison

Entrepreneurs generally have most of the following characteristics. How many of these characteristics describe you?

Business knowledge – Entrepreneurs don't always have the general understanding of business management that's necessary to succeed. Where they have gaps in expertise or experience, successful entrepreneurs seek advice from mentors and other business professionals to assist them.

Desire – When entrepreneurs passionately seek success, their desire pushes them to do the tasks necessary to achieve their goals.

Determination – Successful entrepreneurs do not quit easily. When things look hopeless they persevere, not allowing their business to fail.

Energy – Most entrepreneurs have high energy levels to tackle the demands of building a new venture.

Ethics – Business owners who have a reputation for being credible and honest attract customers, colleagues, investors, suppliers, and a high-quality team.

Good people judgment – The ability to pick the right people is an essential skill and critical for success.

Low support needs – Entrepreneurs usually have little, if any, support staff during the early stages of their business. They are willing to pitch in where needed and adapt to their small-scale enterprise.

Market awareness – Successful entrepreneurs take direction from the market and see opportunity at every turn. Many entrepreneurs see an opportunity that others miss. It can be an asset to be unconventional.

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Persuasiveness – Entrepreneurs must persuade other people to do all sorts of things for them such as lend them money, work hard for them, buy from them, and sell to them on favorable terms.

Problem-solving – Entrepreneurs are quick problem-solvers – they do not need the perfect solution in order to get started. They look at problems from different perspectives and are able to find creative solutions.

Responsibility – Entrepreneurs realize that they are accountable for their own success.

Self-confidence – Entrepreneurs believe in themselves and have confidence that somehow they will solve any problem that arises.

Self-discipline – Entrepreneurs must have the self-discipline to do the things they don't enjoy.

Social responsibility – Entrepreneurs are often passionately motivated to share their successes and wealth by giving back and supporting their communities and society as a whole.

Thrive on uncertainty – An entrepreneur must be able to exist and prosper in an environment that is often or sometimes confusing, chaotic, and uncertain.

Value appropriate control systems – Not all entrepreneurs have an inherent ability to control costs, inventories, cash, and other assets, but such controls are crucial for a business to succeed. Successful entrepreneurs rely on the expertise of their team members to rein in any excesses when necessary.

Tip

Build a culture of "giving back" from day one to show your commitment to being a good corporate citizen.

Technology and Life Sciences Entrepreneurs

Technology and life sciences entrepreneurs share many of the same characteristics as other entrepreneurs, yet they also face unique challenges.

Most entrepreneurs start companies based on market needs for existing products or services. However, technology and life sciences entrepreneurs often base their ventures on technology or science that causes dramatic change in a market. The most difficult venture is one that creates a new market, creates a new product or service category, or changes the way people work, live, or play. Therefore, technology and life sciences businesses often require more detail, carry higher risk, and involve more people than other ventures.

Tip

A good way to begin minimizing risk is to research the industry, test the markets, and write a business plan. Writing a plan significantly increases the likelihood of your business being successful.

For example, the California SBDC system has adopted the following definition of a technology enterprise, "A business in which research and development brings forth an innovative product, process or service. The innovation typically involves intellectual property that contributes to a strong competitive advantage in the marketplace, and serves as a foundation for a high rate of growth."

Technology and life sciences entrepreneurs who have built their own businesses have discovered the following keys to success:

Build on technical or scientific knowledge – If you possess a skill that can be matched to a business need, it can form an effective basis upon which to build or start a business. Of course, skill alone is not sufficient to build a business.

Ability to transfer technology innovations into business concepts – Technology innovations are often developed in University or Laboratory environments and are built in collaboration with many partners including academic, governmental and industry representatives. Leveraging the skill sets of technology transfer offices and other public and private resources is an opportunity for technologists to transfer their innovations into business concepts that address real needs of accessible markets.

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Depend on and develop an inter-disciplinary team – To build a business, technologists need to surround themselves with a team of co-founders, employees, professional service providers and advisors that can effectively understand opportunities and develop and implement comprehensive customer driven strategies to exploit these opportunities.

Develop an intellectual property (IP) strategy – There are direct connections between a company's IP portfolio and its ability to obtain venture funding and maintain a competitive advantage. Actual patents are not always appropriate or critical depending on the type of innovation and competitive space. In many cases the IP strategy may involve trademarking brands, trade secrets and solid agreements with employees, independent contractors and strategic partners.

Manage risk – Financial risks, such as losing savings, house equity, and even income, are always a possibility. Entrepreneurship requires taking calculated risks and reducing the risk factor by researching and planning your product or service, industry, and market. You must manage the downside, always remaining aware of various options in the event that the venture needs fine-tuning to succeed.

Technology risk – Understanding early on the ownership of ideas and uniqueness from an intellectual property standpoint is key for ventures to build value in the business concept and attract the right partners for launch.

From Real Entrepreneurs **manage risk**

Two women founded Yakalo Solutions to provide application services for real estate brokers looking to launch their own websites. Yakalo's back-room software allows brokers to launch their sites, update listings, and manage the intricacies of complicated web programming.

One of the partners spent three years building, operating, and updating websites for brokers in their area. She reasoned that the brokers could save money and time if they could update their sites on their own. Not having a great deal of money, she developed the first version of the software with the help of her husband at night and on weekends. After the software was tested and all the bugs were eliminated, she and a friend started Yakalo.

The next step was to get accepted by a technology incubator that supported high-tech firms by providing them inexpensive office space, guidance, and connections to financing sources. The company had revenue the first year and reached cash break-even in the first part of its second year. The risk in starting this business was low, and now investors are interested in financing its growth.

Reality

All entrepreneurs will exit from their business one day. Planning that exit is critical.

Plan an exit strategy – Savvy entrepreneurs plan their exit from the business in the beginning planning stages because it forces them to analyze what they really want out of the business, as well as to map out the potential return on investment (ROI) for investors. The business plan and exit strategy must match the financing plan and your goals.

The most common favorable exit strategies are to sell the business, merge it with another, or sell shares in the business to the public. Unfortunately, for those entrepreneurs who do not plan an exit strategy, the most common exits are death, retirement, or closing the doors. Your planned exit strategy will drive many day-to-day operating decisions.

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From Real Entrepreneurs **exit strategy**

In just two years, Pete Estler turned a simple idea into an e-mail marketing firm, MatchLogic. He sold it for $90 million to Excite@Home. Before that, Estler turned another basement computer project, dbIntellect, into $50 million in just three years. He sold that database company to Electronic Data Corp. for stock. Like many technology entrepreneurs, Estler knew that he wanted to create dramatic businesses quickly and then exit.

Execute agreements – Many business ideas and relationships start with handshakes. One thing an entrepreneur can count on is change. Invariably team members and strategic partners change priorities. It is critical to reach agreements early on to establish a base from which to build the business.

The Entrepreneur's Personal Vision

How can you determine the success of a business venture? A simple answer is that a business is successful if it meets your personal goals, or your vision. A personal vision is a statement of your own criteria for successfully starting and operating a business. The personal vision statement includes lifestyle, professional, and financial criteria.

The important thing is to identify the criteria that matter most to you. For example, you may require a personal income of at least $75,000 from the business to cover existing obligations. This criterion cannot be compromised. On the other hand, you may have optional goals, such as the desire to travel. These are nonessential criteria and will play a less important role in forming your personal vision statement.

These criteria will guide you in making a go or no-go decision for your venture. Or maybe you know that entrepreneurship is right for you, but you also realize that your current business isn't quite the right fit. These criteria can help you in examining and adjusting a business concept to meet your personal, financial, and professional goals.

From Real Entrepreneurs **personal vision**

While working at Glaxo, Inc., Dr. Alfred Childers and Dr. Lowry Caudill realized the need for a high-quality contract drug development company – a company populated with the same level of talent and know-how resident at large pharmaceutical companies. In response, they formed a contract development company called Magellan Laboratories. Magellan helped large pharmaceutical companies develop drugs faster and more cost-effectively than internal resources allowed. And, mid-sized drug companies gained access to a greater depth of talent than they could otherwise afford.

Magellan created a shift in business model for virtual companies with limited resources and gave businesses time to develop drugs without having to license them away to traditional pharma companies. Childers and Caudill used traditional bank financing and personal savings to launch the business. Earnings were reinvested to support the rapid growth and add service capabilities. While venture capital or other private funding could have financed the company, it was not required. Eleven years after launching, Magellan was acquired by Cardinal Health for more than $200 million.

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Lifestyle Criteria

Entrepreneurship can change your lifestyle dramatically. You should determine what type of lifestyle you desire and then pursue a business that can support it.

Balance personal/professional life – Many tech and life sciences entrepreneurs are constantly working, whether in the office developing the technology, at home thinking strategically about the future of the business, or out networking with potential business partners. Once the company-building process starts, it is very difficult to say "no" to business demands. It is important to note that when a business is first started, the entrepreneur will probably work longer hours and more weekends and holidays than is typical of a "regular" job. There will always be something more to do. You have to determine how much time you are willing to give to your business.

From Real Entrepreneurs **balance**

A faculty member from a St. Louis university wanted to commercialize a technology, leave the university, and start a business. He quickly found that, due to explosive growth, he had little control over his business and his life was in chaos. His original intent was to open a business that would give him more freedom and flexibility, but he quickly found that the business world was not for him and sold his interest in the venture.

Family involvement – It's essential to recognize critical family issues, evaluate their impact on your proposed business, and discuss them with family members. These issues can range from family ownership, investment, or active participation in the business to your familial obligations and acceptance by your family of the time, energy, and emotional demands the business will make on you. How will family obligations affect your vision of success?

Flexibility – You need to consider how much flexibility you want. Do you need to be available to assist family members or friends throughout the day or week? How much control do you want to have over your schedule?

Location – Sometimes entrepreneurs select a location before choosing a business, or they discover the need to relocate or expand into other areas after the business takes off. Location can be especially important when looking for venture capital. Despite a global economy and instant communication, venture capital is easier to find in certain geographical areas. Are you willing to move to support your business? Or is your opportunity allowing you to move to a desired location?

From Real Entrepreneurs **location**

A doctor who decided to start an eye clinic to provide complete eye care did not have a specific location in mind. She made a list of what she wanted a town to have: climate, population, outdoor recreational activities, and educational facilities. She then took a trip across the United States looking for the location that fit these lifestyle criteria. Reno, Nevada, had all the qualities she wanted, so she relocated there and started her clinic.

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Morals, beliefs, and standards – Many entrepreneurs seek a business that supports and cultivates their morals, beliefs, and standards. Is your business concept consistent with your personal standards?

Physical requirements – It's important to consider your health and how it meets the mental and physical requirements of your business. How much physical and mental energy are you willing to expend on your business?

Travel – Are you looking for travel opportunities or trying to avoid them? How much travel are you willing to do?

Professional Criteria

Entrepreneurship can bring limitless professional growth opportunities. The professional criteria within the personal vision help you define what is important to you professionally.

Future professional goals – Take time to visualize yourself five or 10 years in the future. Ask yourself the following questions to avoid costly detours:

- What do I see myself doing professionally?
- Will I be in the same business, or will I be doing something completely different?
- What business has the best potential for getting me where I want to be professionally?

Growth business or lifestyle business – Fast growth is the goal of a growth business, but the goal of a lifestyle business is to meet the personal objectives of the entrepreneur. A lifestyle business typically does not attract angel investors or venture capitalists. A growth business may not always meet the personal objectives of the founder.

Involvement in daily operations – Some entrepreneurs want to be involved in every detail of their business. For tech and life sciences ventures, especially those that need outside equity to grow, the founder you – cannot expect to keep majority ownership of the business. Venture capitalists often demand a large share of a company they invest in and usually expect to be consulted regularly on business decisions.

Job security – Starting a tech or life sciences venture does not guarantee job security. How comfortable are you living with risk?

Power or status – Some people are more comfortable running an operation than taking directions from others. Keep in mind that many venture capitalists will require a founder to step down from the CEO position. It doesn't matter who makes the decisions or where a good idea originates; it only matters that the best decisions are made.

Financial Criteria

Entrepreneurship offers varied financial opportunities. It is critical that you specify the financial criteria that will in part determine whether you actually start or continue your business.

Future personal income – In addition to obligations, you probably have financial goals for future personal income. Bear in mind that most technology and life sciences businesses cannot afford to pay the founder anything for quite some time. The entrepreneur forgoes any income initially, hoping for a large payoff later and understanding the concept of delayed gratification. You must determine how long you can live without income from the business and determine how personal financial obligations will be met until the business can support you financially.

Investment – Starting a business often requires the investment of personal funds. If these funds are limited, you may need to narrow the initial scope of the business.

Reality

Debt, so long as it is being repaid, allows you to retain more control than non-entrepreneur equity financing. It may also allow you to have a potentially larger exit payday.

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Rarely can growth be accomplished without capital beyond your investment. The choice is between debt or equity, or a combination of the two. *Debt* is borrowed money that must be repaid in accordance with the terms of the loan. *Equity* is investment money for which the investor receives some ownership in the business. Once other people invest in a business, they may wish to dictate and control many aspects of the business. Lenders expect to be repaid with interest and may be able to take over the business if they are not.

From Real Entrepreneurs **investing personal funds**

The founder of a software company for telecommunications products was the initial investor in his company and worked without any cash compensation until the company's revenues could support the operation. Twelve years later the company was acquired by Intel Capital for $300 million. The founder's initial investment of cash and unpaid labor was well rewarded by the payoff resulting from the sale of the company.

The Team's Vision

Technology ventures generally start with a team rather than a single entrepreneur. Inventions often have multiple contributors and usually require additional development to introduce versions of the technology for testing and customer development. Other significant players could include Universities, government and industry.

Teams can use the individual team member's personal vision evaluation exercise as a foundation for discussion around compatibility of visions and roles within a company. Equally, it is critical to understand the early goals and roles of key partners. If a University shares the intellectual property for example, they may or may not be interested in a faculty member pursuing commercialization for many reasons.

In Noam Wasserman's book, The Founder's Dilemma, he describes three core dilemmas as it relates to multiple founders – relationships, roles and rewards. The following questions can be used in determining alignment between the founders and partners.

- **Are You Right For Each Other?** – Sharing each founder's personal vision exercise is a great way to compare individuals long range vision for the company and themselves. Understanding the alignment and disparities upfront will allow the team to structure the start-up with each individual's vision in mind and will go far in mitigating risk. It is also important to understand and discuss any interpersonal relationships that may affect the team going forward.
- **Roles and Responsibilities** – Each team member invariably brings a certain skillset to the team but may or may not be acting in those roles or be expected to going forward. Roles often overlap in start-up teams and decisions made by consensus. A well thought out and agreed upon division of labor is essential not only at launch but critical during the development stage. By evaluating a team's skill sets and capabilities the founders will have a better idea of the additional individuals, service providers and advisors that need to be brought in to complete the team.
- **Rewards** – Compensation is always a complex conversation and not only considers actual payment for services performed but also includes equity, cliffs or timing and milestones to be eligible for equity, provisions for when a new partner is brought in or current partner wants to leave, capital required by founders, etc.
- **Keeping Up** – The one thing entrepreneurs can count on is change. Expecting and preparing for team members personal and professional lives and vision to change and building provisions into agreements and expectations is important to establishing a secure base from which to build a company.

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Business Concept Statement

Once you have outlined your personal vision of success, it's time to see whether your business idea can meet your personal goals.

BUSINESS PLAN

Product/ Service Plan

The Business Concept

Most entrepreneurs begin with a business idea. It is their first spark of entrepreneurship. A *business idea*, however, is not the same as a *business concept*. Converting the idea into a concept requires an expanded, more complete exploration of the idea. A business concept includes:

- The **features** of the product or service, in other words, what it actually is or does. Features tell the practical specifics about your product or service.
- A description of the customer and the **benefits** of the product or service to the customer. Benefits sell your product or service by conveying more emotional than practical details – by showing customers "what's in it for them."
- The **uniqueness** of the product or service, or how it is differentiated from other, similar products or services. Uniqueness convinces customers that the only source of these desirable features and benefits is your product or service. You may also distribute your product or service to the market in a unique way.
- **Sales channels**, that is, to whom, where, for how much, and how the product or service will be sold. The same product or service may be brought to market through several different distribution channels. For example, both Amazon and Barnes and Noble sell books and reading material but they have different methods of delivery. Amazon receives orders online or via the telephone, receives payment from the customer and delivers the product to the customer. Barnes and Noble is primarily a retail operation, selling products to customers who visit their locations. These different distribution channels have a profound effect upon all aspects of the two businesses. These different distribution channels have a profound effect upon all aspects of the two businesses.

Components of a Business Concept Statement

Writing a business concept statement is a critical task, whether starting a company or seeking to improve an existing venture. You should be able to summarize your business concept in a document of one to two pages.

The business concept statement answers the following questions:

WHAT does the product or service do?

HOW is it different from other products or services?

WHO will buy it?

WHY will they buy it?

- Price?
- Convenience?
- Provides sense of safety/security/well-being?
- Better than what is currently available?
- Pleasurable experience?
- Uses new technology?
- Saves time or money?

WHERE will it be sold?

- Geographic location of business and customers

WHEN will it be ready to be sold?

- Concept, start-up, initial operations phase

HOW will it be promoted and sold?

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After writing the business concept statement, you will need to test for feasibility prior to preparing a business plan. It is common for the initial business concept statement to change during feasibility testing prior to writing the business plan.

Positive Attributes of Technology and Life Sciences Business Concepts

When developing your business concept, keep in mind key elements that set certain products or services apart in the technology and life sciences marketplace. You'll want to make sure that your product or service features as many of these attributes as possible:

- Involves significant savings
- Solves a serious problem
- Offers convenience
- Fits into the existing scheme of things
- Attracts media attention
- Identifies an accessible market
- Joins a rapidly expanding market
- Promises a big upside and a low downside
- Is a disruptive technology

Fatal Flaws of Technology and Life Sciences Business Concepts

Many new enterprises are doomed from the start because they are based on basic concepts which are somehow fatally flawed. Abandoning a business concept in its initial stages is far better than moving forward with an ill-conceived venture that has a minimal chance of success.

Many business concepts are doomed or handicapped by the following all-too-frequent flaws.

Hidden traps – A barrier may lie hidden in the marketplace. For instance, purchasing agents aren't likely to buy an automated purchasing tool that will replace their jobs. Define an ideal customer profile to make sure marketing and sales efforts are geared toward the prospect most likely to need or want the new product or service.

Inaccurate assumptions – What facts from credible sources support your assumptions? Solid market research using credible resources is critical to initial business success. Speaking to as many prospective customers as possible can help identify the real market need and establish a clear value proposition for your product or service.

Inconvenience – Many new products or services fail because they are inconvenient to use.

Invention disclosure – Because many technologies are developed at or with academic institutions, the pressure and expectation to publish can threaten the ability to attain intellectual property rights which can be key to commercialization.

Inventorship disputes – Most innovations rely on technology building blocks and further refinement before introduction. In fact, intellectual property protection may not be available for development without licensing some basic building block key to the innovation being developed.

It will not work – It is critical that the product work if a new venture is based on technology or life sciences. The new product should be benchmarked against any competing product because most prospective customers want to know how the new option compares to existing solutions. New products must gain credibility in the market quickly for the new venture to succeed.

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From Real Entrepreneurs will not work

A water purifying expert began a business to market his new concept in water purifiers. Supposedly, it would purify even seawater in agricultural quantities at a cost of 30 cents per 1,000 gallons. This individual believed that it would revolutionize the world food supply. So far, after five years and $5 million, the expert has yet to do anything but play show-and-tell in the lab. Evidently, the expert has not been able to make the purifier work as intended.

No protection – Some concepts can be easily copied by other organizations that are capable of quickly exploiting the market, perhaps driving the entrepreneur out. A product or service with a high barrier to entry, such as patents, specialized know-how, or technical sophistication, is a formidable opponent to competition.

No real need – Businesses fail when they do not fill some need that is perceived by enough people to make the operation profitable.

Obsolescence – Many concepts are so faddish that an enterprise based on them has only a few months to make profits.

Potential installation problems – Many things that work well in the laboratory will not work in the field. The technology transfer process in particular is complex, especially when moving technology from the university environment, where infrastructure can be carefully managed. Commercial-quality technology products require adequate testing and support to be successful in the free-flowing real-world marketplace.

Requires change in consumer behavior – If a concept requires a change in consumer behavior, it may be resisted unless the rewards are obviously sufficient to motivate the change in behavior.

From Real Entrepreneurs requires behavior change

The developers of computerized grocery stores failed when they assumed that shoppers would prefer to telephone in their food orders to a computerized grocery warehouse rather than shop in supermarkets. In fact, studies show that most people like shopping in supermarkets rather than dealing with the problems posed by other grocery shopping systems, which have shown only limited success.

Requires education – Educating potential customers is a slow, costly process that poses many risks and affects overall profitability.

Service requirements – A service aspect to a concept greatly complicates it. Costs rise, organizational difficulties multiply, and buyer resistance stiffens.

Unfortunate economics – The market must be willing to pay a sufficient price for the concept before the business can be profitable.

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The Elevator Pitch

The term *elevator pitch* can mean two different things. They both refer to a short, clear statement that could be made in about the time it takes for an elevator ride. One meaning refers to the brief pitch made when seeking funds. The other meaning refers to how you respond when someone asks, "What do you do?" or, "Tell me about your business." Your response begins the process of educating a new contact about you and your business. In other words, it's one means of marketing your product or service.

Your elevator pitch should tell new contacts what you want them to remember about your business. Emphasize the team and focus on succinctly describing the technology in layman's terms. It should also paint a vivid picture in the listener's mind, showing how customers' problems are solved or how they are served well. Focus on the market and what your company does for it. Finally, it should include the stage of development for the technology and any validation it has attained through thought leaders and/or actual testing.

Most people fail to explain how their product or service can make a difference in others' lives. They just give their title: "I'm president of …" They just tell their industry: "I'm in retail." Or they just say their job category: "I'm a manufacturer's rep." Rather than saying, "I'm a web designer," they should say, for example, "I use the power of the Internet to bring customers to my client's door. My clients increase their online sales by 200 percent, on average, after I've done my work."

Tip

Practice makes perfect! Business networking events provide excellent opportunities to try out your elevator pitch.

Tip

Use positive, confident language when speaking with potential investors. Tell them up front that you are seeking funding, and find out what they invest in.

Many entrepreneurs find it awkward to promote themselves and their business, but you can become more comfortable by crafting and practicing an attention-grabbing elevator pitch. Your elevator pitch should contain the following elements:

An attention-grabbing first line – Start your pitch with a statement or question that makes your listener want to hear more.

A description of your product or service and its market – Briefly describe what you sell and who will buy it – not the technology it's based on. Explain how your product or service will solve a problem, meet a need, or exploit an opportunity.

A description of the people behind the business – Tell a little about your background and your team's strengths.

The benefits of investing in your business – Why would the investor want to take a risk with you? What are the benefits? Communicate how you and your business stand out over the competition.

A call to action – Finish your pitch with a request. Do you want to set up a meeting? Have the investor look over your Business Plan? Have the listener recommend you to an angel investor or venture capitalist?

You – Show the uniqueness of your concept and your passion through the enthusiastic delivery of your elevator pitch.

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Understanding Customer Development and the Business Model

2

By identifying your customer and the value proposition your innovation proposes to provide you can start the process to test your business concept feasibility. The business model is a framework used to investigate, through a rigorous process, your foundational assumptions regarding the building blocks of your business concept; your customer, the offer, infrastructure and financial viability. As you develop and test the elements in your hypothetical business model, you will adjust your original assumptions yielding an improved model with greater chance for success.

Remember, the key to success is *not* necessarily having an excellent product or service. It's having someone buy your product or service. If you can't identify who will buy your product or service, and have a compelling value proposition, investors will not be willing to fund your enterprise. The more you know about your customer, the greater your chances of success will be.

Talking to customers will help you to:

- Identify relevant and reachable customer segments
- Develop a value proposition for each segment
- Discover the "right" product features
- Understand your customers' buying behavior
- Learn ways to reach your customer and devise messages they will hear

In this module you will be introduced to a framework for Customer Development developed by Steve Blank and hypothesis testing methodology based on work done by authors Cooper & Vlaskovits. This process is based on the scientific method and forces entrepreneurs to test their assumptions regarding their target customer, their behaviors, motivation and preferences. Starting with the customer provides a crucial reality test for any technology because no matter how revolutionary an invention or innovation may be, without a customer who will buy it there is no business case. Also in this module, you will learn the basic elements of the business model which provides a framework to establish and test your assumptions around your business concept and set the stage for your business plan. The customer development framework, the business model and lean canvas tools introduced in this module enable you to lay out sets of hypotheses that will be tested through research methods further described in the next module.

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Outcomes

- Understanding of the Customer Development framework and process
- Understanding of business model elements
- A set of hypotheses depicting elements of the business model
- A plan for testing hypotheses

Action Steps (Find online tools at **fasttrac.org/resources**.)

- ❑ Refine your Personal Vision Statement, Business Concept Statement, and Elevator Pitch.
- ❑ Talk to 2–3 customers to assess feasibility/interest in your product.
- ❑ View - 20 Minute Lean Canvas Challenge: **spark59.com/leancanvas/20-minute-challenge**.
- ❑ Read Module 3: Conducting Market Research and Analysis.

The Business Model

The business model or business case outlines the things that need to happen for the business idea or technology to make money. Key elements include:

Market and Target Customer(s)

Market definition for technology companies usually begins with what the technology can do and how it may differ or improve upon current innovations. Businesses can target other businesses as their customers, or they can target consumers. Entrepreneurs often refer to this distinction as B2B (business-to-business) or B2C (business-to-consumer) marketing. While some products or services may be marketable only to other businesses or only to individual consumers, some may fit either category. In that case, careful analysis can help you determine which market has the greatest potential.

For example, for life sciences companies' market definition usually begins with an epidemiological analysis. Which diseases can my product diagnose or treat? How many people suffer from this disease? What are current diagnosis and treatment patterns, and what is the current value of these products? How are these solutions currently provided to the end-users or patients? In health care, the patient is rarely the key decision-maker in the buying decision. Rather, doctors, hospitals, insurance companies and research institutions may be your primary customer.

Technologies can often be applied to many potential end uses, and each possible end-use application must be reviewed in detail. Some will require more involved and costly studies. Other end uses may have well-met needs that offer little room for new entrants. A careful analysis of all the possible outlets for your technology and products will reveal the target markets that can be pursued most rapidly and with the highest return.

From Real Entrepreneurs

identifying potential end uses

When enythropoetin was first introduced, its clinical indication was for anemia associated with renal failure and dialysis. Once the product was introduced, clinicians began off-label prescribing it for a much larger market – anemia associated with chemotherapy treatment.

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Clinical testing of new therapeutics can cost hundreds of millions of dollars, so most young health-tech companies often plan to partner with larger pharmaceutical firms to fund later-stage clinical development. In these situations, the product is the partly developed technology, and the customer is a potential pharmaceutical partner.

Likewise mechanical and software innovations often are sold to other businesses or B2B and incorporated into their customers products. One of the challenges in creating a customer profile is identifying who the customer really is. The customer may not be the actual consumer of the product or service. To make this task easier, you should think of the customer as the individual or business that pays your company for the product or service. The consumer is the end user of the product or service. If the customer and consumer are the same person or business, the task of identifying a customer profile is simplified.

Understanding Customers
It is important to understand customers very clearly, so that your company's limited resources can be used most effectively to grow sales volume. For technology products, the sales cycle is usually long and the decision process involves complex evaluations and negotiations with many diverse buyers and customer representatives.

Think about the following five questions as they relate to your specific product or service.

- Where do the customers want to buy?
- When do they buy (sales cycle)?
- What do they buy?
- Why do they buy?
- How do they buy?

Frequency of purchase is an important component. For example, some persons buy a new car every few years, while others buy one each decade. Automobile manufacturers and retailers market the latest innovations and designs to those customers who buy every few years, while marketing durability and long term service warranties to those customers who want a car to last many years.

Problem Identification
For each target customer it is critical to identify what problem your product or innovation is solving. This is especially challenging for technology entrepreneurs since innovations are not necessarily developed with the customer in mind. Understanding the level of pain being experienced by the customer is equally important and leads to the creation of a value proposition that will motivate customers to buy. Determine how customers are currently solving this problem.

Segmenting Markets

Market segmentation is the next step in defining and targeting markets. After you have identified your larger market, you can break it into smaller, distinct groups of buyers.

Most B2B businesses segment their markets based on categories such as:

- Companies that use a certain service or product.
- Companies of a certain size.
- Companies that have a certain amount of revenue.

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In contrast, most B2C businesses segment their markets based on the following categories:

Demographic variables – age, gender, income, family size, life cycle, occupation, education

Geographic variables – regions, climate zones, population density

Behavior variables – product knowledge, usage, benefits sought, distribution channels used, responses to marketing

Psychological variables – lifestyle, values, personality, risk aversion, media watched or read

These market segments, because they are more homogeneous than the larger market, will respond similarly to promotions, communications, advertising, and other marketing mix variables. By segmenting your market, you can target your efforts and make your marketing plan more efficient and effective.

As Alexander Osterwalder and Yves Pigneur point out in Business Model Generation, customer groups represent separate segments if:

- Their needs require and justify a distinct offer
- They are reached through different distribution channels
- They require different types of relationships
- They have substantially different profitability's
- They are willing to pay for different aspects of the offer

How your customer relates to the Technology Adoption cycle introduced in *Crossing the Chasm* by Geoffrey Moore, (Collins, 2006) further segments your market through insight into your customers behaviors. Innovators and early adopters are classes of customers which are more apt to try and accept new technologies; however, their numbers are generally not sufficient to support your business model from a financial viability standpoint. A common oversight for technology entrepreneurs is understanding the value proposition for the majority of buyers. This oversight often results in innovations being developed and introduced without a sufficient sized market or the wrong features and benefits being emphasized.

Value Proposition

A value proposition defines the benefits your company's products and services offer to the customer and expresses the essence of your business in a way that compels the customer to buy.

It is important to craft a compelling value proposition since it will form the basis for all your sales, marketing, and product development efforts. The value proposition is also part of your Business Plan.

A value proposition is a valuable tool to guide your marketing efforts. Here are some benefits that you will receive by having a clear, compelling value proposition:

- Create a strong differentiation between you and your competitors or competitive advantage.
- Increase not only the quantity but also the quality of prospective leads.
- Meets the specific qualitative or quantitative needs of your targeted segments.
- Improve your operation efficiency.
- Increase your revenue.
- Ensure that everyone in your company communicates the same message.

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In crafting your value proposition keep in mind the following:

- Use your Business Concept Statement as a starting point for expressing your value proposition.
- Address the needs of your target market. What problems do your target customers need to solve? What's not working for them? Where do they want to go?
- Emphasize benefits, not features. Don't explain what the technology does; explain what the buyer will get out of using the technology. Some examples of benefits are greater revenue opportunity, a competitive advantage, reduced costs and expenses, greater convenience, greater Return on Investment (ROI), better results, perform better, more reliable and easier to access.
- Keep in mind that a customer segment must be identifiable and reachable and the pain must be sufficient enough for the elements of the solution you are creating to represent a legitimate value proposition.

Solution or Technology

What is your solution and what will it take to deliver it to the market? It is common that technology is in some state of development at the same time the business model case is being built. Grants like the Small Business Innovation Research and Small Business Technology Transfer SBIR/STTR programs contain commercialization sections in the application requiring technologists to build a hypothetical business case even before the technology has been tested.

To test your hypothesis it is important to have something to show or demonstrate to the customer. The concept of Minimum Viable Product (MVP) was developed by Eric Ries whose definition from *Lean Start-up* (Crown Business, 2011) is "the minimum viable product is that version of a new product which allows a team to collect the maximum amount of validated learning about customers with the least effort." Establishment of an MVP is a difficult exercise for technologists because it requires showing the technology essentially half-baked lacking features, benefits, critical functionality and design. However by sharing a MVP with customers early on their reactions can be integrated into the initial design if the technology and increase the likelihood that you have in fact identified a real value proposition.

Channels

The people and processes involved in getting a product to market constitute its *distribution channel*. The easiest way to get a product to market is to place it in an established distribution channel already serving the desired market.

A distribution channel for a service business is different. In fact, distributing a service really means promoting it. The way in which a potential customer wants or expects to buy the service should be compared to the way the entrepreneur wants to sell the service. Service entrepreneurs must learn how potential customers expect to find and engage the business.

Sometimes, the business concept suggests distributing both products and services. Due to the complexity of combining both distribution channels, however, it can sometimes be best to establish the business by concentrating efforts on either products or services to start. As distribution processes are perfected, the business can add new products or services with new distribution channels.

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Revenue Streams

It is important to identify potential revenue streams understanding how the money would flow, when and how much. Pricing is a big piece here. Find out how your customer is currently solving the problem, at what cost and how. If a customer is not used to paying for a solution you provide, even if it solves a significant problem, they may not be willing to pay for it. There are various market rules that apply to how you price your product which take into account the distribution channels and potential payers for the actual technology as in the case of insurance providers for many life sciences companies.

Cost Structure

Costs include those required to fully develop the technology and take it to market, on-going development costs, fixed costs, and costs necessary to produce the product or service. In determining costs key partnerships and relationships with suppliers and distributors can be evaluated.

Using preliminary information from revenue and cost assumptions will allow you to visit critical financial metrics like return on investment and gross margins.

Customer Development

Customer Development is a malleable and customizable research methodology for testing the assumptions made about the business model, learning from customers, and iterating. It is predicated upon Steve Blank's Getting Out of the Building concept and speaking in person with customers. Surveys and other methods are complementary to, but not substitutes for speaking with customers.

Steve Blank's Customer Development framework is a four-step process including:

- **Customer Discovery**
  identifying and listening to potential customers and testing your hypotheses
- **Customer Validation**
  establish a sales process and financial model based on what you know about your customer
- **Customer Creation**
  strategy to "cross the chasm" – building customers from few to many
- **Company Building**
  done in the context of continual customer feedback

Once you've completed your business model assumptions, you need to brainstorm, write down, and test all of the assumptions you've made to build and sell your product or service to the customers you've identified.

Adapted from authors Cooper & Vlaskovits work on Customer Development the following tools are discussed as a method to test hypothesis in your business model in the first phase of Customer Development – Customer Discovery.

This phase is about:

1. Questioning core assumptions in your business model
2. Conducting research that affirms or disproves
3. Iterating your business model

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Step 1:
Write down what you believe to be true about each element in your business model. Make sure that you write down all the assumptions required to build, market and sell your product to the customer segment you've identified. It's better to be specific, rather than vague. In the web analytics example below, a vague assumption about your customer segment = marketers. A specific assumption about your customer segment = outbound marketers in small – and medium – sized businesses. If a specific assumption turns out to be wrong, that's useful information and you can iterate your business model.

Next, write down questions that will help you explore and understand your assumptions. It's helpful to use sticky notes for this phase.

Customer Segments: I believe my best customers are outbound marketers in small- and medium-sized businesses.

Problem: They have no idea if a specific campaign is generating a return on investment. They cannot easily measure campaign ROI because existing solutions are too expensive, complicated to deploy, and display a dizzying array of non-actionable charts.

Solution: Low-cost, easy-to-deploy analytics designed for non-technical marketers who need actionable metrics.

Feature requirements and the value provided by each:

- **Feature**: Dashboard
- **Advantage**: Displays actionable metrics in a single location.
- **Benefit**: Enables data-driven decision-making.

Partners: In order to deliver a complete solution, we need to partner with…

Revenue Streams:

- We will monetize free users by…
- We believe that % of free users will upgrade…
- Some customers will pay for premium features.

Channels: My product reaches customers through…

Funnel: We will acquire and convert customers by…

Research questions to test these assumptions:

- ✔ Who has the problem?
- ✔ How is this person dealing with the problem now?
- ✔ How are you solving the problem?
- ✔ How is your solution better than established competitors' solutions or substitutes?
- ✔ What benefits does the user get by adopting your solution instead of his or her existing solution or workaround?
- ✔ What priority would you place on the value of this feature?
- ✔ How often would you use this feature?
- ✔ What functions would you perform before and after using this feature?
- ✔ What are the critical elements of this feature?
- ✔ Would you be willing to pay for this product/service?
- ✔ If the basic version was free, would you be willing to pay for additional features?
- ✔ Would it be more desirable to have a one-time, monthly or per use fee?
- ✔ How do customers learn about alternatives? What information resources carry the most weight with potential customers? What information do they need to inspire trial? What information or experience converts them to satisfied user?

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Divide your Post-It notes into two categories:

1. Questions that have answers that can be found in information that is already published and available, through an online search or a library.
2. Questions that have answers that can only be discovered by talking with people.

It's helpful to use a white board or wall space for this phase.

Step 2:
Outline the research plan.

In module 3 you will be introduced to the various ways to conduct market research. As the Customer Development approach dictates – the most critical market research to perform is to talk to your customer. A research plan will enable you to put structure, process, milestones and expected outcomes around how this interaction with the customer will take place and what other information can be gleaned from secondary sources.

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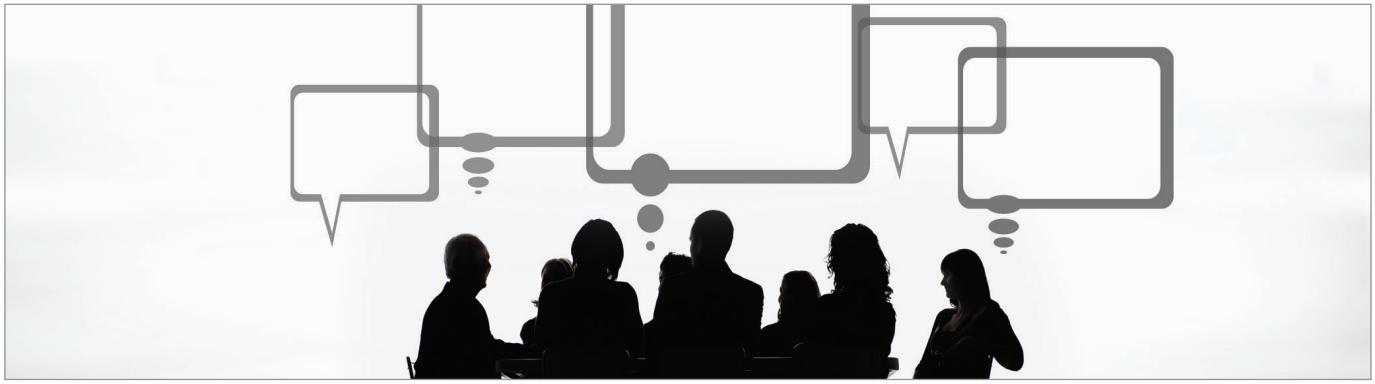
Conducting Market Research and Analysis

3



What separates successful entrepreneurs and businesses from those that don't succeed? Hard work, passion, and luck all play a role, but one of the key factors is the quantity and quality of market research and analysis they do.

Market Research is a systematic approach that involves definition of research objectives, design of an information gathering process, collection and analysis of data as well as interpretation of findings. Conducting market research is not a one-time event in your business planning process. It is an activity that will continue throughout the life of your business. Since the market research that you perform today may be outdated in three months, you need to get into the habit of routinely confirming your assumptions. Organizations that can respond rapidly to shifting customer needs conduct market research on a regular basis.

Utilizing approaches developed primarily for web based start-ups, technology entrepreneurs can use market research to guide in the development of the product that will ultimately go to market. In this module, you will learn how to analyze your market research to uncover opportunities and obstacles in your future. You will also learn how to take the information you have gained from your market research and leverage it to make better-informed business decisions.

Outcomes

- Develop strategies and survey questions for primary research.
- Use primary and secondary research to test your business model assumptions.
- Leverage market research and analysis.
- Draft preliminary sales projections.
- Draft a value proposition to target customers' needs and wants and to differentiate your business from your competitors.

Action Steps (Find online tools at **fasttrac.org/resources**.)

- ❑ Conduct customer surveys. Start with a minimum of 5-10 representing end users, customers and key channel members.
- ❑ Write the first draft of the following sections of your Business Plan:
  - Sales Projections (Financial Plan section)
  - Value Proposition (Product/Service Plan section)
- ❑ Perform a SWOT Analysis of at least one competitor (Action Files Tab).
- ❑ As necessary, modify your Business Model in light of ongoing market research.

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- ❑ Continue to refine your Personal Vision Statement, Business Concept Statement, and Elevator Pitch.
- ❑ View Ash Maurya's *Running Lean* webcast at **fasttrac.org/authors**.
- ❑ Read Module 4: Testing Your Business Concept.
- ❑ Complete the Business Concept Feasibility Assessment and Technology Feasibility Assessment and Plan (Assessments tab).

Purposes of Market Research

Tip

Conduct structured market research early and informal market research often.

Market research can provide your company with its most critical strategic asset – knowledge. Armed with accurate information about market size, market segmentation, industry trends, competition, and customer needs and behavior, you can develop a well-conceived business plan.

The quantity and quality of your research will help you in many areas of your business.

Testing the business model – Many hypotheses are laid out in the business model summary. You should test your assumptions reflected in the business model to either verify or use the information to modify the business model elements. Putting an iteration of a product or service in front of the customer quickly allows the product to be developed fully with the customer in mind. MVP or minimal viable product is a term coined in the lean start-up theories generally associated with web-based start-ups. However, hypothesis-testing methodology is strongly rooted in the scientific method. The MVP approach can be used to build and test innovations early in and outside of the laboratory.

Reality

In spite of its importance in writing the business plan, research is frequently the weakest part of the planning process. It requires the most action, such as visiting potential customers, attending trade shows or conferences, conducting research, and performing competitive due diligence.

Building a business plan – The business plan must be built on facts, not feelings. As you gather facts for the business plan, you can begin to build logical conclusions in the form of assumptions to support the plan. For example, if research indicates an industry is expected to grow by 12 percent in the next two years, entrepreneurs may build assumptions about the expected growth of their own company based on this industry projection. (If you project growth well in excess of the industry projection, you'll need to provide logical explanations for these numbers.) Potential investors and other readers of the plan will expect to see facts and sources behind the assumptions.

Monitoring trends – An on-going systematic approach to trend watching through market research should be integrated into business practices.

Market Research Methods

It is tempting to conduct too much secondary research and too little primary research. Secondary research involves gathering data that already exists in some form. Sources include internal databases, on-line databases, periodicals, blogs, industry associations, research reports etc. Rarely does free information exactly answer the questions you are asking. Instead it is necessary to extrapolate information to serve your needs, conduct primary research and consider paying to have the research compiled or conducted. Exhausting secondary sources first provides a springboard for primary research and can take you in broader directions often helping provide for context to the larger research questions. Primary research takes you right to the source, that is, to people you deal with directly such as customers, competitors, vendors and distributors. This research provides you with the most current and useful information about the viability of you product or service.

Primary Research

Primary research is critical for filling in the gaps left after initial secondary research is complete. Primary research involves gathering information directly from the source. You can collect this information through various channels such as interviews, questionnaires, surveys, and conversations with industry experts, prospective customers, and competitors.

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Email is a great way to communicate with people in the industry to gather information, but it cannot replace the value of face-to-face meetings and as Steve Blank emphatically states, "Get out of the building!" The problem is perhaps even more poignant for researchers who often times do not have ready access to potential customers. Participating in Internet discussion groups or posting questions on an Internet bulletin board for people in the industry to comment on can also prove helpful.

This type of research is time-consuming, and obtaining sufficient unbiased primary data is difficult. Still, primary research is necessary to ensure the best results from your market research efforts. It is important that major issues be clearly defined prior to conducting your research. This helps avoid gathering too little information or superfluous information that does not assist in critical decision-making. Establish priorities for your primary research by evaluating your business model and underlying assumptions and identifying the areas that are 1 – most critical for the business model to be viable and 2 – those areas where the assumptions are relatively uncertain and contain some level of risk.

Tip

Focus on the key issues that provide the greatest assessment of your product or service viability, and listen more than you speak. Confirm an assumption each time you talk with a potential customer, competitor, or distributor.

Tip

When defining your B2B customers, also define their customers so you can identify the need your customers must fulfill for their buyers.

Once you have established your information priorities, develop a market research plan containing objectives, methods to gather the information you need and research questions. It is helpful to imagine what information you could have and from whom in order to confirm your assumptions or discover information from customers you do not know. Determine the best method to gather that information. Consider whether subjective, not statistically significant information is appropriate or whether you need to carry out research where establishing scientific certainty is key. There are many methods in between and entrepreneurs should challenge themselves to embark on primary research in as scientific way as possible. Most likely you will be using several methods and have multiple people involved in this process simultaneously. It is critical to adopt a process and use tools to gather and store information from research so that it can be accessed and evaluated. Keep in mind that market research may be most intensive in the feasibility and business planning stage, but should be integrated in standard business practices.

In Ash Maurya's book *Running Lean* (O'Reilly, 2012) he suggests that research begins with knowing what questions to ask. Open-ended questions, although difficult to quantify, can provide valuable feedback on a variety of issues regarding your product specifically and also the broader marketing environment in which your product will be introduced. You can develop a script and test it out perhaps modifying as you observe how questions are guiding the conversation. The following tactics are offered by Maurya:

- Build a frame around learning, not pitching.
- Don't ask customers what they want. Measure what they do.
- Stick to a script.
- Cast a wide net initially.
- Prefer face-to-face interviews.
- Start with people you know.
- Take someone along with you.
- Pick a neutral location.
- Ask for sufficient time.
- Don't pay prospects or provide other incentives.
- Avoid recording the interviewees.
- Document results immediately after the interview.
- Prepare yourself to interview 30-60 people.
- Consider outsourcing interview scheduling.

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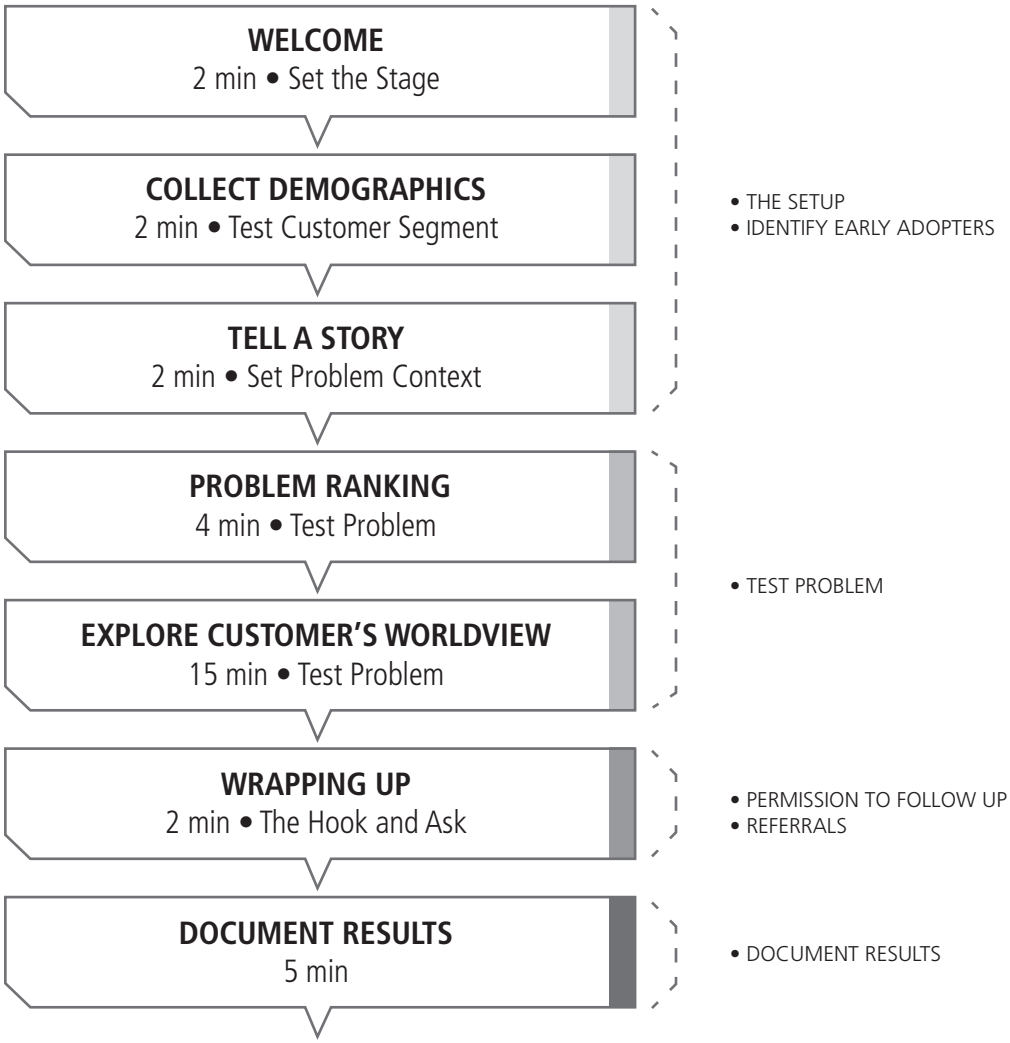
People like to be asked their opinion, especially if it is something they feel passionate about. It may seem impossible to reach out to 30-60 people but you will be surprised. Make sure your sample represents a diverse enough cross section to help you understand the reactions and opinions of various adopter groups within your targeted customer segments. Another trap technologists commonly fall into is talking to people that think like you. It is critical to get outside your reference group and interview a representative sample from targeted segments. Remember to record your results immediately afterwards and ask the individuals for referrals of additional people to contact. Maurya provides the following examples for interviews around top priorities – the problem/solution and MVP.

PROBLEM INTERVIEW SCRIPT DECONSTRUCTED



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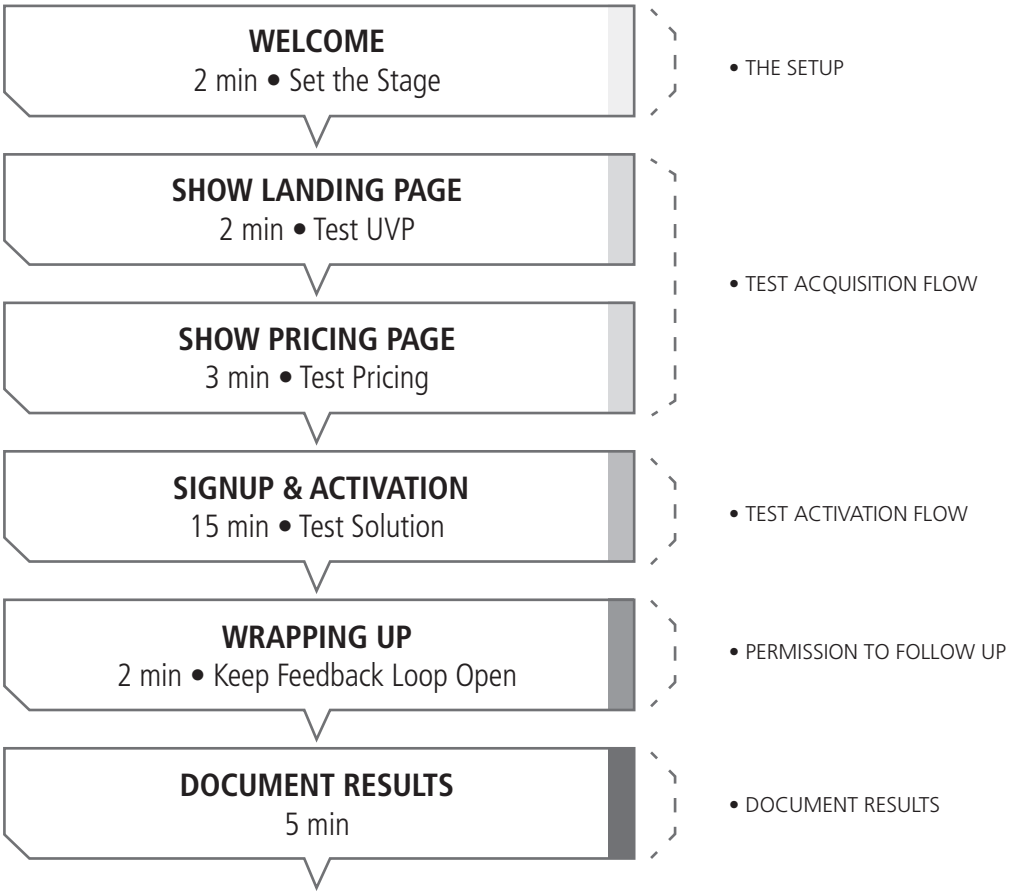
MVP INTERVIEW SCRIPT DECONSTRUCTED



Preparing good questions is key to gathering solid and useful market research. Ask open-ended questions of how, why, what, when, and where that allow the interviewee to talk. After the first few interviews, reassess your questions and make changes where appropriate. During primary research you are not there to sell anything; rather you are there to collect data. Surveys and focus groups can be used to gather information as well.

Creating Customer Surveys

A customer survey, or market survey, is a method of collecting information from current or potential customers by having respondents answer a questionnaire administered by telephone, mail, e-mail, or in person. Surveys are a convenient, relatively inexpensive method of gathering marketing information. The number of respondents surveyed may be small or large depending on the requirements of the research.

On the other hand, surveys can be difficult to design, and depending on the dissemination method, costly to use. However, there are now many online tools that help entrepreneurs design and host their surveys online and have instant access to the data at all times. When conducting a survey, it is important to have an accurate sampling, so survey respondents must be selected very carefully. In assessing the value of survey results, the amount and quality of the marketing information is compared with the costs of obtaining it.

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Focus Groups

A focus group is a form of primary research which uses a small-group discussion format to obtain information from people who represent the company's target market. The group discussion is centered on a specific, predetermined set of questions. A typical focus group session includes six to 10 participants and lasts about two hours.

Focus groups are typically used by B2C companies but can be used by B2B companies as well. If you are going to conduct a focus group, you may want to search out an expert facilitator to ensure that you get really helpful information from the group.

A focus group can be used any time you wish to obtain qualitative information from your potential customers. Focus groups are frequently used to:

- Identify new ideas for products and services.
- Develop questionnaires for statistical research.
- Identify new uses for existing products and services.
- Identify new advertising or packaging themes.
- Test alternative marketing approaches.
- Diagnose competitors' strengths and weaknesses.
- Discover how others judge the uniqueness of your product or service.

Tip

As it is frequently difficult to be unbiased and accepting of others' suggestions, you should consider using the services of an outside, neutral third party to facilitate the group discussion.

There are, of course, both advantages and disadvantages to focus groups. A focus group is a good way to obtain valuable, quick, low-cost marketing information directly from potential customers. On the other hand, the results from a focus group are not statistically significant. Because of the small size of the sample group, the information cannot be projected to the entire target market. In addition, the information obtained may be misleading, and results of focus groups are often difficult to compile. Sometimes people tell you what they think you want to hear, or say they would buy, but wouldn't in actuality. Planning and conducting focus groups can also take a great deal of time.

On-line tools make surveys and focus groups more accessible then in the past. You can use the basic framework and processes behind these methods to guide your approach.

Your Competitor's Profile

Competitor Profile

The old saying is that you should keep your friends close but your enemies closer. Just as you should always monitor the changing demands of your target customer's so should you keep an eye on your competition.

All companies have competition. You must determine who your competitors are and how their product or service differs from yours. To be successful, you must provide a product or service that can in some way be differentiated from the competitors' products or services. If you cannot find any competition, then perhaps your product or service has no market.

You should know information for every significant competitor, including the competitor's personalities, thought processes, and reactions. Some of the competition may react very aggressively to any challenge to their market position, while others may take a more tolerant view of newcomers in the industry. You should identify which firms will provide the most significant competition and anticipate what they will likely do if a newcomer enters the market.

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Researching the Competition

Some entrepreneurs talk with competitors' employees about the services offered, pricing discounts, and company weaknesses. Interviewing competitors' customers or visiting the competition is another strategy for finding information. Before starting a business, you can even conduct research by working for your competition.

One of the best strategies is to interview a competitor that does not compete locally. By talking with a competitor outside your trade area, you will often be able to obtain a significant amount of information about the industry, the marketplace, and the operations of the business.

If the product or service is research-intensive, university networks may uncover some competitors. You may find professors conducting similar research or technology development and tap into their circles. Another method of discovering competition is to search on websites of venture capitalists who invest in the industry for portfolio companies who may be competition or even partners.

A good coach analyzes the opposing team before going up against them on the field. You must do the same in business. Obtain the following information about each of your direct, indirect and future competitors:

- Company name, parent affiliation, years in business
- Size (headcount and revenue)
- Their value proposition and product
- How many customers (share of decisions and revenue)
- How long in the market
- How they compete against you
- State of their technology
- Specifics of how they sell into their markets
- Their strategy
- Their financial resources
- Price comparison
- Strengths and weaknesses for the company and their products
- Their anticipated response to your challenge
- Whether they are a potential acquirer or partner down the road (Do they have complementary products?)

SWOT Analysis

A SWOT analysis can help you identify your competitors' Strengths, Weaknesses, and examine the Opportunities and Threats they face.

Strengths and weaknesses are internal factors. For example, a **strength** could be:

- Marketing expertise.
- A new, innovative product or service.
- Location of the business.
- Quality processes and procedures.
- Any other aspect of your business that adds value to the product or service.

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A **weakness** could be:

- Lack of marketing expertise.
- Undifferentiated products or services (that is, in relation to competitors).
- Location of your business.
- Poor quality of goods or services.
- Damaged reputation.

Opportunities and threats are external factors. For example, an **opportunity** could be:

- A developing market.
- Mergers, joint ventures or strategic alliances.
- Moving into new market segments that offer improved profits.
- A new international market.
- A market vacated by an ineffective competitor.
- Deregulation of the markets.

A **threat** could be:

- A new competitor in the market.
- Price wars with competitors.
- A competitor with a new, innovative product or service.
- Competitors with superior access to distribution channels.
- Taxation introduced on your product or service.
- New governmental regulations on your product or service.

Before carrying out a SWOT analysis, consider the following guidelines:

- Be realistic about strengths and weaknesses. When performing a SWOT analysis on your business, be neither modest nor overly optimistic.
- Consider answers from the company's point of view and from the point of view of customers, vendors, distributors and others who do business with them.
- Distinguish between where the organization is today and where it could be in the future.
- Always compare the organization with its competitors. If a strength is providing high-quality products, yet everyone in the field produces high-quality products, then it is not a strength. It is a necessity.
- Note that the SWOT is subjective. No two people will come up with the same SWOT.

You won't be able to answer all these questions about your competition, but try to answer as many as possible. Remember, knowledge is power. Learning more about your competition will help you gain greater insight into the market.

When you conduct a SWOT analysis on your own company, you can use this information to focus on your strengths, minimize weaknesses, take the greatest possible advantage of opportunities, and minimize the risk of threats.

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How to Leverage Market Research

In the feasibility stage market research is being used to test the business model by developing hypotheses based on assumptions, learning from customer interaction and industry research then incorporating findings into a better business model and product. In the business planning stage market research helps to develop the tactics that will be used to produce the product or service and successfully launch the business. On-going market research is used to continually monitor trends that can be used to modify existing business models, products and services to maintain a competitive advantage – solving real problems for identifiable customer segments by offering products and services that offer a value proposition that is unique and defensible and creates a sustainable company.

Product Development

There are two important questions to ask when assessing the feasibility of your product:

- Does it work?
- Will someone buy it?

Customer analysis is perhaps the most critical issue to consider in product development. You must determine customer needs and develop a product that has features and benefits the customer desires as well as price points the customer can afford. If you develop a larger, heavier product with more capabilities and then discover that customers care about size and weight more than features, you will not be able to sell the product. Likewise, if you develop a product with more features that costs more than a customer can afford, you will not be able to sell the product.

From Real Entrepreneurs **customer analysis**

A company invented baseball caps for truck drivers with electric nodes inside the cap to sense if the driver is falling asleep. If the driver dozes off, the baseball cap sends an electric shock to the driver to wake him up. The founder of this company talked to executives at the trucking companies who thought the idea was fabulous. It turned out that the truck drivers are such an independent breed that they were not willing to wear caps that the trucking company gave them to wear. Thus the trucking company stopped purchasing the hats, and the hat company went out of business. The company performed market research but failed to uncover the needs of the actual end user.

Estimating Share of Decisions

Your business concept is not feasible if it will not capture a large enough share of the market to generate the sales and revenue necessary to sustain and grow the business.

A sales forecast based on the estimated share of decisions is critical to assessing whether to proceed with the business as planned. Developing an accurate estimate for a new company's share of decisions is difficult. It requires an understanding of the many variables that affect a purchase. For example, an advertising and promotion effort will have a significant impact on the sales of a product or service and its competitors.

A common approach to estimating share of decisions is to use actual industry sales figures, identify competitors and estimate their sales, and then estimate how the product or service will do relative to competitors. Customer intention surveys and

BUSINESS PLAN

Financial Plan
///
Sales Projections

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Reality

Estimates are educated guesses. The better the input – the facts – the closer the estimate will be to reality.

expert opinions from suppliers and trade associations can provide information for this estimate. The market share is usually expressed as a percentage.

Another approach for estimating sales is referred to as a bottom-up approach. In this approach, you identify all potential customers for the product or service and then estimate the number that would most likely purchase the product or service. The following steps detail the process:

1. Estimate the number of potential buyers for the product or service.
2. Determine how many interested buyers have the income to purchase the product or service.
3. Consider how to develop awareness of your new product in the target segment. A partnership with a strong marketing organization can be especially helpful.
4. Estimate the quantity of the product or service a customer will purchase to determine how many units could be sold in a year. This number is the market demand for the product or service. Consider the strength of your patent position and competitive products. How long can your unique benefits be protected by a patent?
5. Calculate a share of decisions by estimating how the projected unit sales compare with competitors' or potential competitors' sales.

Remember to be clear about the benefits your company's products and services offer to the customer. When creating your value proposition, be sure to differentiate yourself from the competition. What do you have that no one else has? And – most importantly – how is this an advantage to your customers? Ensure that your message strikes the right note with the right people.

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Testing Your Business Concept

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Scientists know that you have to test your hypothesis to evaluate its merit. What sounds like a clever idea in your head may not pan out in the lab. The same is true for your business concept. You need to put it under a microscope to test its feasibility. The Business Concept Feasibility Assessment allows you to test your business concept against some best practice parameters. Remember, at this stage your answers should be based not on your opinions but on comprehensive feedback from potential customers, channel partners and industry experts.

In this module, you will assess the following areas of your business:

- **Business Feasibility** – Tests the business concept in the areas of product or service, market, and financial feasibility.
- **Technology Feasibility** – Tests the technology that provides the foundation for the product or service.

You will analyze the results of your feasibility tests and plan next steps. Many entrepreneurs discover that this is a good time to refine or modify their business concept.

Upon assessing feasibility, you will use the results to help you draft and Executive Summary which is a document of not more than two pages that provides an overview of your company. Essentially, you will create a document of not more than two pages that provides an overview of your company.

Outcomes

- Test your business concept against a model business through:
  - Product or service feasibility.
  - Market feasibility.
  - Financial feasibility.
  - Technology feasibility.
- Decide the next step for your business concept.
- Learn about the topics contained in an Executive Summary.

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Action Steps (Find online tools at **fasttrac.org/resources**.)

- ❑ Decide the next step for your business concept, and plan the actions necessary to implement that decision.
- ❑ Continue to conduct market research with more potential customers, clarifying the market opportunity both quantitatively (money and size) and qualitatively (value proposition).
- ❑ Draft the Executive Summary section of your Business Plan.
- ❑ Complete the Marketing Plan section of your Business Plan.
- ❑ Continue to refine your Elevator Pitch.
- ❑ Read Module 5: Entering and Capturing the Market.

The Model Business

Reality

Assessing a business concept against the model business without adequate research to back up the assessment is meaningless. What you think about the business concept doesn't matter nearly as much as what the market research says about the business concept.

The model business exercise tests for feasibility in the following areas: the product or service, the market, financial considerations and technology considerations. A business that achieves a perfect score would be a model business.

You will use the Technology Feasibility Assessment to make a preliminary decision as to whether the technology is feasible. The questions are designed to assure you that you have taken all the necessary steps in the research and testing stage prior to proceeding.

Testing the Concept Using the Model Business

Establishing feasibility for a business concept can be a difficult task. Using the model business as a tool for comparison can make assessing a business concept easier. The Kauffman Foundation has collected a set of critical success factors for businesses. You will test your business concepts against these success factors with the assessment rating system.

A range of weighted answers is provided for each success factor to give you a feasibility score. The score will not be perfect – no company (not even GE, Wal-Mart or Microsoft) can generate a perfect score. The purpose of the feasibility testing is to help identify your business concept's relative strengths and weaknesses.

The feasibility score can also be used to establish areas of improvement. As your planning progresses, the scores on the Business Concept Feasibility Assessment should improve.

As you progress through the rest of the program and complete your business plan, you should continually go back and re-evaluate your business against the model to see how you are progressing.

One important note: keep the results in perspective. A health-tech start-up will almost always score lower than a technology start-up in the length of time to market and the amount of regulation required. Compare your results against the success factors as they relate to your industry. But also keep in mind that when seeking funding, investors will evaluate your business against investment opportunities outside your industry – just make sure you can address these potential concerns in your business plan. For example, how will you effectively manage the regulatory risk?

Scoring the Test

As is true in most aspects of business, answers to the Business Concept Feasibility Assessment are not black and white. A good rule of thumb is that for a business concept to be feasible, it must, when tested against the model business, achieve at least one-half of the possible points overall and no less than one-half of the possible points in any of the three areas – product or service, market, and finances. A score of less than 3 for any individual

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criterion indicates a weakness in the business concept that requires further consideration. Likely, no business will have a score of 5 in every criterion, but that doesn't mean you shouldn't try to reach that level. Each criterion is explained in detail in this module.

You can also use the model business feasibility score to compare one concept against another. The concept with the higher score may be the concept that will best meet your personal vision. *Note: Do not rely solely on the total score in comparing opportunities. Look at each individual criterion in each area. It could be that the highest scoring concept rates very low in one or two critical areas needed for success.*

Product or Service Feasibility

The first section of the Business Concept Feasibility Assessment focuses on whether the product or service is viable. Many businesses have failed simply because the product or service was not feasible. It was too costly, too regulated, or simply not wanted by the customer. You will be analyzing your product or service against the criteria included on the Business Concept Feasibility Assessment.

- **Customers perceive a need for the product or service.** When the customer already wants the product or service, marketing and selling are simplified. The model business has customers who perceive a need for what the business has to sell. If the customers do not have a perceived need for your product or service, you may spend substantial marketing dollars to convince them of their need. You must sell the product or service twice: first, to convince the potential customers that they want or need the product or service and, second, to convince them that they should purchase it from you.

From Real Entrepreneurs — customers perceive need

Internet marketers found that they needed a source of e-mail addresses that had not been culled from areas of the Internet and then sold without the owners' knowledge or consent. Using such lists made them guilty of spamming, or sending unsolicited advertising messages. To effectively use e-mail as a marketing medium, online marketers needed the addresses of those who had chosen to receive advertising messages in exchange for points toward online purchases. Opt-in e-mail companies such as **mypoints.com** were built to fill this need.

- **Product or service is ready to sell.** The model business has a product or service that have been created, tried, and proven to work before mass marketing. The model business develops systems to provide additional services when the market demands it.
- **Product or service has unlimited life.** The model business has a product or service that does not become obsolete, out of fashion, perishable, or affected by weather.
- **Product or service is unique and can be protected.** The model business has a product or service with unique aspects that can be protected from competitors. Intellectual property safeguards such as patents, trademarks, copyrights, and trade secrets are important forces in warding off competition. Even an agreement to distribute certain products in profitable markets can be a valuable proprietary right.

Reality

Though entrepreneurs may consider a product or service complete, they should expect and plan to make necessary adjustments and modifications if the initial customer feedback warrants it. The product or service is far easier to sell when customers are involved in preliminary design or specification.

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From Real Entrepreneurs

unique and can be protected

Amgen is the largest health-tech company in the world. Amgen manufactures naturally occurring proteins, a product which cannot be patented. Instead, Amgen patents the way these proteins are manufactured, which provides the same level of protection for their core products.

- **Product or service is not regulated by the government**. The model business has a product or service and business operation not regulated above and beyond the normal issues that pertain to all businesses and individuals. For health-tech or medical device start-ups, you should compare the level of regulation required for the business versus like companies in the industry. For example, medical device companies with products that require comprehensive clinical trials are far more risky ventures than those that require only 510K approval.

From Real Entrepreneurs

not regulated by government

To solve the problem of the many state laws regulating sales of alcohol, the founder of a retail wine firm took it online. The company built a nationwide network from existing wine shops. With about 100 retailers, the Internet company can easily and legally arrange shipments to more than 80 percent of the nation's population. Future regulations, however, could create additional hurdles.

- **Product or service line has expansion potential**. The model business has potential to expand through additional products or services and new product or service lines. The company must constantly look for ways to expand the product or service line and bring in new products or services.

From Real Entrepreneurs

expansion potential

The partners who started **theknot.com** thought the Internet would be a good place for couples to shop before they married. The website offers one-stop wedding information and planning – including an online gift registry, a tool for locating the right gown, write-ups on honeymoon locations, and advice on other wedding decisions. The site generated advertising revenues from the outset because weddings trigger other purchases. The economic life of **theknot.com** is bright, since every new couple that becomes engaged represents another potential customer.

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- **Product or service has no liability risk.** It will be difficult to sell a tech product or service with no liability risk. As a general rule, any tangible product that comes into contact with people has the potential to hurt them, particularly anything that is ingested. Service businesses, those selling advice – especially "expert advice" – face similar risks.

Reality

The greatest rising expense for a business today is product liability insurance. Astute entrepreneurs look carefully at the liability potential for their concepts.

Market Feasibility

The second section of the test for feasibility requires that the business concept have a market. In other words, do people want to buy the product or service? Too often, entrepreneurs think everyone in the world is a potential customer. Even with the global marketplace, this view is not realistic. This second test may keep the entrepreneur from misreading or underestimating the competition.

- **Market can be recognized and measured.** The model business has a market that is easy to recognize, define, and measure.
- **Existing competition has identifiable weaknesses.** The model business's competition has left room for others to improve on certain aspects of their products or services, or have holes in their product or service portfolios. A new supplier of custom-made private jet interiors must do more than move in next door to a private jet manufacturer. It must also take advantage of the weaknesses of its competition such as in materials, workmanship, and service.

From Real Entrepreneurs

existing competition has weakness

Before the advent of the high-pressure, low-volume toilet, the developer of an ecological water-saving device used in the toilet tank unrealistically estimated his market to be everyone in the world who owned a toilet. His device, when installed, lowered the amount of water used for each flush, making it an excellent choice for the ecology-minded consumer. After six months of marketing to homeowners without making a sale, he consulted a plumber about the situation. The plumber quickly answered that he had been recommending bricks to his customers for years. "Properly installed," he said with a smirk, "the brick lowers the amount of tank water used by 30 percent." This entrepreneur would have benefited from exploring the competition, both direct and indirect, in greater detail before producing 15,000 water-saving units now sitting in his garage.

- **Distribution system is established and receptive.** The model business has established and receptive distribution channels. The distribution channels include the various companies responsible for moving the product or service from the producer to the customer. Established distributors can immediately begin marketing new product or service lines to their existing customers. They understand how the new item fits into their current customers' needs.

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Tip

Astute entrepreneurs know that customers consider editorial coverage more credible than paid advertising. "Giving away" a product or service to users who could create a newsworthy event using their products or services is a great way to get valuable publicity.

- **Market will readily accept new technology.** Sometimes a new technology so substantially changes the fundamental way that business is conducted or represents enough of a threat to an existing business that it meets with resistance. The Internet is an example of disruptive technology. It represented a paradigm shift in the fundamental way business was done. They both represented paradigm shifts in the fundamental way business was done. Existing businesses can adopt the new technology, offer competing technology, fight off the new technology by showing how existing technology offers a better product or service, or simply ignore the new technology. It is critical to identify and profile early adopters and their potential to influence the market. Do they represent a substantial market in size, or do they influence the purchasing habits of a much larger customer population?
- **Business has great news value.** Businesses can realize continued rewards from one good story in the right media.
- **Customers purchase frequently.** The model business has customers who purchase the product or service frequently. Therefore, fewer dollars are spent to convince new customers to try the product or service.

From Real Entrepreneurs **customers purchase frequently**

Nelcor produced the first pulse oximetry system – a combination of a monitor and a disposable pulse oximetry sensor. Nelcor's model was to sell the monitor at a substantial discount in order to secure the high-volume disposable business.

Financial Feasibility

The third section of the feasibility assessment covers financial criteria. Money must be found to start and operate the business. And even if the product or service can be sold to potential customers, the sale must result in an acceptable profit. This test of profitability is sometimes the hardest for entrepreneurs to apply, but many would argue it is most important. In order to determine profitability, you must have an adequate understanding of the financial plan. While assessing your business concept, keep asking a very simple question – how will this business make money?

Reality

Funding is never easy to obtain, but if it is extremely difficult to obtain, maybe potential investors or funders see an inherent weakness in the venture that you are missing.

- **Funding is easily obtained.** It takes money to make money. For the model business, start-up and growth funding is more easily obtained because the financial rewards are apparent. When writing your Executive Summary (and, especially, your Investor Presentation) always assert how the investor will make money by investing in your company.

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- **Revenue stream is continuous.** The model business generates a continuous flow of revenue after the initial expense of marketing to solicit potential customers. Revenue continues to stream into the business from existing relationships with customers. Good examples of businesses with a continuous or recurring revenue stream are:
  - A web-hosting business that charges its customers a monthly fee or uses an annual contract.
  - A software company that charges a yearly maintenance fee on its installed software.
  - Computer security consultants who are on a retainer to react to threats against networks.
- **Money is collected prior to sales.** The model business collects money from customers when the order for products or services is placed. Any delay in payments received from customers creates a cash crunch because money has been spent to create the product or provide the service, but no money has been collected on the sale.

Reality

It doesn't matter how many widgets are sold if the customer never pays for them.

- **Hiring and retaining employees is easy.** In the model business, hiring and retaining employees is easy because the entrepreneur has developed a plan to meet employee needs, including detailed job descriptions and growth plans that are tied to the company's growth.
- **Inventory and service providers are dependable.** The model business has dependable companies providing inventory, raw materials, and services.
- **Gross margin is 100 percent.** Gross margin is the amount of money businesses have left after they pay direct material and labor costs. It represents the dollars available to cover the operating costs of the business. Gross margin minus operating costs results in a profit or loss for the business. With a gross margin of 100 percent, the model business has all of the money received from the sales of products or services to cover operating expenses.

  Although it is unrealistic in most cases for any business to have a gross margin of 100 percent, the larger the gross margin, the better the business. The problem with low-gross-margin industries is that slight errors in calculations quickly result in losses. High-gross-margin businesses can make substantial profit on modest sales volumes.

  The projected gross margin of a business is the main key to profit. Investors making a commitment to a new venture consider gross margin a major factor in their decision to invest. The ratio of operating expenses (infrastructure, administration, and selling expense) to gross margin is also critical.
- **Legal problems do not exist.** All real businesses have some legal considerations. The able entrepreneur investigates the entire array of potential legal factors that could affect the business concept or the purchase of an existing business. The advice of an experienced business lawyer is imperative.
- **Wealth is harvested through exit strategy.** The model business is structured from its inception to create wealth for the entrepreneur through selling, by merging with another business, or by selling shares in the business to the public at large. This wealth is collected at the point of the entrepreneur's choosing.

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Technology Feasibility

The Technology Feasibility Assessment allows you to test the technology that serves as the foundation for your product or service. You will examine the following areas:

Tip

For health-tech start-ups, a solid intellectual property plan is necessary to protect the business during the typically long time-to-market. Critical patents should be secured or filed by a well-respected, experienced law firm – a critical investment that will pay off long-term.

- **Technology Research.** Just as you need to conduct research to verify your business plan, so you need to conduct research to verify your underlying technology. In this section you will assess your document search, discussions about the concept that you've had with experts, and your analysis of your competition. You will also determine how easily the technology can be implemented and manufactured.
- **Intellectual Property Protection.** For many businesses, having a unique product or service sets them apart from others in the field. If other businesses can copy your concept, you may soon cede to the competition. To ensure your competitive advantage, assess your eligibility for a patent, trademark, or service mark protection.
- **Proof of Concept.** You have to verify and be able to demonstrate that the technology works. Can you show investors verifiable data that the technology works and that it has been tested under appropriate conditions? Have you designed, built, and tested a working prototype with a real, potential customer (a beta customer)?
- **Market Feasibility.** You must be able to show that there is a market for your product or service. You must also have done the research to show that your product or service will compare favorably to your competitors and the features they offer.

Deciding the Next Step

Testing your business concept by comparing it to a model business and by assuring its technology feasibility will help you identify its strengths and weaknesses. This evaluation should be based on researched facts. Only by reviewing the facts can you make an informed decision as to which of the next steps – 1, 2, 3, or 4 – is right for you.

1. Proceed with Business Planning

If your business concept is deemed feasible (which means it is a good match with your personal vision, scores well on the Business Concept Feasibility Assessment, and proves to be technologically feasible), it is time to proceed to writing a Business Plan. Researching the business concept, refining the idea, and improving the concept as it compares to the model business will continue throughout the business planning process.

Reality

Most statistics show that 40 percent of new business start-ups fail within the first year. Most of these businesses should never have been started in the first place. Smart entrepreneurs walk away from business concepts that are not feasible.

2. Modify Concept and Test for Feasibility

If the business concept compares poorly with your personal vision, the model business, or the Technology Feasibility Assessment, then the business concept should be examined more closely. Would changing some aspect of the business concept create a more feasible concept? You may use facts to change objective, external factors, or logical conclusions. But your personal vision should be changed only after careful reflection, because a change that makes the concept more feasible but is contrary to your personal vision most likely will lead to an unsatisfactory business experience.

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3. **Finish Research and Test for Feasibility**

   Perhaps additional research will be necessary before the concept can be tested against the model business. Often, information is hard to find and more time is needed. If so, you should finish the research and then evaluate the concept against the model business. You may also need to take steps to test and protect your technology before reassessing its feasibility.

4. **Abandon Concept**

   If you determine that your business concept is not a good risk and you decide to pursue something else, the concept analysis process has still been successful. You have learned what you needed to learn about your business concept. Rather than pursue a risky concept, you may choose to consider several options, including:

   - Identifying and researching a new business idea.
   - Getting more education and training.
   - Improving your own personal financial situation for funding a business.
   - Getting a job in the industry to learn more about it before starting a business.

If the concept analysis process has led you to pursue a different business idea in search of something more feasible, you are fortunate. You have saved valuable resources – the time and money that would otherwise have been invested in the business.

Maybe you have decided business ownership is not for you. You can still use your newly developed planning skills to make you a more attractive employee in the workplace. Most organizations need persons with entrepreneurial skills who can analyze and evaluate business opportunities.

Executive Summary

BUSINESS PLAN

Executive Summary

The Executive Summary is the first section of your Business Plan. It's a two- to three-page summary of what your company is all about. The final version of the Executive Summary can't be written until you have completed all the other sections of the Business Plan. However, you can begin to capture ideas for each of the following topics, which you will revisit and refine as you complete each section of your Business Plan:

- **The Company.** Describe your business purpose and model. Provide a summary of your company's history and current status, including major milestones achieved and the outlook for key future milestones leading to success.
- **The Market.** Describe the size and growth of the targeted market segment and why it is attractive as a compelling business opportunity. Explain who the buyer is and what compelling issue(s) or need(s) your product or service will solve.
- **Competitive Analysis.** Explain who the main competitors are, why they are important, what their weaknesses are, and how the company will beat them. This answers the investor question: "Why will you win?"
- **The Product/Service.** Explain the product or service that will be delivered to address the compelling opportunity described above. Indicate where you are in the development of the product and the outlook for its completion.

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- **Value Proposition.** Show the value that the company's product or service brings to the customer and the benefit to the customer.
- **Marketing and Sales Plan.** Describe how the company will bring the product or service to market by identifying qualified customers and selling them the product or service.
- **Management and Organization.** Profile the executive team and highlight its qualifications to run the business. (*Note: This is often the most important section for investors when they review your summary.*) Explain what form of organization the business operates under and why.
- **Financial Summary.** Summarize the main conclusions drawn from the financial statements: cash flow, profitability, break-even point, capital spending, debt, equity, and the sources and uses of funds being sought. In other words, explain how your company makes money – its economic engine.
- **Investor Summary.** Provide a short paragraph with a bulleted list of the major reasons why someone should invest in your company. Describe the detail of what is being offered to investors and its basis.

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Entering and Capturing the Market

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In the Concept Analysis section of this program, you researched your market and confirmed the feasibility of your concept, determining that your product or service had a large enough market to propel your company's growth. Now, in the Business Planning section of the program, it's time to plan how to capture that market. The process of entering and capturing your target market is called *market penetration*. The process doesn't just happen – you have to plan it.

Your Market Penetration and Sales Plan details the best way to sell your product or service. In order to transform the potential customers from your target market into real, paying customers, you have to strategize how to get your product or service into the market and how to make consumers aware of it. In this module, you will learn about the details that contribute to your market penetration plan.

Technology and life sciences companies often gloss over the sales process and market penetration planning because it is difficult, requires immense time and effort, and usually involves hiring or directing sales professionals (who generally work quite differently than a tech or science professional does). However, the quality of your marketing strategy and your enthusiastic implementation of it could significantly affect your level of sales – which means it's worth your time and attention.

In this module you will learn about the product or service adoption curve, creating an image for your business, sales channels, marketing methods, and pricing.

Outcomes

- Identify customers on a product or service adoption curve.
- Consider the image you want for your business.
- Formulate a market penetration plan with associated financial assumptions.
- Select appropriate sales channels and marketing methods.
- Evaluate pricing strategies for your products or services.

Action Steps (Find online tools at **fasttrac.org/resources**.)

- ❑ Draft the Market Penetration and Sales Plan section of your Business Plan, with particular focus on the Pricing section.
- ❑ Refine the Executive Summary section of your Business Plan as you draft other sections.
- ❑ Continue to conduct market research with more potential customers, clarifying the market opportunity both quantitatively (money and size) and qualitatively (value proposition).
- ❑ Continue to refine your Elevator Pitch.
- ❑ Read Module 6: Planning for Financial Success.

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Market Penetration

BUSINESS PLAN

Market Penetration and Sales Plan

Market penetration is the process of entering and capturing your target market. You must plan how to go after your target market, get the market's attention, and stand out from your competitors for that market.

The Market Penetration and Sales Plan

This plan comprises one section of your Business Plan. It details exactly how you will enter and capture the market for your product or service, specifies how customers will be told about your product or service, and explains how the product or service will get into customers' hands. Base your Market Penetration and Sales Plan on the extensive market research and analysis you've already completed.

One of the best ways to develop this plan is to brainstorm your options and then evaluate them based on the most likely results and your budget. You can even include samples of promotional materials, such as sales literature, brochures, advertisements, illustrations of packaging and labels, and copies of warranties.

Pricing your product or service is a critical topic that is addressed in your Market Penetration and Sales Plan. This component of the plan explains the pricing strategy for your product or service, including the break-even point, pricing constraints, your price list, and the rationale for your pricing policies.

The Product Adoption Curve

Before you can craft a market penetration plan, you need to understand the product adoption curve. (While most marketers refer to this as the product adoption curve, it can also apply to services.) The product adoption curve traces the three phases through which consumers (or a market) proceed in deciding to adopt a new product or technology. At the individual level, each consumer must move from

the *first* phase, a cognitive state (becoming aware of and knowledgeable about),

to the *second* phase, an emotional state (liking and then preferring the product),

and finally into the *third* phase, a behavioral state (deciding and then purchasing the product).

Therefore, your marketing efforts need to first identify consumers on the product adoption curve and then build consumer awareness, show why your service or product is unique, and spur consumers to action.

You can use many marketing methods to move consumers through the three phases of the product adoption curve. The key is to select the methods that will provide the most return on investment.

Creating an Image

Reality

If you don't intentionally create a business image, you will create one unintentionally.

Creating an accurate image of your business is the starting point in penetrating the market. Image is critical in today's marketplace. With so many options to choose from, your positive image may be the one feature that distinguishes you from the crowd. Your business's image will also be important in attracting strategic partners and investors and in recruiting management team members.

You should carefully craft a business image that matches your market position and target market. The image needs to portray your business's position in the market as well as its value and integrity. If a poor business image is established, it can be almost impossible to overcome.

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From Real Entrepreneurs

creating an image

Companies with more than one target market must create an image that appeals to each without alienating the others. For example, William Shatner, acting as a spokesperson for **Priceline.com**, has the ability to communicate a positive image to both young and old consumers.

Image goes beyond advertising. It includes the total experience customers have with the company. Image is projected in how the phone is answered, how the invoices look, how the company contributes to the community, and so much more.

The first step in creating an image is to determine what message to send to customers. The next step is to decide how to convey that message.

Naming the Product or Service and Business

A memorable name is a valuable part of a company image. Some businesses have the same name as their products or services. For example, Xerox is the name of both the company and its products. Others have different names. For example, Intuit is a business's name, while Quicken® is the name of one of its products.

You should select names that will be appropriate throughout the life of the product or service and business. Several factors should be considered in selecting names:

Competitors' names – The name should be distinguishable from its competition, but still fit within the industry.

Tip

Test your ideas with persons who are part of your target market. Your preferences are not as important as those of your target market.

From Real Entrepreneurs

naming the business

Law firms often use the partners' names such as Johnson, Wu, and Riojas, Attorneys at Law. The name Legal Ease is creative, but it may set the business too far apart from the competitors to still fit within the industry.

The message – A company should not use a name that sounds catchy if it does not fit with the business image.

Usage – Will the customers' primary experience with the name be written or oral? A business may have an impressive-sounding name, but if customers can't spell it, they may not be able to find the phone number or website.

Descriptive of the business – Names like Microsoft®, Holiday Inn®, and Thermos® are more descriptive of their products or services than names like Dell® and Fuji. A descriptive business name can help create the image you desire. If your business's name doesn't fully describe your product or service, you may want to add a tag line to attract customers.

Reality

The name "Curl Up and Dye" might be a creative name for a hair salon when written. However, potential customers may not be impressed when they call to make an appointment and are greeted with, "Curl up and die."

And don't forget communicating a consistent image on your website. Many companies hire attorneys to protect their intellectual property, including their business name. Within your state, you can perform searches with the secretary of state to avoid

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infringing on another company's trademark or service mark. However, a local search offers no protection nationwide. If you plan to do business nationwide, you must perform a search of existing names and register your business in your trade area.

Tip

Hire a graphic designer to achieve a distinct identity and professional look for all your materials.

Communicating Your Image

The company name, logo, business cards, letterhead and stationery, product packaging and displays, brochures, and flyers all send a message to customers. Once a visual image is created, it should appear on all materials for a consistent look. The goal is that customers recognize the business when they see any of its associated materials.

Sales Channels

Once you have identified your customers on a product or service adoption curve and have created an image for your business, you're ready to consider the various sales channels through which you will actually penetrate your target market.

Numerous channels exist, so you need to carefully consider how well each one might work for your business. You'll want to choose the sales channel(s) that will most effectively get the word out about your business and its product or service, but that won't break the bank doing so.

Distributors

One way to introduce your product into the marketplace is to lean on the expertise and networks of an established distributor. Distributors are responsible for warehousing, selling, billing, delivering, and servicing the product or service produced by a company. Using a distributor has many advantages:

- Distributors can give a new company some credibility and allow the fast movement of products or services to the target customer.
- The distributor usually has many assets in place to serve the customer, such as a sales force, delivery trucks, a service department, a customer hot line for complaints, and warehouses.
- A company can have nationwide or worldwide coverage in a short period of time by persuading a large distribution network to stock and sell its product or service.
- The company can get immediate sales by selling the original inventory to the distributor.

The disadvantage of using a distributor is a loss of control because the salespeople work for the distributor and not directly for you. Also, the distributor will require you to have backup inventory so it can have quick delivery and keep its inventory low. This practice can also make the product or service more expensive to the customer because each company, yours and the distributor's, has to make a profit.

Internal or External Sales Team

You may elect to use sales agents to promote your product or service in the marketplace. Sales teams may be classified as internal or external.

Internal salespeople, also known as a direct-sales force, work directly for you and are paid a salary, salary plus commission, or straight commission. The advantage of using a direct-sales force is that, because they are full-time employees, you can direct their sales efforts. You have more control in training them to sell, price, and support the product or service. The disadvantage is the expense involved in maintaining a full-time sales force. You have to pay salary, travel, office support, and benefits for each salesperson.

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External salespeople, also known as manufacturer's representatives or sales agents, work as subcontractors for your business. Agents are paid by commission, which is calculated as a specified percentage of the wholesale price. They receive their commission after you collect from the customers. The sales agent pays for expenses incurred in selling the product or service, such as product samples, travel, office, telephone, and supplies.

The advantage of using sales agents is that you don't incur any sales costs until the customer pays for the product or service. You are able to build a large sales force and sell the product or service nationwide quickly. The primary disadvantage of using sales agents is that they usually sell other products or services as well. Sales agents tend to push the products or services that are easiest to sell and those that have already established a large customer following. You have very limited control over the sales agents since they are subcontractors and do not work directly for your company.

Your Sales Process

Whatever your sales channel, the sales process will be nearly the same. You should master this process or use an experienced sales manager who will direct this process for you.

The Sales/Service Process

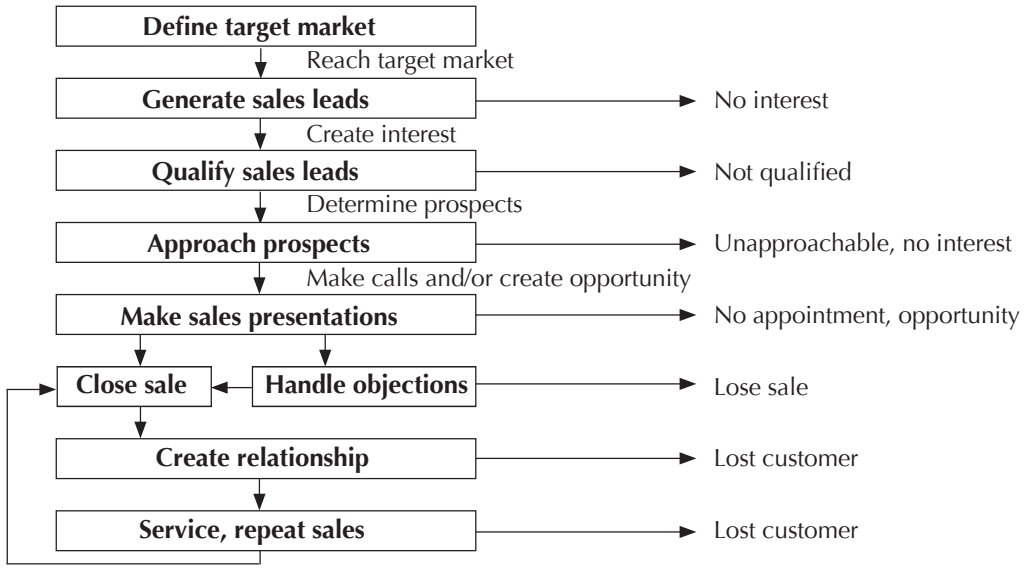
The *Sales/Service Process* refers to the steps you take to prospect, sell to, and retain customers. By adapting this process, you can create a pattern to follow, improve, streamline, and replicate successful sales. You can also train others to use the same process. If your sales begin to drop, you can use this process to diagnose whether one aspect or another of your sales process needs particular attention. Planning your sales process will help you address deficiencies more quickly to keep your business running smoothly.

Using the following Sales/Service Process, determine how prospects in your industry turn into a first sale and then become repeat customers and referral sources. By anticipating each step in the process, you can prepare your approach, learn customer's needs, highlight features and benefits of your products or services, overcome objections, close sales effectively, and build long-term relationships with customers.

Tip

Periodically document your actual sales process to identify how well you or your sales team follow each step. Determine what changes should be incorporated and define a new sales process.

A Sales/Service Process



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Define Target Market
Your target market is a specific group of customers you have identified as the best fit for your product or service. Your target market should be relatively easy to enter, offer a significant profit potential, or have competitors with identifiable weaknesses.

Generate Sales Leads
Once you know your target market, consider methods for generating sales leads. You can use marketing to reach your sales leads and generate interest for your products or services. Referrals from your current customers are often the best source of sales leads for many businesses.

Another way to generate sales leads is to join local clubs or networking groups created for business owners or sales people to share sales leads. Chambers of commerce often have several such groups and others are listed in the local newspaper.

You can also purchase mailing lists from list brokers that match your customer profile to generate sales leads. List brokers usually price lists by the number of names and sort them by zip codes or other demographic variables. You can develop your own mailing lists from online networks, professional association directories, or other local sources.

Qualify Sales Leads
In this step of the Sales/Service Process, you determine whether the sales lead matches your customer profile. If leads were generated by a list broker – a firm that gets paid to sort out potential customers in a target area that matches pre-selected demographic variables – or comes your way through a referral, you may consider these leads as potential customers.

If sales leads have not been generated by a professional list broker or referral source, then you will need to develop a process to determine their suitability through further research. Create a set of questions that may help you determine if a lead matches your customer profile and then answer these questions by conducting more market research. This research may be as simple as asking others who may know more about the consumers you are considering contacting.

Approach Prospects
In order to make sales, you have to approach potential customers. For many businesses, this step usually means that the sales representative makes an initial contact with the prospect in person or by phone. If sales is currently one of your responsibilities, you may find that as your business grows, adding someone to your management team to lead the sales effort makes sense.

Prospects may also initiate the approach by coming to your business or by calling, mailing, or emailing with requests for information. Part of your Sales/Service Process is creating a standard for greeting prospects, making them feel welcome, and responding to their requests or visits. With some businesses, the prospect is the one initiating the approach. For example, retail stores and restaurants generally have prospects coming to them.

Regardless of who initiates the approach, the objective is to establish rapport with the prospect and determine the level of interest in your product or service. You will spend a great deal of effort, time, and money marketing your products or services. Interacting effectively with prospects is critical to making sales.

Make Sales Presentation
In this step of the Sales/Service Process, prospects learn more about your products or services and how they align with their needs. Although some sales presentations

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are pitched formally using a script or pre-determined format, many entrepreneurs have found that using either *consultative selling* or *relationship selling* is more successful. Concentrating their focus on each client's particular situation, needs, and vision, a sales staff can create opportunities to increase business. Consider how your company and product or service can provide meaningful value to a client and include that in the sales presentation.

Consultative Selling – In a consultative selling approach, sales representatives diagnose each customer's particular situation and needs. The goal is to find out if the benefits the sales representative can provide match the needs. They ask questions to learn more about the prospects' problems and then collaborate with prospects to consider solutions. This approach is also called *solution selling*. The emphasis is on the prospects' needs and not on the product or service. The sales representative's objective is to provide the prospect a solution with the company's product or service.

Relationship Selling – When using the relationship selling approach, sales representatives first focus on building a relationship with a prospect. Once rapport and trust have been developed, sales representatives provide valuable solutions to meet the prospect's needs and problems. This approach is focused on connecting with people profitably, not on persuading them to buy. By creating and nurturing relationships with prospects, sales representatives can build long-term customers and generate more referrals. Recognize that if your product or service does not meet a customer's needs you can create future opportunities by referring them to another product or service that does.

Handle Objections

During the Sales/Service Process, you might encounter obstacles that could prevent the sale from closing. Customers may express objections to the price, features or benefits, or their perceived need. The best way to prepare for this step is to anticipate possible objections and be prepared to address them.

Use the *Yes, and* technique when prospects raise objections. Agree with the objection (the *yes*) and then offer additional information that will influence the sale (the *and*). Avoid acting defensively. Objections are part of the sales process and provide opportunities to close the sale.

Close the Sale

The next step in the Sales/Service Process is about recognizing buying signals made by prospective customers and asking for their business. Buying signals may include body language, comments about delivery or quantity discounts, or other statements that show readiness to buy. The best way to close a sale is by asking questions that indicate you are ready for the transaction. If prospects raise an objection, you will need to respond to those concerns before closing the sale. Consider these sample questions for closing:

- "How many cans of paint do you want to take with you today? If you need more to finish painting the fence you can call us, and we'll have it available before you come down."
- "What day would you like it delivered to your home?"

Create Relationships

Although the sales transaction is complete when the prospect buys the product or service, you want to maintain ongoing relationships with your customers. You want customers to buy again. Many companies only focus on marketing to customers and closing sales. Very few businesses concentrate on creating long-term relationships with customers. Several studies have documented, however, that it costs as much as five times more to get new customers than it takes to keep them.

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By developing strategies to create relationships with first-time customers, you are more likely to generate repeat sales and referrals. In fact, repeat customers may become a strong competitive advantage for your new business.

Service and Repeat Sales
Depending on your business model, you may perform services after the sale. For example, if a house cleaning company makes a sale and schedules the service, the actual service occurs after the sale. If your business involves service after the sale, take this step even further by contacting customers after transactions are completed to check on their satisfaction and to determine if additional opportunities exist. Most businesses overlook this step and lose repeat sales and referral opportunities.

For many companies, this part of the sales and service process is about being responsive to customers when they contact them. If sales and company representatives respond favorably to customers, they have a higher likelihood for repeat business and referrals. In almost every industry, building a strong business depends on repeat sales and referrals. If current customers and their referrals generated 20 or 30 percent of your company's new business, you would spend less on marketing costs and build a strong and loyal base of customers.

Marketing Methods

Many different vehicles can be used to communicate with potential buyers and create marketplace awareness of your product or service and company. Marketing is not an exact science. A product or service may be marketed in many ways. An entrepreneur may have literally thousands of alternatives from which to choose.

Social Media

Social media is transforming the ways companies market their business. It offers unprecedented ways to reach customers and can play an important role in influencing your company's growth. Social media is not a one-size-fits-all but rather a cornucopia of websites, applications, networks and tools. For technology businesses social media can be an excellent way to establish the founders as thought leaders in the field and establish interest in technology solutions you are working on. It is critical to determine a social media strategy that ties directly to your marketing objectives knowing that these will change over time as you move through your feasibility stage to funding and launch. Defining and planning your web presence is a core component of your marketing strategy.

Some of the most popular media sites for business include:

Linkedin – Linkedin is one of the most popular sites for business professionals with an estimated 90 million users, spans more than 200 countries and territories and is available in 15 languages. Use the status updates to keep your information current and to stay top-of-mind with your connections.

Consider setting up a Linkedin site for your business. There are interest groups for most industries and professions, making it a useful platform for sharing solutions, engaging others in web-based discussion and building your professional reputation. It will also provide you with an opportunity to better understand what your customers and constituents are thinking about and what is important to them.

YouTube and online video – Forrester Research found that video is 50 times more likely to get a first-page search ranking than other content. YouTube is a video-sharing website on which users can upload, share, and view videos. In 2010, there were more videos watched on YouTube than there were searches performed on Google, according to **comScore.com**.

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Use short-form video to easily share product/service demonstrations, capture a computer screen and the activity that happens on it as a Flash video or hold a video conference. You can also embed videos in your website, blog or Facebook page, or link to them from Twitter or Linkedin.

Twitter – Twitter allows users to "tweet" text-based posts of up to 140 characters with quick-hit messages in real time to their followers. Companies can use Twitter to create interest among consumers looking for the types of products and services you offer. With an estimated user base of 190 million, eMarketer estimates that nearly 22 percent of people on Twitter use it for business-related reasons making it a tremendous resource for connecting with your customers and increasing your brand visibility. It's also becoming a major driver to business websites.

Twitter is ranked as one of the ten-most-visited websites worldwide. By monitoring what's said about your business and product/service category, you can easily monitor trends, connect with prospects and customers, and support your brand. Twitter also allows you to respond to feedback immediately, provide quick updates about hours of operation or specials.

From Real Entrepreneurs **connecting with customers**

Tax preparation giant H & R Block uses Twitter for customer care. @HRBlock is a quick response vehicle for addressing customers' questions with links to the corporate website or by connecting them with service representatives directly. The feed is an immediate channel to inform customers of tax code changes or tax-related news. More than 4,000 people follow @HRBlock.

Facebook – Facebook is a profile-based, social networking service that connects consumers to each other and to companies, organizations and topics of interest to them. The number of companies using Facebook for business grew by 192 percent in 2010, according to Palo Alto Networks research. As of January 2011, Facebook has more than 600 million active users. Companies and brands like Zipcar, Oreos, and, PopTarts all have vibrant Facebook pages. You can use Facebook to promote incentives, sales and specials, share news, announce events and provide content that creates loyalty to the channel and your business.

A survey by Lucid Marketing found that many moms use Facebook to communicate with family and friends, but that three-quarters had "fanned" at least one brand; 16 percent were fans of 10 or more companies or brands. To further harness the power of Facebook, put a link to your fan page on your company website, blog, resume, business card, Twitter account, and email signature.

Business/Brand Blogs – Every venture needs a web presence, and thanks to blogging software such as WordPress or Blogger, you can make an attractive, dynamic site on your own. These free services don't require deep technical knowledge and are an easy way to stay in touch with your customers.

Get your blog noticed and appear higher in search results by using keywords which are words or phrases that users put in search engines. Google's free AdWords will help you research which words or phrases will be the most effective for your business. Remember to be specific in choosing your keywords. For example, a freelance Technical Writer might do better with the search phrase "Technical Writer" rather than "Writer" since the latter will

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be far more common. The more specific your phrase, the more likely you are to reach your target customer.

The key to a successful blog is to provide information that's timely, relevant and valuable to your target audience – whether it's new research, breaking news, product/service information or answers to commonly asked questions from your customers. Use your blog to demonstrate how your business can answer a need. Finally, allow comments so you can get feedback and build community – both of which enable you to capture insights from users and buyers of your product and service.

Plan Your Web Presence

Successful social media marketing starts with a plan. Find a platform that is best for your business. It should be a key piece of your marketing strategy with clearly outlined objectives and an implementation plan that includes specific activities. To take advantage of all the opportunities social media offers, ask yourself the following questions:

What are my objectives? As Stephen Covey says, begin with the end in mind. What are you trying to achieve through the use of social media? Are you trying to create brand awareness? Reach an existing customer base? Create a new customer base? Do you want to educate, inform, entertain? Just as smart goals are part of your marketing plan, they should also be an integral part of your social media plan.

Who is my target market? Refer back to your market research for demographic information and other key market characteristics. Identify which social media sites are most likely going to be used by your target market. Spending time tweeting when most of your target audience is on Facebook isn't going to do you much good.

How do I want to position my brand? There are many opportunities to profile your business using social media. It is important to identify which are best suited to meet your support your business goals and attract your customers. It is also imperative to remember that you are representing your company. Be true to your values and ensure alignment with the market you are trying to reach.

How can I get the most out of social networking? It is important to focus your social networking efforts in order to maximize the search engine optimization (SEO). Because so many business searches are done on the internet, you want your organization to appear at or near the top of all queries. Eighty-two percent of consumers use the internet as their first choice to find a local business – 92% find what they need during the search.

Do I have time to devote to keeping my information current? Because social media applications enable instant updates, it's important you monitor your digital channels regularly to stay on top of what people are saying – and to address problems or issues that are mentioned. Some experts suggest updating your information as often as three times a week and spending 30-60 minutes per week participating in social networking.

Do I understand the culture? Every social network has its own standards, characteristics and atmosphere. Learn the "norms" and become familiar before deciding if the site is right for your business.

Monitor Your Impact

Once you have established your web presence it is important to monitor it to assess the impact. Use tools such as Google Alerts, Google Blog Alerts and Google Analytics to be notified whenever you or your business is mentioned online. **TweetBeep.com** will notify you if you are mentioned on Twitter. Facebook also has an insights function (**facebook.com/help/search.php?hq=insights**) that tracks the number of visitors to your company's

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Facebook page and provides information on the number of new fans you have and their demographic information. Remember - While it's great to know the all the statistics, the real objective is to measure the business you actually gain.

For easy information updates, **Ping.fm** allows you to update a variety of social media sites with one post. You can also save time by using **SocialOomph.com** which allows you to schedule Twitter updates in advance.

A Word of Caution

Max Muller, attorney, author and owner of Speak! (**speakllc.com**), warns that for all the benefits social media offers, it has a dark side.

According to AMA/ePolicy surveys taken in 2007 and 2009:

- 14% of employees admit to sending third parties potentially embarrassing and confidential company e-mail that is intended strictly for internal readers.
- 89% of employees admit to using the office system to send jokes, gossip, rumors or disparaging remarks to outsiders.
- 9% of employees have used company e-mail to transmit sexual, romantic or pornographic text or images.

The many forms of social media available to employees while both onsite, on duty and offsite, off duty has created a number of risks for employers. Depending on the nature of their businesses, company owners face some or all of the following risks:

- Liability for words, photos or videos employees post using the organization's electronic systems.
  - Discriminatory and/or harassing statements about/to other workers.
  - Discriminatory and/or harassing statements about/to individuals or entities external to the organization.
  - Allegations of libel or invasion of privacy.
  - Trade libel. Misstatements or misrepresentations about a competitor.
- Computer system security breaches that get through or around firewalls and anti-malware software.
  - Employees posting significant amounts of personal information on the internet, e.g., birthdays, pets' names, etc., and then using that information as the basis for pass or login codes at work.
  - Hackers creating false identities on social media sites and then "friending" an employee they wish to target. They then send a message with a poisoned attachment that an employee downloads and opens believing it is from a trusted source.
- Significant damage to an organization's reputation when employees post offensive words, photos or videos that feature the entity's name, logos, service marks or products. (This is known as "denigration through association.")
- Liability for copyright or patent infringement.
- Liability for violations of privacy laws, e.g., HIPAA, ADA.
- Loss of patentability.
- Emails or blog post violating securities laws, e.g., Sarbanes-Oxley.
- Endangering the organization's intellectual property, e.g., trademarks, logos, service marks, customer lists and proprietary, and/or operating information.

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In order to manage the risks associated with employee use of social media both on- and off-duty, employers – both large and small – must:

- understand the nature of the risks directly related to their particular situation,
- appreciate what must be included in their written policies to prevent, mitigate and react to social media use by their employees, and
- develop contingency plans for mitigation and reaction to actual events or issues arising out of employee use of social media.

Because of the rapidly changing nature of the technologies and case law surrounding social media even organizations that have written social media policies that were drafted one or more years ago may not be positioned to control or minimize the subject risks.

Traditional Print and Media Advertising

Traditional print and media advertising includes newspapers, magazines, radio, and television. If you are considering this kind of promotion, you need to ensure that the advertising will yield your desired results. The chosen media need to provide the right kind of promotion for products or services that will yield quick results and rapid sales.

Tip

Many potential customers hear about a product or service an average of seven times before they make a purchase. Budget for repetition in your promotional efforts.

Advertising in traditional print and media can be costly. If you plan to promote your business in this way, consider:

- Purchasing small blocks of local radio or television time at a reduced rate.
- Buying preemptible time.
- Selecting a smaller local newspaper, radio station, or television station that reaches your market.
- Working with a media-buying service that provides expertise in buying various types of media.
- Buying advertising space in a niche-market magazine with fewer readers rather than a more general magazine with a larger reader base.

Trade Shows

Demonstrating or presenting at industry trade shows can be an efficient and cost-effective way to meet and influence prospective customers, investors, distributors, and partners.

Direct Mail

Direct-mail marketing provides a medium to reach a large number of customers quickly. Disadvantages of using direct mail can be the costs and the low response rate, which averages about 1 percent to 3 percent. Carefully targeting the recipients can improve response rates.

Catalogs

The catalog industry has grown significantly. Firms like Dell have enjoyed tremendous growth and success using catalogs. Catalogs, however, are expensive to produce and send, and these costs are incurred prior to making any sales. It is important to develop a targeted customer list to send catalogs to.

Promoting Through Technology

E-commerce catalogs – The Internet offers another avenue for catalog companies to reach new customers. Customers can access electronic catalogs on company websites 24 hours a day. With electronic catalogs, printing and mailing costs are eliminated, prices can be changed easily, and products or services can be added or deleted at any time.

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Web banner ads – You can place advertisements for your company or product or service on other companies' websites. Some are placed along the top or sides of the web page, while others open separate windows.

Infomercials – You can produce a short, scripted show to demonstrate how a product or service works. The advantage of using this market-penetration method is that many satellite networks or cable television channels can reach large population bases with high sales potential. Also, the airtime costs can be relatively low. One disadvantage is that the production expenses for the program can be substantial. Costs for setting up a toll-free number and purchasing the television time are incurred before knowing the results and before any sales are generated.

> **Tip**
>
> When selecting another company's website to promote your product or service, choose a website that your potential customers visit.

Electronic media – Some businesses distribute an interactive CD instead of a print brochure. This marketing technique allows customers to view diverse forms of information on their own hardware and on their own time. A disadvantage is that you cannot control whether the potential customer actually views the information. Print information should accompany the CD to motivate the customer to try it out.

Interactive kiosks – Many shopping malls have kiosks that customers can use to locate the stores and products or services that they want to examine. These units respond to shopper requests for information using interactive computer programs. Kiosks are typically an expensive way to penetrate markets.

Telemarketing – With the advent of automatic dialers and computerized-screening sales pitches, telephone selling has emerged as a major sales tool. One advantage of telemarketing is its low cost. It costs little to get started, and the marketer can choose the scale of operations. The disadvantage is that rejections are encountered often, and customers are not always pleased to be called by telemarketers. The increase in "no-call" lists has significantly limited "cold call" telemarketing.

> **Tip**
>
> Before using telemarketing to promote products or services, you should become familiar with today's "no call" rules.

Marketing Alliances

Forming marketing alliances is an increasingly important way to accelerate growth, access new competencies, and enter new markets. By pooling your efforts and resources, you can multiply your rewards. Marketing and distribution alliances can help overcome barriers to market entry. Business development arrangements can increase credibility and market knowledge and improve any consolidation efforts. Marketing alliances are generally low-risk and low-cost initiatives.

> **Tip**
>
> Remember that your elevator pitch is one of the most important marketing tools you have.

Public Relations

Public relations can be a low-cost way to build awareness about your company. Newspapers and magazines frequently need stories or information on specialized topics. By providing well-written articles in advance, you can often obtain free publicity when those articles are published or you are quoted in an article written by a reporter. You can answer reporters' or authors' questions and become the "expert" to whom writers will turn when needing technical information. Such recognition is far more valuable than any paid advertising.

Also, many entrepreneurs give public talks, perhaps to school groups, to industry groups, or to chambers of commerce. All such activity establishes your credibility as a knowledgeable industry expert and puts your name and business in front of the public.

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Customer Service

Good customer service can support one of your most important marketing tools: good word of mouth. As part of the marketing plan, you should develop customer service strategies to build the desired reputation for your business, as well as for your products or services. Most customers like to feel appreciated or recognized for their patronage. Special pricing for preferred customers is one way to build customer loyalty.

No matter how carefully a company conducts itself, at times a customer will be unhappy. If you can resolve customer problems, you may win customers for life. As part of your customer service strategies, you should establish policies for warranties and guarantees. Industry standards for returns and service costs can serve as a baseline.

Tip

Employees are the face of the business to a customer. Train employees so they know exactly how you want them to treat customers. Most businesses do not adequately empower their employees to handle problems. An unhappy customer does not want to be told to wait until the employee can check with the owner.

Pricing

Pricing is a complex issue. Some experts consider it a marketing concept. Others argue that it is a financial concept. Both sets of experts are correct. Pricing affects *both* marketing and finance.

This section will help identify pricing strategies that support your marketing and financial plans.

The Right Price

Pricing is one of the most complex challenges entrepreneurs face because it affects both marketing and profitability. Marketing strategies help dictate the price for products or services. For example, a marketing strategy that will attempt to create a premium image will likely feature a premium price.

The right price is what customers are willing to pay for a product or service. Therefore, the question is whether the business can make a satisfactory profit at that price.

The amount of profit a company can make depends on how much it can get for products or services above and beyond costs. Once costs are covered, the remaining sales dollars go directly toward profit. Based on that rationale, entrepreneurs would always charge a high price for their products or services. It is not that simple, however. The price also has a direct impact on how much is sold. If the price is set too high and no one is willing to purchase the product or service, then the company probably will not attain profitability.

Profit involves several different elements:

Profits = Revenues – Costs

Profits = (Unit sales x Price per unit) – Costs

Usually, the lower the price, the more units a firm will sell. And theoretically, the more a business sells, the more profits it makes.

From Real Entrepreneurs the right price

Antonio wants to add an extra $250 to the price of the electronic sensors he manufactures under his brand, Eclectics. If his business sells 100 sensors a month, that means $25,000 extra profit for that month. That does not sound like much when the trade press discusses sums in the millions and billions of dollars. To Antonio, however, the additional $25,000 a month is all profit, which will contribute substantially to his bottom line. So Antonio will evaluate the market in which he sells sensors to determine what type of impact a $250 per unit increase in price will have on the number of units that he sells.

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Break-Even Analysis

You can use break-even analysis to determine how much product or service you need to sell at a specific price to meet all costs. Break-even analysis is a mathematical formula that discloses how much output must be sold for the business to break even. Break-even is reached when the money coming in equals the money going out.

The break-even point in units is the number of units that need to be sold to cover all costs, both fixed and variable. Fixed costs remain relatively constant no matter how many products or services are produced or sold. These costs typically include rent, insurance, interest charges, and executive salaries. Variable costs fluctuate directly with production and sales levels, such as manufacturing labor, materials used in production, and sales costs.

Example – When starting his manufacturing company, Ralph used break-even analysis to consider prices. The fixed costs of the company were estimated at $50,000 and variable costs at $.20 per unit. With a $1 retail price per unit, the break-even point would be 62,500 units.

Reality

Break-even can only help you establish a range of profitable prices. The true price will be determined by how much the market is willing to pay.

Here's the formula Ralph used to determine the break-even point:

Fixed costs divided by (Sales price per unit – Variable costs per unit) = Break-even point

Fixed costs = $50,000
Sales price per unit = $1.00
Variable costs per unit = $.20
50,000/(1.00 – .20) = 50,000/.80 = 62,500

Ralph then asked, "Can I sell 62,500 units? What would happen if the price were increased to $2 retail with the same variable cost per unit of $.20?" So, he recalculated as follows:

50,000/(2.00 – .20) = 50,000/1.80 = 27,778

Then Ralph thought, "Would it be easier to sell 27,778 units for $2 or 62,500 units for $1?" Going through this evaluation several times helped Ralph consider an appropriate range of prices for his products.

Pricing Products

When pricing products, you must set the price at a point that will both contribute to profits and compel customers to purchase. You also need to cover the direct costs of the product and your operating costs.

The price a business establishes for its products is affected by several factors:

- **Amount customers will pay**. This amount is sometimes the hardest to determine, especially before starting a business. Customer surveys can be especially helpful in determining how much customers will pay.
- **Break-even point**. When the costs to operate the business are covered, any additional money is profit.
- **Competition**. The range of prices offered by the competition may limit the price.
- **Cost**. The price must adequately cover the cost of producing the product and provide a reasonable profit.
- **Marketing costs**. When large amounts of time are spent marketing and distributing a product, the price will generally be higher.
- **Marketing strategy**. You may add a premium to your price to appeal to a certain market.
- **Location**. Location will affect the price charged for a product.
- **Personal goals**. The price should contribute to overall profitability and help you reach your personal goals.
- **Uniqueness**. A higher price can be charged for a unique product with high customer demand.

Reality

In general, costs determine the minimum price you can charge, and the competition determines the maximum price you can charge. Ultimately, the benefit perceived by the customer establishes the real "value" of your product and what you can charge.

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Pricing Services

If you have designed a service with greater perceived value, you can charge a higher price. Experts report that professionals who charge fees in the upper range of the pricing bracket usually have a large client base and high profitability. Prices for services can be based on your reputation, years of experience, amount of competition, length of time as a service provider, and what the market will bear.

Consider non-billable time and taxes when setting prices. Include enough margin to pay federal and state income taxes and payroll taxes, including FICA (Social Security and Medicare taxes) and federal and state unemployment taxes. Be sure to use income tax rates based on your own individual tax situation.

Procedure for Pricing

A four-step procedure is recommended for setting prices:

1. Determine the relevant price range.
2. Evaluate price sensitivities.
3. Select a strategy.
4. Set the price.

Determine the Relevant Price Range

First, determine the reasonable range of prices in which a price must be set. In other words, know the following limits that apply to your product or services:

Price floor – The bottom of the range, the floor, is usually set by costs. Just how little can a business sell its product or service for and still stay alive? The costs determine whether you will stay in business or go out of business at the market price.

Market price – The market price is what a seller is willing to sell the product or service for and what a customer is willing to pay.

Ceiling price – Just how much can a product or service sell for? How high can the price be and still attract purchasers? That question is far more difficult to answer than the one concerning the price floor. When you find the answer, you have found the price ceiling for your product or service.

Reality ☑

Don't hasten to the conclusion that costs set prices; the market always determines price.

Evaluate Price Sensitivities

In most markets, customer demand is sensitive to the price. *Elasticity* refers to the degree to which a change in price affects the quantity of demand. If demand is very elastic, a lower price means the amount purchased increases significantly. If demand is inelastic, the amount purchased does not vary much with price changes. Understanding the elasticity of demand for a market helps entrepreneurs recognize opportunities in setting their prices.

The following major factors affect price elasticity and should be studied before deciding on an item's price:

- **Savings**. When a business sells something that saves the customer money, its price can be based on those savings.
- **Competitors' prices**. Competitive prices clearly affect your prices. In one way or another, competitors will influence how you set your price.
- **Negotiation**. In some industries, list prices are really just invitations to negotiate. In other industries, asking prices are firm. Prices can almost always be cut when the seller needs to do so.
- **Prices of substitutes**. Like competition, substitutes can limit how much a venture can ask for its goods. You should recognize the potential substitutes for your products or services and understand the effects the prices of those substitutes have on the market.

Reality ☑

Entrepreneurs must be careful to avoid the trap of negotiating away too much and working for less than they want.

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- **Role of complementary products or services**. Often an item is purchased as part of a package of products and services. The purchaser of an automobile for $40,000 hardly pays any attention to $2,000 for a navigation system. Yet a great deal of money could be saved by buying the GPS elsewhere. High profits can be made when selling products or services that are small in the total package.
- **Market's perceived values**. This factor is elusive because the value a customer assigns to a product or service is difficult to determine. In the end, what the product or service costs or what other products or services sell for matters less than what the customer will pay. The extreme of this situation is referred to as an *inverse-demand curve*. Normally, the economic theory of demand dictates that fewer goods will be sold as the price increases and vice versa. That theory is logical. But people are not always logical. If the quality of a product or service is not apparent, which is often the case, price is often the major element by which the customer determines the quality of an item. Buyers often assume that the highest-priced article is the best.
- **Distributors**. Often price must conform to the attitudes of product distributors. A computer manufacturer might have three price points, sometimes called price lines, for his computers: $995, $1,250, and $1,325. That manufacturer would go to market to buy components to fit into those price points. You should investigate where the middleman wants to price the products.
- **Governmental regulation**. Sometimes this regulation is helpful and sometimes it is not. Airlines might prefer to return to the time when the government set their prices, because they made more money then. Now that they must compete in an open market, many airlines cannot maintain profitability.

Tip

An inverse demand curve happens in the fragrance industry, where the best selling perfumes such as Chanel No. 5 are the most expensive. To many consumers, an exclusive image justifies the higher price.

Select a Strategy

Two basic pricing strategies exist: price skimming and penetration pricing. The question is whether to price at the top of the range or at the bottom of it. In many instances it makes sense to price somewhere between the extremes.

Price skimming – Some new ventures begin by trying to price skim. That is, they price their wares or service at the top of the relevant price range. The reasons for doing so are persuasive.

- **Guards against pricing mistakes**. This strategy guards against errors in estimating the cost of the product or service.
- **Keeps production low**. An entrepreneur may have good reason to want to limit sales, and thus production, in the early stages. Typically, much learning occurs early in a venture, and it is best done at low levels of activity. A low price may attract more activity than you can handle. This could lead to an unfortunate reputation for poor service just at the time the company is trying to impress the market.
- **Increases gross profits**. A price skimming strategy increases gross profits, which brings in money at a time when it is especially needed. Over time, this strategy maximizes total revenue for the item as each market segment is charged what it will pay. By starting high and progressively lowering price, each segment of the market buys in on the proposition when the price hits its value scale.
- **Inverse demand requires it.** Finally, a price skimming strategy is encouraged if an inverse-demand situation seems likely. To price low in the face of an inverse-demand curve is to invite disaster.

Reality

It is far easier to lower a price set too high than it is to raise one set too low.

The major disadvantage of price skimming is that it attracts competition. Other firms noting a high price can figure out the costs and offer goods at a lower price. High profits attract competition.

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Reality

Don't fall into the trap of lowering your prices at the inception of your business to try to gain market share. Raising your prices later and keeping the same customers is nearly impossible.

Penetration pricing – For the entrepreneur who thinks an item will have a good, long-run market and who doesn't have any way of restricting competition, setting a low price may be an effective pricing strategy. First, it will discourage competition. Second, the low price will facilitate market penetration. By getting into the market first and obtaining the best distributors, you help block competition from the market.

By pricing an item to penetrate the market quickly, you must be prepared to deliver the goods, a huge task for new concerns. Financial requirements for a penetration-pricing strategy are often higher than a new venture can afford.

Set the Price

Determining prices is a continual process, as you constantly reconsider all the relevant factors. Prices should never be static simply because they were previously set. After you have studied your marketplace, conducted your break-even analysis, and selected your pricing strategy, you still need to consider factors that will influence setting your price. As you continue to evaluate your price in the marketplace, keep in mind the following pricing best practices.

- **Motivate large orders with volume pricing**. Small orders are costly, and many are even sold at a loss. Entrepreneurs should study costs carefully to determine how much they can afford to reduce prices in order to encourage large orders.
- **Avoid price conflicts if possible**. Price wars are generally worthless and costly. If a price war develops, a firm should try to handle it in an indirect way and not try to match the competitor's price cuts penny for penny. Price cuts are too easy to copy.
- **Bundle products and services**. By selling related products or services together, entrepreneurs increase the amount of sales per purchase.
- **Offer tiered pricing**. Preferred customers receive better pricing, typically based on the amount purchased over time.
- **Bid a fixed price**. Instead of working for an hourly rate, service providers should give the customer a fixed-price bid for the job. This practice protects the customer and provides an incentive to work efficiently. The customer is paying for results, not time.
- **Disguise price cuts**. Price reductions should be disguised so that the previous price structure is not destroyed. A business may want to go back to an earlier pricing structure when more favorable market conditions return.
- **Price creatively**. Some of the biggest fortunes have been made by people who develop slightly different ways of pricing their goods to the market. Payment terms are one way of creatively pricing products or services.
- **Push high-margin products or services**. Different products or services usually have different gross margins. The high-margin articles are often more difficult to sell, so the marketing program will need to target these items.
- **Avoid making money on price and losing it on terms**. Some clever buyers will not argue about a price because they are fully aware that a business will stand firm. Rather, they will try to gain more favorable terms. For example, the seller pays the freight, delays billing, or allows a larger cash discount. You should carefully cost out any concessions.

Tip

If you are not happy with sales volume at the existing prices, you can consider cutting prices or providing incentives such as free goods with a purchase.

Tip

Your price list can be one of the most important marketing pieces your company distributes.

- **Use a price list**. Unfortunately, some businesses open without having a price list. When customers call asking about quantity discounts, the entrepreneur does not have the answer. Featuring quantity discounts on the price list can be a highly profitable marketing strategy. The price list is an unappreciated marketing tool. When a distributor, dealer, or industrial customer needs to buy a certain product or service, the price lists and marketing materials serve as an on-the-spot sales representative. A price list does far more than disclose prices. A price list should also clearly identify the products and services, inform the customer of cost per item and terms of sale, and tell the potential customer where the goods can be purchased.
- **Use discount pricing strategically**. When you need to move inventory or keep service employees busy, you may offer discount prices for a short period of time.

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Planning for Financial Success

STARTUP YOUR IDEA

6

Planning for financial success is a key responsibility for you as an entrepreneur because your business is likely one of the biggest investments of time and money you will ever make. To meet your financial goals, your business will have to realize an increase in value and generate a revenue stream. Your financial planning will help your company reach these goals.

When you assessed the feasibility of your business concept, you studied the marketplace and determined whether your concept could turn a profit. Now it's time to forecast how much profit you will make. By estimating future sales and then comparing them against operating expenses, you can project how your business will perform financially. Financial forecasting also allows you to assess the cash and funding needs of your venture.

Once your business is up and running, you can use financial statements and common ratios to monitor your company's financial health. Financial statements don't just report numbers; if you know where to look and what questions to ask, they can show you where to cut costs and boost profits.

In this module you will explore the use of financial statements to plan for financial success. You will also begin preparing a financial plan that projects sales, expenses, profits, cash needs, and sources of funding.

Outcomes

- Identify components of the Financial Templates.
- Project the financial condition of your business.
- Analyze and interpret financial statements.
- Use ratios to determine the relative financial status of your business.
- Prepare and use various financial statements, forecasts, and ratios to communicate with various audiences.

Action Steps (Find online tools at **fasttrac.org/resources**.)

- ❑ Decide which of the two Financial Templates (Templates and Glossary tab) is appropriate for the current stage of your business and begin entering data into the template you select. Complete as many of the worksheets as possible with the data you have at present.
- ❑ Review the Sample Financial Statements and Ratios (Guidelines and Sample Documents tab).
- ❑ Determine how much funding is needed to launch or grow your business at the desired rate.
- ❑ Draft the Financial Plan section of your Business Plan.
- ❑ Refine the Executive Summary section of your Business Plan as you draft other sections.
- ❑ Continue to refine your Elevator Pitch.
- ❑ Read Module 7: Building and Compensating Your Organizational Team.

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The Financial Templates

You can use either of the two FastTrac® TechVenture™ Financial Templates to save you hours of time in producing projected financial statements for your business plan. As you answer questions and enter data, the templates automatically prepare financial statements for you.

Tip

Familiarize yourself with the Financial Templates so you can use one of them easily in subsequent assignments. The time you spend now will make it easier to complete your plan later.

3-Year Financial Template – Consists of nine worksheets, linked to projected financial statements. After you thoroughly read the Introduction on the first sheet of the template, follow the instructions to complete various worksheets as appropriate.

6-Year Financial Template – Consists of six worksheets (where you enter data) linked to projected financial statements (quarterly and annual). This template also produces a variety of general and detailed cost and revenue reports and analyses. Extensive instructions for this template are included in the Templates and Glossary tab of the FastTrac® TechVenture™ Toolkit. It is recommended that you print out the instructions and read them thoroughly before you begin.

If something in any worksheet does not apply to your business, *don't delete it* – just leave it blank. Adding or deleting rows or columns in the template will corrupt the preset calculations in other sections of the spreadsheet.

If you would like to print out the instructions, worksheets, or financial statements, you must print them using the print buttons on each sheet (do NOT print directly from the Excel menu). If you are using the 3-Year Template, another way to print is to go to the last sheet of the template, which is the Print Options Worksheet.

It's important to note that the financials that will be produced by these templates are neither sufficient nor lawful for use as part of a prospectus. Depending upon the specifics of the funding sought and the sources sought, more detailed pro formas will most likely be prepared by your financial adviser.

You should include the projected Annual Snapshot from the Financial Template as part of the Financial Plan section of your Business Plan. Include additional financial statement projections and relevant worksheets in the appendix of the plan.

Financial Projections

Financial Plan

Your financial plan focuses on three primary outcomes: profitability, cash flow, and financial performance. First, you and your investors need to know that the business venture is profitable or at least has a potential for a profitable future. Second, you want to understand the cash needs of the venture and have adequate resources to meet these needs. Third, you and your investors want to know that the business is projected to perform financially as well as or better than others in the industry.

To make your financial projections, you need to amass accurate data, compile it in the appropriate financial projection worksheets, and make written assumptions based on these numbers.

Researching and Collecting Financial Information

One of the key steps in the business planning process is projecting a future financial position. Reliable financial projections are built on reliable assumptions. Assumptions, in turn, are based on researched facts.

When creating financial forecasts, the first place to look for information is at your own historical financial statements. Since history often repeats itself, investors will rely on these statements to validate future financial projections. Even if you plan on making significant

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changes, the information from past financial successes, and even failures, can provide a basis for making estimates.

Your industry can be another source for financial information. Many trade associations provide information about sales and expenses that you can build into your assumptions. Additional industry information appears in the databases of business magazines and journals. Articles about existing businesses may mention information about profits, expenses, or other financial data.

The Securities and Exchange Commission (SEC) has financial information about publicly traded companies online at **sec.gov/edgar.shtml**.

Studying financial statements from similar companies may also provide valuable information. Several publishers collect information from companies and compile it by industry. By using the industry classification codes – Standard Industrial Classification (SIC) or the North American Industrial Classification System (NAICS) – you can review the financial information of competitors within your industry. Information is organized by the size of the company and includes data concerning sales, expenses, assets, liabilities, equity, and financial ratios.

You can find the following financial statement studies at most large, public libraries or business libraries:

RMA Annual Statement Studies – Includes seventeen sections arranged by primary SIC code. They contain composite company financial data supplied by Risk Management Associates' member institutions.

Industry Norms and Key Business Ratios, Dun and Bradstreet – Includes financial information based on financial statements of various companies arranged by SIC code.

Almanac of Business and Financial Ratios, Leo Troy, Ph.D. – Financial information from IRS data on millions of companies.

Reality

Building financial projections without adequately researched financial assumptions is like building a house without a foundation.

Entering Data in the Financial Templates

The Financial Templates have the necessary components to create your financial plan. As you enter data in the worksheets, you will form your financial forecasts.

The following sections begin with a discussion of the forecasting process based on the methods used in the 3-Year Financial Template (including a reference to the appropriate worksheet). There is then an insert for each category noting how the 6-Year Financial Template differs and a reference to the appropriate worksheet.

FINANCIAL PLAN

3-YEAR TEMPLATE /// Set-Up

6-YEAR TEMPLATE /// Beginning Balance Sheet

Set-Up Company Information/Historical Balance Sheet

Basic Company Information – details such as the company name and whether the company is incorporated – is the starting place for developing your projections.

Existing companies will begin projecting future performance based on past history. Beginning balance sheet data is the starting place for incorporating existing assets, liability, and equity into the plan.

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Start-Up Funding and Expenditures

This worksheet pertains only to start-up companies. Calculating your start-up expenses will help you gain a more realistic picture of your funding needs and potential cash-flow problems in the initial stages of launching your business. Examples of possible start-up expenses include:

FINANCIAL PLAN

3-YEAR TEMPLATE /// Start-Up

- Filing fees
- Legal and consulting fees
- Accounting fees
- Salaries and wages: training/setup
- Benefits and taxes: training/setup
- Office supplies
- Business supplies
- Printing: business cards, stationery, brochures
- Pre-launch marketing or advertising

Ask yourself these questions to determine start-up costs:

- Where will the business be located?
- What size will it be initially?
- What will the office look like?
- What type of equipment will be needed, such as computers and copiers?
- What kinds of deposits will be required? For instance, how much will deposits cost for telephone, utilities, and first and last month's rent?
- What city codes must be complied with, and what are the costs involved?
- What types of governmental (local, state, and federal) business licenses will be required?
- What kinds of marketing costs will be incurred before opening the business for items such as brochures, advertising, stationery, and business cards?
- What are potential costs for recruiting and hiring initial staff?
- What type of staff training is necessary before launch?
- Is lab space needed? Is lab equipment needed?
- Is a sterile environment needed?
- What certifications need to be obtained before conducting research, developing the product, or starting the business?
- What types of furniture and fixtures will the office have?
- What types of signs will be required?
- How much of an opening inventory will the business need?
- How will the inventory be paid for?
- What types of supplies will be needed for cleaning, office correspondence, shipping, and packaging?

During the start-up stage, you may pay for certain operating expenses prior to opening your doors for business. These amounts are recorded as expenses on the income statement and are deducted from the revenue generated after start-up.

6-Year Financial Template – This template does not have a section for start-up expenses (many expense projections are based on headcount). Start-up businesses will enter initial capital outlays on the Capital Budget, or they may find the 3-Year Financial Template easier to use.

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Forecasting Future Sales

Sales will drive your cash flow and your profitability. You need to make a realistic estimate about how much money will be coming into the business. First, you should consider the total amount of sales you expect the first year in business. This estimate will be based on what the company has accomplished in the past, everything you have researched about what other companies have done, and what you think is reasonably possible. This approach is called the *top-down sales projection method*.

Second, you should take a more focused look at sales starting with the average sale expected per customer. Multiply the average sale per customer by the number of customers reasonably expected.

FINANCIAL PLAN

3-YEAR TEMPLATE /// Sales

6-YEAR TEMPLATE /// Total Available Market

From Real Entrepreneurs researching sales forecasts

After considerable research, Tom found that sales for a particular type of business in his industry rarely reached $800,000 the first year. Even though he thought he could sell $1,500,000, it did not seem reasonable to estimate sales over the industry amount. In reality, Tom was able to do more than the industry number, but only by $80,000.

Third, you should look at how much revenue must be received to cover costs. This number will determine the amount of sales necessary to cover all costs and return an adequate profit. This method is more mathematical than visionary. The goal is to cover costs. This process represents the *bottom-up sales projection method*. (Be aware that this method can lead to overestimating sales; make sure you can justify sales estimates with reasonable assumptions.)

A common mistake is to build sales estimates without considering the capacity of the business. If the projected staff can only produce a certain number of products or services, projected sales must reflect this number. Also, entrepreneurs must realize that working at full capacity may mean producing as little as 25–50 percent of the time, with the remaining time dedicated to raising money, customer relations, marketing, and administrative duties.

6-Year Financial Template – Sales in the 6-Year Financial Template are projected based on a percentage of the total available market (TAM).

Writing Sales Assumptions

Determining demand for a product or service before a business opens is difficult. The accuracy of your sales estimates reflects the quality of your research on the industry and the market.

Sales projections should be based on the facts you uncovered about the business venture and industry. These facts should be written into assumption statements that support the financial projections. Assumptions provide invaluable information to the reader of the plan, help readers understand the financial projections, and serve as a reminder to you about the facts used as a basis for projections.

The assumptions should explain how you predicted your sales forecasts and growth. Variances among months should also be explained (for example, seasonal variations, number of sales days in the month, heavy marketing, repeat business, new product or service release, or expansion plans). The assumptions should substantiate sales forecasts by including facts and figures.

Tip

Assumptions may need to be very detailed to provide adequate information for the reader. In the 3-Year Financial Template, you must condense the assumptions to fit on one line. Any detailed information should be included in the appendix of your business plan.

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FINANCIAL PLAN

3-YEAR TEMPLATE
///
Headcount

6-YEAR TEMPLATE
///
Staffing Inputs

Headcount

Investors want to know how many people will be hired, in which functional area they will work, and their compensation. It is also good accounting practice to allocate those employees by the area in which they work. This allows a more accurate financial report.

Employees perform work for the business in three major departments or functional areas: General and Administrative (the front office), Sales and Marketing, and Production (which could include Research and Development). Production employees are those directly involved in making the product or providing the service. Only those employees whose costs to the company will be included in the cost of goods sold will be entered in the production department. Consult with your accountant if you are unsure about how to categorize certain employees.

In the Headcount worksheet of the 3-Year Financial Template, you project the number of employees in each department, their salaries, taxes, and benefits.

6-Year Financial Template – Entries for headcount are made on the Staffing Input worksheet in four categories: Administrative, Sales/Marketing, Research/Development, and Manufacturing. A base salary for each employee or job title is entered along with a percentage increase amount for each year. Increases in headcount are entered on a quarterly basis.

Tip

Avoid duplication. If you enter your payroll costs into production, do not include those costs in any other category.

Cost of Goods Sold and Inventory

One of the primary goals of the financial plan is to determine profitability. Only with adequate profits can debts be repaid, inventory purchased, and future growth funded. Profits are what is left over after the expenses of business have been deducted from the sales generated in the business.

Net profit or Net loss = Sales – Expenses

The two main categories of expenses are cost of goods sold (or cost of sales for services) and operating expenses. When the cost of goods sold is subtracted from sales, the result is the gross margin (also called gross profit).

Gross margin = Sales – Cost of goods sold

Gross margin is a critical number to understand because it reflects the amount of money left to cover the cost of operating the business (operating expenses).

FINANCIAL PLAN

3-YEAR TEMPLATE
///
Inventory

The Inventory worksheet focuses on cost of goods sold and inventory. Many businesses have inventory costs. Some service businesses do not. When a business venture includes the sales of products, you need to understand how this inventory will affect the business. In some businesses, such as a website design service, the focus may be on providing a service rather than selling a product. Some service companies, however, have a product component, such as a computer training company that sells training materials and other learning aids.

Inventory is the term accountants use to describe what is available to be sold, merchandise that is being held for sale in the normal course of business, or materials in the process of production or held for production. Inventory is an asset because it maintains value. At any given time, assuming a customer wants it, inventory can be sold to regain cash. In a manufacturing company, inventory goes through several stages before it is ready to sell. It begins as raw materials and is fashioned into work-in-progress before it is considered finished goods ready for sale.

Many businesses resell already produced products. This practice is called merchandising. *Merchandise inventory* is the stock of goods that the company has on hand at any given time. Whether a company has manufactured inventory or has purchased merchandise inventory for resale, planning for these inventory costs is critical to cash flow.

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From Real Entrepreneurs

planning for inventory costs

Backyard Solutions produces and sells wooden garden sheds called Yard Closets. Every month, Backyard Solutions purchases raw materials. These include wood, metal hardware (such as hinges, door handles, and hooks), and production supplies (nails, screws, and glue). While the raw materials are being built into Yard Closets the inventory is called work-in-progress. The completed garden shed is called finished goods inventory. Because of the time needed to produce the sheds, accept orders, ship the products, bill customers, and receive final payments, Backyard Solutions has to pay for raw materials three months prior to receiving cash from sales of the sheds. This time lapse drains cash flow. With proper planning, however, Backyard Solutions has enough cash reserves to cover the delay. The company also has to control the costs of producing each shed. The retail price of the shed must cover the direct cost of production plus the operating expenses of the company, and also provide an acceptable profit.

Raw materials – If you are going to manufacture or assemble products to sell, you must plan for raw materials inventory. This task can be difficult. You must answer many questions, including the following:

- How many types of raw materials does the product use? When many types of raw materials are used, the costs to keep or warehouse those materials grow.
- How much raw material needs to be on hand? Purchasing larger quantities to obtain quantity discounts can help increase profits, but it can be hard on cash flow.
- How quickly can raw materials be turned into finished goods ready to sell? Consider ways to streamline the production process. This efficiency can help free up inventory to be sold more quickly, which will bring cash into the company faster.

Production costs – In addition to the raw materials, producing the finished goods usually costs money. These production expenses become part of the total cost of goods. Following are some common production expenses you may incur:

- **Freight-in and trucking/shipping costs** – Represents a direct cost of having raw materials for production or products for resale.
- **Insurance** – Included only if the insurance applies to the production facilities.
- **Payroll expenses** – This may be the highest production cost. All personnel who play a direct role in producing inventory or supervising the production process should be included. Payroll expenses include salaries, benefits, and employer-paid payroll taxes.
- **Rent and utilities** – Includes only the costs of the production facilities, which could also be a major portion of the production expenses. If the production area is shared with office or retail space, the amount used directly for production should be considered. The rest will be included in the operating expenses.
- **Repairs and maintenance** – Should be taken into account if production equipment must be periodically repaired or maintained.
- **Rework** – Should be considered if manufactured products need rework from time to time. This figure should include the costs invested to make products salable.
- **Subcontracting** – Occurs in companies that subcontract out a portion of the production process.

6-Year Financial Template – Cost of Goods Sold and Inventory projections are built from Direct Costs per unit projections and any Inventory Buildup on the Base Assumptions Worksheet.

FINANCIAL PLAN

6-YEAR TEMPLATE /// Base Assumptions

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From Real Entrepreneurs the cost of rework

Southside Electronics Company found a new vendor that could supply an essential part for 50 percent less per piece than the previous supplier did. But after a few months, the company discovered that payroll expenses (in the form of overtime) were increasing. Why? The new piece had a failure rate 25 percent higher than the last one. That meant more rework. This discovery required the management to decide which cost the company more, the item or the labor expense.

FINANCIAL PLAN

3-YEAR TEMPLATE /// Operating Expenses

6-YEAR TEMPLATE /// Base Assumptions

Operating Expenses

Operating expenses include all of the expenses of operating the business. These expenses are necessary to support the selling, administrative, and general operations involved in the business venture. The three functional areas of operating expenses are Research and Development, Sales and Marketing, and General and Administrative. These three areas are responsible for the *burn rate*, which refers to how much cash a company consumes day in and day out. For a pre-revenue company, the burn rate is primarily consuming investor capital; hence, investors watch this measure very closely.

If your business is past the start-up phase, you can determine Operating Expenses by reviewing historical financial statements and doing a mental walk-through of the monthly costs associated with operating the business. Some entrepreneurs build faulty projections by merely taking a yearly operating expense estimate and dividing that number by 12. For cash flow purposes, it is critical to evaluate the actual costs planned in the month in which they are expected to be paid.

Research and development (R&D) – Research regarding existing and new products or services is continual. You may have salaries for researchers, materials to be purchased, equipment testing, contracts to be paid, and perhaps competitors' products or services to be purchased and evaluated. These costs must be budgeted. R&D is the most important and largest expense for many life science companies. Due to the long timeline needed for clinical trials and FDA approval, these expenses can grow large.

Sales and marketing – Some of the operating expenses of the venture are necessary to generate sales, such as sales employees, advertising, and other marketing expenses. These expenses are called *selling expenses*. Selling expenses alone can tell you a lot about how much it costs to generate revenue.

General and administrative – Some costs are necessary to support the overall operations of the company but cannot really be linked directly to generating sales, such as the costs of support employees, dues and subscriptions, legal fees, accounting and bookkeeping expenses, rent, utilities, and insurance. These expenses are called *administrative or general expenses*. Reviewing these expenses can tell you how much it costs to support the administrative activities of the company.

Expense assumptions – Operating expenses should be estimated based on facts uncovered about the business concept and industry. These facts should be written into assumption statements that support the expense estimates. The assumptions provide invaluable information to readers of the plan to help them understand the financial information. The assumptions also serve as a useful reminder about the facts used as a basis for the projections.

Reality

Determining the projected operating costs for the intended business is an important reality check. While you hope that sales will take off once the door is open for business, the reality is that several months often lapse before a business generates enough sales to cover all of its expenses, let alone make a profit. How much money will be needed to help cover these initial months of operation?

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The operating expense assumptions should explain how each expense category was estimated. Also, the variances between each of the months should be explained (for example, seasonality, number of sales days in the month, heavy marketing, repeat business, new product or service release, and expansion plans). The assumptions should substantiate expense estimates by including facts and figures. Assumptions may need to be very detailed to provide adequate information to the reader and there may not be sufficient room to fit on the one line provided within the Financial Template. If that is the case, you should include these as supporting documentation in the appendix of the business plan.

6-Year Financial Template – Operating Expenses are based on percentages. For example, marketing expenses (variable promotions) are based on a percentage of sales. Expenses such as travel and office supplies are based on the number of employees.

Tip

Investors need to be comfortable with the way a company plans to spend their money. High founder salaries, overly elaborate facilities, and other expenses that may not clearly advance the company's core business will be challenged prior to the investment. If not checked, these items often become a source of contention during the course of the relationship.

Capital Expenditures

Capital expenditures are assets purchased by the company. These assets may be used to generate revenue or may be purchased to help organize and operate the company, such as a computer and customized software. No matter what the intended use of the capital expenditure, it is considered an asset.

FINANCIAL PLAN

3-YEAR TEMPLATE /// Capital Budget

Capital expenditures are recorded as assets on the balance sheet. An asset is an item that retains value. In other words, the item could be sold to recapture some of the cash spent to obtain it.

The following are several examples of capital expenditures:

- Equipment
- Furniture
- Vehicles
- Buildings

Capital expenditures – assets – are always recorded in the company records at the purchase price. This amount is considered its *book value*. The book value is important because it helps the entrepreneur track the uses of cash. The book value, however, does not indicate the real value, or market value, of an asset. The market value is the amount that someone outside the company will pay for the asset.

Understanding Depreciation

Depreciation is an accounting method used in creating financial statements. It is used to adjust the value of an asset to reflect more accurately the current state of the assets in the company. Depreciation reduces the value reported for each asset on a yearly basis.

Tip

Talk with your accountant to determine the right depreciation method for ongoing operations of your company.

When an asset is purchased, its value is determined by how much it cost the company. The value of an asset generally declines every year the asset is owned or used. This decline occurs because the asset's usable life has been reduced by one year. The book value is reduced to reflect this decrease in usable life.

Another important reason for depreciation is called the *matching principle*. The matching principle says that the expenses involved in generating revenue must match (or be recorded in) the time period in which that revenue is realized. In other words, when a sale comes in, all expenses associated with that sale should be recorded (or expensed) at the same time. Another way of looking at this principle is that an asset is fully expensed during the period it is being used or consumed. Then, when its useful life is over, the asset will be fully depreciated and have a book value of $0.

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Asset depreciation methods vary. The objective of some methods is to lower tax liability. For others, the objective is to match depreciation expenses with the revenue generated by the use of the asset. For planning purposes, straight-line depreciation is most common. It is easy to calculate; the value of the asset is evenly distributed over its useful life.

Other Asset Purchases

Common assets are furniture, equipment, and inventory. Money can be spent on other types of assets as well. Consider the following:

- **Prepaid expenses.** Often in a business, certain expenses must be prepaid. That is, the money is spent in advance of the service being received. Insurance is a common example of a prepaid expense, which is an asset. Items of value, assets, are shown on the balance sheet. Prepaid expenses are shown on the balance sheet and are expensed as the value diminishes.

From Real Entrepreneurs **prepaid expense**

Swank Technologies pays up front for an insurance policy that covers the business for a six-month period of time. If the policy were cancelled, a portion of the premiums would be returned; therefore, it has value as an asset.

- **Security deposits.** Sometimes a security deposit must be paid, such as to a utility company or a property manager. These security deposits are usually held in an escrow account and are returned in the future. Therefore, they maintain value as an asset even though they are intangible.
- **Land.** Land is a unique asset because it tends to appreciate in value rather than depreciate. Therefore, land is excluded from the depreciation methods discussed previously. When land is purchased, it is recorded at the purchase price and maintains this value on the balance sheet, even though its market value may increase.

Payouts to Owners or Investors

Another cash outlay includes money paid to owners and investors as compensation for their involvement in the company. This payment can take many forms.

In sole proprietorships, the owner can receive a check at any time for compensation. Therefore, the owner is not on a regular salary. This payout is called an owner's draw because money is drawn out from the company. This amount is not an expense or an asset. It is considered a reduction in equity.

FINANCIAL PLAN

6-YEAR TEMPLATE /// Base Assumptions & Capital Budget

Depending on the legal structure, an equity distribution is called by different names. Corporations call it a dividend. Limited liability companies call it a distribution. It can be called a payout or draw. No matter what it is called, it amounts to a reduction in equity.

6-Year Financial Template – Several Capital Purchases are based on headcount and are entered on the Base Assumptions Worksheet. Additional purchases and depreciation estimates are entered on the Capital Budget Worksheet. Companies are assumed to be Corporations. Payouts are in the form of salaries to owners or executives. Dividends or returns on investment are not contemplated (investment return is assumed to come at the exit strategy or sale of the business).

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Financial Statements

Financial statements are an important tool in assessing the financial health of your business. You can use financial statements to monitor the financial performance of the company against projected budgets. This analysis first requires a certain level of understanding about the accounting system.

The Accounting System

Financial transactions occur every day in business. Each time a bill is paid or a sale is made, a financial transaction takes place. These financial transactions can't be interpreted unless they are arranged into a useful format. The transactions must be recorded in a way that easily provides the information you need to make good financial decisions.

The accounting system categorizes the transactions into accounts, such as Utility Expense, Consulting Revenue, or Bank Loan. Accounts are grouped into the following categories:

Balance Sheet Categories	Income Statement Categories
Assets	Revenue
Liabilities	Expenses
Equity	

These accounts are then arranged into several reports, mainly the income statement, balance sheet, and historical cash flow statement or cash flow report.

The Accounting Equation

Languages are built on rules, and it's always helpful to learn those rules in order to speak the language. This information provides a basis for understanding the language. The same principle applies to understanding accounting – first you need to learn the rules.

One of these rules is called the accounting equation. This equation provides the basis for accounting procedures. It states that the value of the assets must equal the value of the rights of the creditors (liabilities) plus the rights of the owners (equity). Therefore, even though the company may have acquired assets, both owners and outsiders probably have rights to those assets.

Assets = Liabilities + Equity

Each time a transaction is posted into the accounting system, it affects at least two accounts. When transactions are done properly, the accounting equation stays in balance. For example, when a cash sale is made, both the cash account and the sales account are increased. The accounting equation reflects the increase in assets (cash has value) and the increase in equity (the owner's rights to the assets).

The Big Three Financial Statements

Financial statements are as essential to business management as wrenches to a machinist. Does a machinist only have one wrench? Do all the wrenches work the same way? No. Different jobs require different tools – whether wrenches or financial statements – and the knowledge to choose the right tool for each job.

Financial statements are a reflection of management decisions over a period of time. Every day, business decisions have an eventual, if not immediate, impact on the financials of the business. Financial statements are the tools you need to examine and forecast the ability of your company to achieve its financial goals.

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The three financial statements you'll use most often are the income statement, the balance sheet, and the cash flow report. The income statement reflects the company's profitability, and the balance sheet reflects its solvency. The cash flow report identifies the cash that flows in and out of the business.

Samples of these three documents are available in the FastTrac® TechVenture™ Toolkit, under the Guidelines and Sample Documents tab.

Income Statement

FINANCIAL PLAN

3-YEAR TEMPLATE /// Monthly Income Statement & Year-End Income Statement

6-YEAR TEMPLATE /// Financial Statements & Income and Retained Earnings

The income statement shows how much money a company made or lost for a given period of time. This amount is called *net profit* or *net loss*. The income statement also shows the amount of revenues (sales) earned by the company and the expenses that were incurred to generate those revenues.

Some people consider the income statement to be a sort of report card because it communicates whether the company's business strategies are working. In addition, the income statement is largely a tax document developed according to IRS regulations. The company's tax obligation is determined by the profit or loss on the income statement.

Two categories of accounts are shown on the income statement – revenues and expenses. Cost of goods, one of the primary costs of doing business, is the first expense to be deducted from revenues. The balance left is called gross margin. The rest of the expenses of doing business are deduced from gross margin to identify the net profit or net loss of the business.

From Real Entrepreneurs **projected income statement**

When Roger and Jayne developed a Business Plan to start a biomedical waste disposal service, they projected an income statement based on industry averages. They found out during their first six months in business that the average transaction was considerably higher than the industry average they used. Actual expenses for hazardous waste disposal were more than they had projected. They adjusted their projected income statement based on this information and used the new projected statement as a budget.

Balance Sheet

FINANCIAL PLAN

3-YEAR TEMPLATE /// Year-End Balance Sheet

6-YEAR TEMPLATE /// Financial Statements & Balance Sheet

The balance sheet is a reflection of how much the company owns, how much is owed to the company, and how much the company owes to both creditors and owners. It shows the company's assets, its liabilities, and the owner's equity. In other words, it shows the accounting equation. If the company owns a building (an asset), it probably still owes money to the bank (a liability), and of course, the company may have some equity in the building as well (equity).

On the balance sheet, the assets are divided into current assets and fixed assets. Current *assets* include assets either currently in the form of cash or expected to be turned into cash within one year. Examples include cash, accounts receivable, and inventory. *Fixed assets* are not considered current because they are not expected to be converted into cash within a year. Fixed assets include plant and equipment, and intangible assets, such as patents.

Liabilities are divided into current liabilities and long-term liabilities. Equity is the difference between assets and liabilities, and it represents the owners' rights to the value of the company.

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Cash Flow Report

The two primary financial objectives for any business are profitability and cash flow. *Profitability* is the ability to generate income. *Cash flow* is the ability to pay obligations as they become due and to build cash for future growth.

The cash flow report charts the cash that flows in and out of the business each month. The primary source of cash is sales. Sales, as reported on the income statement, do not always result in positive cash flow. A prime example is when customers do not pay on a timely basis. The revenue is recorded, but the cash has not been received.

Other differences exist between the cash flow report and the income statement. Significant cash outflows may not be recorded on the income statement. Inventory, payments to the owners of the business (dividends or draws), cash inflows from borrowings from lenders, and other activities are not recorded as sales or expenses. The differences between these two reports are shown below.

Income Statement	Cash Flow Report
Revenue – All cash and credit sales are reported.	Revenue – Only cash sales and money received from prior billings are reported.
Operating Expenses – All expenses incurred, including non-cash-related accounts of amortization and depreciation, are reported.	Operating Expenses – Only paid expenses are reported; therefore, amortization and depreciation are excluded.
Other Non-Operating Costs	Other Non-Operating Costs – Debt repayments, owners' draws, investor and stockholder payments, and equipment purchases are reported.

The monthly cash flow report projects a company's ability to meet its cash obligations on a monthly basis. **The cash flow report is perhaps the most important supporting document in the business plan.** It is also the most important tool that management has for contemplating and controlling the financial affairs of the enterprise.

FINANCIAL PLAN

3-YEAR TEMPLATE /// Cash Flow

6-YEAR TEMPLATE /// Financial Statements & Cash Flow

Tip

The concept of cash flow is similar to an individual's checking account. In the checkbook you record money flowing into and out of your checking account.

From Real Entrepreneurs

averting a cash flow crisis

Duane Johnson had a three-year-old company that specialized in environmental clean-up technology. Each year Duane's sales grew and by the third year, sales had reached over $1,000,000. Duane's background in sales helped stimulate this growth. Even though the company was growing, it seemed to have a consistent and growing need for cash. Halfway through the third year Duane realized that he needed help. He hired an accountant, for the first time, and had extensive work done to analyze his financial position. The accountant recommended a working capital loan to compensate for the increasingly tight cash flow. According to his projections, Duane's company would have been bankrupt within a year because of its lack of cash to pay for ongoing expenses and financial obligations. Duane closely analyzes his financial statements now, especially the projected cash flow report.

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Monthly Cash Flow Report

The cash flow report starts with the cash balance at the beginning of the month. To this amount is added the expected cash received through sales, collections on account, loans, or equity contributions. This sum comprises the total cash available. All items paid for with cash during the month are considered equity contributions. This sum comprises the total cash deducted from the total cash available to identify the cash balance expected at the end of the month. This amount must always be above zero. In fact, it should have a healthy cushion to absorb variances in actual cash transactions.

Historical Cash Flow Report

Another report of cash flow must be mentioned even though it is not used as part of the financial projection process. It is the historical cash flow report. This statement reports the changes in account balances that have ultimately affected the cash account. These changes are described as increases or decreases in each account. For example, if the accounts receivable balance decreases over a certain period of time, one can assume that an increase in cash is the result, because the money due the company (accounts receivable) was probably paid. An increase in expenses would result in a decrease in the cash balance.

Reality

A business can operate for a long time at a loss – many do – but no company can operate without cash. No cash…no business.

The goal of the historical cash flow report is to identify how cash flowed through the company during a certain period of time – usually a year. This statement can be difficult to understand and even more difficult to create. Since its purpose is to analyze historical use of cash, it is not used in this program. It is still a valuable financial statement and may be required by external investors, accountants, and bankers.

Financial Ratios

FINANCIAL PLAN

FINANCIAL TEMPLATES
///
Ratio Analysis

Financial statements are projection and management tools and should be used by management to analyze the business. Ratios use information from these reports to reveal the financial status of the company. Ratios allow you to judge the company's relative performance compared to others in the industry and to its previous performance. Ratios also help you see relationships or correlations between financial items on different statements.

By measuring performance in percentages rather than raw numbers, ratios allow you to evaluate the company's performance over a period of time, to compare the company to other companies of different sizes but in the same or similar business, and to plan for the future. Calculating financial ratios should become part of your regular financial reporting process. The ratios can then be assessed at the same time as the other financial reports.

The four types of ratios are profitability, liquidity, risk, and efficiency. Samples of all of these ratios are available in the FastTrac® TechVenture™ Toolkit, under the Guidelines and Sample Documents tab.

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Profitability Ratios

Profitability ratios help you evaluate the profitability of your business. By comparing certain numbers, these ratios can help identify elevated expenses, inefficient operations, and profitable margins. Although dozens of ratios exist, an understanding of a just a few simple profitability ratios will get you started.

Gross Margin

How it is calculated	Gross income / Net sales
What it measures	The profit a company enjoys on the goods it sells after direct costs are subtracted.
What it tells	This rough measurement of overall profits – gross margin – tells companies how well they are controlling direct costs. If costs are increasing faster than sales, then the direct costs are out of control. Owners of the business would want to do some research to determine why the costs are increasing.

Operating Margin

How it is calculated	Operating income / Net sales
What it measures	A company's operating profitability and efficiency.
What it tells	Operating margins show how well a company is managing its overhead costs. If the company's gross margins are rising while its operating margins are falling, management knows immediately that the company is having difficulty controlling indirect costs.

Net Margin

How it is calculated	Net income / Net sales
What it measures	Profitability.
What it tells	The net margin shows how many cents on each dollar of sales is profit. A falling net margin may signal problems in controlling costs or prices.

Return on Assets (ROA)

How it is calculated	Net income / Total assets
What it measures	Profits against assets.
What it tells	ROA can be used to compare the profitability of companies of different sizes. Assets remain fairly stable, so an increasing ROA indicates greater profitability, while a decreasing ROA indicates less profitability.

Return on Equity (ROE)

How it is calculated	Net income / Total equity
What it measures	Income against stockholders' equity.
What it tells	This ratio tells whether the company is a good investment. As ROE increases, the company becomes more attractive to potential investors. Generally, improving net income will also improve shareholders' equity as the profit will become retained earnings.

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Liquidity Ratios

Liquidity ratios measure the amount of cash or investments that can be converted to cash to pay expenses and short-term debts. Liquidity ratios determine your ability to meet current liabilities. The two commonly used liquidity ratios are the current ratio and the quick ratio.

Current Ratio

How it is calculated	Total current assets / Total current liabilities
What it measures	Whether the company has enough liquidity to pay its short-term obligations.
What it tells	This ratio tells whether enough cash is available to pay the bills. Theoretically, a current ratio of 2.0 is preferred for most companies. It is important to watch this ratio closely. If it begins to go down, then a company's cash position may erode quickly. The quickest way to increase cash is to improve sales.

Quick Ratio

How it is calculated	(Current assets – Inventory) / Current liabilities
What it measures	Whether the company's assets minus inventory will provide enough liquidity to cover its short-term obligations.
What it tells	This ratio is also referred to as the acid test. It shows whether the company has enough cash to meet its short-term obligations. A 1.0 ratio is usually preferred. If this number is going down, then sales are not strong enough to meet daily cash obligations. Quick cash management intervention is required.

Adjusted Quick Ratio

How it is calculated	(Current assets – Inventory) / (Current liabilities – Deferred Revenue)
What it measures	Whether the company's assets minus inventory will provide enough liquidity to cover its short-term obligations.
What it tells	This ratio is more often used by technology ventures as a more accurate test than the more traditional Quick Ratio because of their frequent substantial deferred revenue. It shows whether the company has enough cash to meet its short-term obligations. A 1.0 ratio is usually preferred. If this number is going down, then sales are not strong enough to meet daily cash obligations. Quick cash management intervention is required.

Risk Ratios

Risk ratios measure what portion of the company belongs to people outside the company including how much money the owners could lose to creditors.

Debt Ratio

How it is calculated	Total liabilities / Total assets
What it measures	The proportion of assets that are financed by creditors' funds (debt).
What it tells	A debt ratio of more than 1 means negative net worth. In other words, if a company could sell all of the assets for full value, it would still not have enough money to meet all its obligations.

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Debt to Equity Ratio	
How it is calculated	Total liabilities / Total equity
What it measures	How much the company relies on debt versus equity financing.
What it tells	The more a company's debt exceeds its net worth, the less likely it is to obtain financing. As this number increases, the company's ability to obtain financing decreases. Additionally, the owner's position is weakened and those that own the debt (banks, large suppliers) can establish control of the company.

Efficiency Ratios

Efficiency ratios tell how well business is being conducted. These ratios measure how quickly inventory moves, how well the company collects its accounts receivable, and what kind of sales a company's assets generate.

Inventory Turnover Ratio	
How it is calculated	Cost of goods sold / Inventory
What it measures	Measures how often inventory turns over.
What it tells	This ratio shows how efficiently inventory is being managed. High turnover is generally good. However, high turnover may also indicate that a company does not have enough merchandise and is losing sales.

Days Sales Outstanding (DSO)	
How it is calculated	Accounts receivable / (Net sales / 365)
What it measures	Average number of days it takes customers to pay their bills.
What it tells	This ratio shows how effective a company is at collecting money and how much float it must finance. DSO also shows how effective the company's credit policies are. Remember, the tighter the credit policy, the lower the DSO ratio. That policy, however, may also reduce sales.

Investment Turnover Ratio	
How it is calculated	Net sales / Total assets
What it measures	The amount of sales generated by the assets.
What it tells	The turnover ratio shows how efficiently a company uses its assets. The measurement shows how quickly and how often an asset (piece of machinery or investment) pays for itself. If an older piece of equipment works more slowly but pays for itself three times in a year, while a newer model takes two years to pay for itself, the owner must reflect on whether the payoff is worth the greater investment.

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Ratio Analysis

When using financial ratios to analyze a company, you should answer the following questions:

> **Tip**
>
> Only make decisions based on ratios calculated with consistent and realistic numbers.

- **How consistent and realistic are the numbers used to calculate the ratios?** If the numbers have been tallied in an inconsistent manner, are not realistic, or are not up-to-date, the ratios will be of no value.
- **How closely do the individual ratios compare with company policies?** Company policies should be established to help the business meet financial goals. For example, most entrepreneurs set a standard for the number of days they will allow on credit terms. If they allow customers a Net/30 payment schedule, then their Days Sales Outstanding should be near 30 days. This number would confirm that the company is following the policy to collect on receivables within 30 days.
- **How closely do the individual ratios compare with other companies within the industry?** A very valuable use of a company's ratios is to compare them to other businesses in the same industry. By doing this, much can be learned about ways to improve overall profitability. For example, you may find that your company is in a very small minority of companies with a slow inventory turnover; you are keeping inventory longer than most other companies within the industry. Since this practice is a poor use of cash, you would need to evaluate the reasons and make improvements in your inventory policy.

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Building and Compensating Your Organizational Team

7

Professional investors consider the management team to be one of the most important factors in determining the attractiveness of an investment. One of the world's great venture investors and company builders (Compaq, Lotus, Sun Microsystems, Amazon.com), Joe Doerr of Kleiner, Perkins, Caufield, and Byers, says:

In the world today, there's plenty of technology, plenty of entrepreneurs, plenty of money, plenty of venture capital. What is in short supply are great teams. Your biggest challenge will be building a great team. There's enormous change under way in every facet of the world. Some is technology driven, some is market driven. All that change creates unprecedented opportunity. But, to take full advantage of those opportunities, focus on teams. Teams win.

The first step in building a winning team is recognizing where people can use their skills and experience to do the best job. Understanding the unique roles of executives in high-tech industries will help you place people in the right positions. Once you have your personnel in place, you want to create a work environment that will foster innovation, commitment, and a positive team spirit.

In this module, you will assess the strengths and limitations of your founding team. You will also examine the founder's changing role, how to compensate team members, how to motivate and support team members, and what investors want to see in a team.

Outcomes

- Evaluate the founding team's ability to fulfill various management roles and responsibilities.
- Plan to build a management team that can meet the business's needs at all stages.
- Create a basic equity compensation plan to recruit and retain top management employees.
- Determine ways to recruit and hire motivated employees.
- Identify ways to create a positive working environment.

Action Steps (Find online tools at **fasttrac.org/resources**.)

- ❑ Draft the Management and Organization Plan section of your Business Plan.
- ❑ Outline a compensation and stock option plan and an organizational chart.
- ❑ Refine the financial assumptions in your Financial Template and update the Financial Plan section of your Business Plan.
- ❑ Bring your financials as-is to the next session for review by professional financial advisers.
- ❑ Refine the Executive Summary section of your Business Plan as you draft other sections.
- ❑ Continue to refine your Elevator Pitch.
- ❑ View Noam Wasserman's *The Founders Dilemmas* webcast at **fasttrac.org/authors**.
- ❑ Read Module 8: Protecting the Business and Your Intellectual Property.

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The Management Team

BUSINESS PLAN

Management and Organization Plan
///
Management Team

There is no set rule as to the exact structure of the management team. Instead, there needs to be a blend of the right people in the right roles at the right time to take best advantage of the entrepreneurial opportunity. Some critical management roles include:

Scientific Founder – The researcher or engineer who generates the idea or ideas that become(s) the early technology base for the company. These creators often become the first chief scientific officer or research and development director of the company, but may also find a position in the company (as consultant, board member, or otherwise) that does not require them to become a line manager, allowing them to focus on creative projects for the benefit of the company.

President or **Chief Executive Officer (CEO)** – The senior driving force for the business. The person who provides the leadership to make things happen, including creating the company's strategic vision and generating the resources to make that vision come to life. This is the person with overall responsibility for success or failure of the company. In technology and life science companies, the CEO and the scientific founder are often the same in the early stages of the company. As the company grows or raises capital, a more experienced CEO is recruited.

Chief Scientific Officer (CSO) or **Director** or **Vice President of Research and Development (R&D)** – The person who creates and implements the plan to develop a new technology product or service to the point where it is ready to be brought to market. Initial CSOs or R&D directors often are the scientist and/or engineers who first discovered or created the product or service.

Tip

Someone with the necessary skill and experience must make certain that the financial records accurately reflect what is happening in the business and meet IRS requirements. New laws and financial reporting rules have made the role of CFO highly structured and visible.

Chief Financial Officer (CFO) or **Vice President or Director of Finance** – This watchdog, usually a certified public accountant or bookkeeper, looks at the financial records of the business, comparing actual to budgeted figures and preparing reports for the management team. This position is often filled by the company's accountant or a part-time person in the early stages of the company. As the company grows and starts to generate sales, a CFO is often brought in as a full-time position.

Vice President of Marketing or **Marketing Director** – In a company that has a product or service ready for the market, this person uses marketing skills and industry knowledge to develop and implement the right plan to effectively penetrate the targeted markets.

Vice President or **Director of Business Development** – Analogous to the marketing director, but in a company centered on a technology platform or a product or service not yet ready to come to market, the business developer uses knowledge of the industry to generate strategic partnerships for the company. These partnerships can be based on the company's technology platform or can address other strategic needs, such as cooperative product development or marketing.

Vice President or **Director of Sales** – The sales director develops and manages a team of internal salespersons, manufacturer representatives, or a combination of the two, to sell to the target markets identified by the marketer.

Manufacturing Director – The person responsible for actually making the product to be sold into the marketplace.

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Organizational Structure and Organizational Charts

When writing the Management and Organization section of your Business Plan, you will want to highlight the strengths of your management team and show the responsibilities and relationships among individuals. Give an overall description of the management structure and how it will evolve as the company matures.

Management Background – Highlight critical, relative past accomplishments of each key management team member, such as: has started or grown a technology company, has introduced technology to new markets, has access to important customers, or can provide unique technological or scientific insight. Summarizing the skills and experience of your management team will allow you to recognize the strengths and weaknesses of your organization. You may see that you have gaps in your company's knowledge and skills base, and need to fill these gaps with appropriate personnel.

Organizational Structure – Describe management positions and link qualifications to the position. Highlight responsibilities and key performance metrics; describe critical management needs and plans for addressing those needs.

Reality

Organizational charts show that there is someone in charge of every important function of your company. Investors like to see that you have thought out exactly who will be doing what.

Organizational charts are especially helpful in visually illustrating the hierarchy within an organization. Typically, organizational charts are made up of boxes connected by lines. Each box represents a unit of the organization, with the top box being the division or person that has the most responsibility or power. Organizational charts should be limited to 10 or 15 boxes to minimize reader confusion, and similar elements should be combined into one box if necessary.

Board of Directors and Advisory Boards

At every stage of a company's life, you will need input from both inside and outside the company.

BUSINESS PLAN

Management and Organization Plan
///
Board of Directors / Advisory Board

Board of Directors

If a company is organized as a corporation, it must have a board of directors. The board is the managing agent for the company. It makes big-picture decisions and elects officers. In many states, one person can be the sole owner of the stock in a corporation and the sole director on the board. A full board of directors, however, has the advantage of bringing together ideas from many minds. The board of directors may include one or more key members of the management team (most often the President and/or CEO), investors, and independent outside advisers.

After you have established a board of directors, concentrate on using that board to its fullest potential. Hold regular board meetings in addition to the mandated annual meeting with specific agendas, outcomes, and purposes. In the early stages, company boards often meet monthly (more frequently if circumstances demand). As the company matures, the schedule may ease so that meetings are held every two months. While some mature companies have meetings on a quarterly basis, meeting that infrequently can make it hard for directors to maintain sufficient contact with the company to fully live up to their fiduciary duties as directors. This is especially true given the new rules and regulations and heightened expectations facing corporate directors.

Regardless of the formal board meeting schedule, it is essential that the President and/or CEO interact with the directors between board meetings for ongoing counsel on the issues facing the company. Calling on the experience and expertise of board members individually cannot be to take any sort of formal action by the Board as a corporate body, which may only be done at formal board meetings in accordance with the bylaws. Do not be afraid to discuss difficult issues with the board. It exists specifically to offer guidance and direction.

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Advisory Boards

Another way to gain valuable advice is to recruit one or more boards of advisers. An advisory board can be a group of business and technical experts who provide occasional advice to management but who are not full-time employees of the company. Advisers generally do not have to commit the same amount of time to the company as do directors; nor do they bear the same legal responsibilities. As a result, it is often possible to get talented people involved with the company who could not otherwise make the commitments necessary to be a member of the board of directors.

Entrepreneurs use advisory boards in many ways, but the ultimate goal is to get ideas, advice, and direction from experts. Advisory board members may be scientific or technology experts, bankers, marketing consultants, industry experts, financial consultants, customers, or other established entrepreneurs. They may meet monthly, quarterly, or as needed by the entrepreneur. They are usually compensated in some way, although compensation is generally relatively small – a meal during the meeting, a small payment per meeting, or in some cases, equity in the company. Few advisers join an advisory board for the money. Many established entrepreneurs attribute their success to the help that they received from mentors and advisers, and they feel that serving on an advisory board allows them to give back by helping someone else.

Reality ☑

The Sarbanes-Oxley Act of 2002 set stringent standards for a public company's directors or officers by imposing fines and even prison terms for corporate wrongdoing. In addition to these measures, Sarbanes-Oxley also raised the likelihood that civil damage claims will be brought against public company directors and officers. While most early-stage companies are not public, the standards set by Sarbanes-Oxley in the public arena will likely begin to find their way into the private arena as well. This means you should take seriously the choice of people to be on the board of directors, and that those who accept a seat on a board of directors must be fully apprised of expectations and responsibilities.

Selecting Board Members

It is important to select the right people to serve on your board. This can often be a difficult process, but it is critical that time and attention be paid to this part of organizing the board as it can make or break its effectiveness and be a leading indicator of the company's long-term viability. With that in mind, it is critical to identify potential board members who complement your own skill set while bringing additional capabilities and experiences to the table.

Fred Wilson, Managing Partner at Union Square Ventures and prolific blogger on a number of entrepreneurial and startup related topics (check him out at **avc.com**), serves or has served on a number of boards and offers the following advice for everyone building a board – especially for those who are building or already have a bigger, perhaps public, company – and need to fill that board with good people.

- Avoid "big names." For the most part, they are useless.
- Select people who will attend each and every meeting, who will pay close attention to the business.
- Select people who have an affinity for your business, who understand your challenges and your opportunities.
- Avoid putting someone you can control on your board. In tough situations they will have a fiduciary duty to do what's right and you won't be able to control them when it matters most to you.
- Don't let conflicts get in the way of selecting the ideal board member. Conflicts will be disclosed and can be managed. Many times the people who will understand your business best are conflicted in some way. There are ways to deal with this problem.
- Make sure to have an experienced accountant/auditor on your board and have them run the audit committee. That is no place for amateurs.

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- Make sure to have at least two or three CEOs of comparable companies on your board. Make sure they are on the comp committee. Compensation issues are best handled by people who understand the talent market.
- Select people who have the time to do the job right. Being a board member is a job. It's not a retirement perk. If someone cannot commit to attend each and every meeting and to spend at least several hours a week on your company, they are not the right choice.
- Select people who will get along with each other. The very best boards I am on are friendly social active groups. Serious business doesn't have to be stilted and formal. It can and should be fun.
- Above all else, look for great judgment and ethics.

Board Governance. Most boards outline a set of bylaws that specifically lay out responsibilities and powers. Bylaws should clearly state who has the ultimate authority for making decisions about the company, whether the advice of the board is binding, and whether things like compensation or employment decisions are the board's responsibilities or fall with the company's management team. The bylaws should also include term limits for board members – by rotating board members on and off of the board, you ensure an always fresh perspective.

As for size of the board, business professionals say there isn't one answer that will suit all companies. Most recommend having a body between seven and 15 members, but the important thing is to make sure to find the right balance for the size of your company. If the body is too small, the board won't have a diversity of opinion; too large and it could get unwieldy and difficult to organize.

You should also be sure to document how new board members are selected and added to you board. Options may include selection by management, election by members of your organization or by members of your existing board.

Preparing for Meetings. As you prepare for your board meetings, Fred Wilson goes on to suggest some tips to set the right tone:

- Always send the agenda and board materials at least one day in advance of the meeting and expect/demand that the members read it before coming to the meeting.
- Try to do a dinner the night before at least four times a year with all the directors attending. Don't bring senior management to these dinners. They should be for board bonding which is key to a well-functioning board.
- Bring the senior management to the board meetings. They should know the board and the board should know them.
- Do the meetings first thing in the morning when people are fresh. No laptops and no blackberries other than the laptop that drives the presentation if one is needed.
- Do not spend the meeting going through the materials slide by slide. People can read, expect that they will.
- Do spend the meeting reviewing where the business is, where it needs to go, and what strategic decisions need to be made to get there.
- Remember that the board works for the Company as much as the management works for the board. Expect board members to do what you need from them and manage them to make sure they do.

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Management Transition Roles

As companies launch and grow, their management needs may change. Early in the planning process, you should focus on the management team needed to grow the enterprise and on the roles that team members will play.

You must also think candidly about the role you will play as the business evolves. Founders and inventors often do not have the right training or skills to lead a company out of the early stages of development. You may need to hire management with complementary talents and skills, such as a seasoned chief executive officer or chief financial officer with experience running a full-fledged entrepreneurial company.

Investors bet on the jockey, not the horse. A management team with experience in starting businesses is ideal at the beginning of a venture. However, some investors will invest in a stellar concept as long as they can bring in their own people to manage the company. If you seek investor capital, you should be willing to be replaced as chief executive officer of your company.

Reality

Although the entrepreneur often plays the roles of both creator and driving force during the business start-up, this situation cannot continue as the venture grows and the demands of each role escalate. As the venture continues to grow, roles will differentiate. For example, the CSO will continue to drive the technology and product development while most of the CEO's and CFO's time will be spent raising funds.

Consider the following stages a business may go through and the types of management team members needed at each stage:

Initial conception stage – During the idea stage, the entrepreneur identifies the range of possible business opportunities and then determines which one to pursue. The entrepreneur often plays all roles of the management team to get the business up and running.

Start-up stage – The business is launched. Cash is usually tight in this stage, and entrepreneurs struggle to survive, modify their products or services, and experiment with market-penetration tactics. By this stage every venture must have both a creator and a driving force. The same person, usually the entrepreneur, often plays these roles during this time.

Early stage – In the early stage, the company may attract its first tier of professional investors and, if appropriate, begin to land customers but struggle to increase sales. The entrepreneur begins to rely on other management members and key personnel. The business may need a great deal of cash to fuel research and development projects. This need may require expertise in fundraising that can be secured through the employment of a business consultant or seasoned CEO who will work with the company for an equity position. If you have a product company, this stage may be a good time to engage a professional marketer to implement a strong marketing plan for the company.

Growth stage – In product companies at this stage, the markets are established, but the company experiences continual cash flow crises. New investors, customers, and staff are added quickly. The entrepreneur must rely on an organizer to begin taking over the operations of the company. Also, a sales professional is critical to lead the sales efforts of the marketing plan. Manufacturing companies need to hire a production manager. Although technology-platform companies experience many of the same growth challenges, the focus is not on product marketing and sales but rather on further development of the platform and on generating opportunities for strategic alliances.

Rapid growth stage – When the business outpaces industry growth rates and has established itself as a viable, ongoing concern, it is in rapid growth. A full professional management team should now be in place, including a CFO.

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Maturity stage – The company has established its position within the marketplace. It experiences increased competition and saturation of the market. The entrepreneur focuses on how to support the growth of the business so it will continue to be healthy and increase in value. The management team works together to fulfill the strategic plan of the company.

Innovation or decline stage – The final stage of any business emerges when it must innovate or lose market share. All levels of the organization must be actively involved in innovation.

Management Team Compensation

Business owners need to pay managers and executives enough to attract qualified applicants and retain talented employees. Most start-up entrepreneurs cannot afford to compete with large enterprise salaries, so they must be creative to entice prospective employees to join the company.

BUSINESS PLAN

Management and Organization Plan
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Compensation and Ownership

Some highly skilled employees will willingly trade a higher salary for more flexibility in their work schedule. Today's employers are learning to be open-minded and more flexible regarding employment policies and working hours. New strategies include providing for job sharing, working at home, using temporary help and contract labor, and hiring the disabled or retired seniors.

Due to a scarcity of cash, employees are frequently rewarded with stock options and salaries that slightly lag those of more established companies. Be prepared to give up a percentage of the company to the initial management team. You should emphasize that stock options will potentially be far more valuable than cash compensation. Stock warrants and options are a popular way of attracting, motivating, and retaining employees because the company's performance determines the employees' eventual level of compensation. Linking compensation, including salary increases, to the company's performance is another way to motivate employees.

Whatever a company pays its employees, additional benefits such as health insurance, life and accidental death insurance, short-term and long-term disability, and a 401(k) plan (excluding stock options and the like) can add as much as 30 percent to their base salary. In the very early stages, companies frequently cannot afford to offer benefits. Benefit packages should be spiraled up gradually and consistently with the company's ability to pay. Start with the employees' basic needs, such as health care, before adding other benefits, such as a 401(k) plan.

Entrepreneurs should determine the total cost of the compensation package and adjust the salary offer accordingly. However, when determining salary, it is important to recognize the labor supply in your particular industry. For instance, if software developers or process development scientists are in great demand, you may be forced to pay more competitive wages and offer significant stock options in order to attract qualified candidates.

Recruitment and Selection of Employees

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Management and Organization Plan
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Recruitment and Selection of Employees

As your business grows, you will most likely need to add more employees to your organization. Your success will depend on your ability to put together a team of highly qualified people who are committed to the goals of your firm.

For many entrepreneurial businesses, hiring capable, self-motivated employees provides a competitive advantage. Prospective hires should have not only great technical skills but also the motivation to work with the entrepreneur to make the business a success.

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The same employees who thrive in a university lab or large corporation may not feel comfortable in an entrepreneurial setting. Look for individuals who:

- Embody the company's values.
- Work hard and work smart.
- Have the specific skills required.
- Learn quickly when new skills are needed.
- Are able to work with little supervision.
- Take initiative to make things happen.
- Are comfortable in the uncertainty of an entrepreneurial situation.
- Are flexible regarding business needs and changing requirements.

Tip

Without an entrepreneurial organization of productive people, your business will only grow as far as your own abilities can take it.

Entrepreneurial companies frequently look appealing to employees seeking an escape from the limitations of large corporations. However, success in a large corporation does not always ensure success in an entrepreneurial environment where resources and support staff are limited, employees wear multiple hats, and risks of job security are different in nature. Extra care should be paid to ensure that the candidate fully understands the expectations prior to an offer.

From Real Entrepreneurs select the right employees

Many entrepreneurs have experienced difficulty when they've hired people who have experience only in formalized business structures. Judd was hired by an entrepreneur after having served 10 years in the accounting department of a large multinational corporation. Judd wanted a change of pace, and the entrepreneur thought Judd's experience could help refine her own accounting systems. Judd did good work for about three months, but he hated the chaos and uncertainty of the small-business environment. He gave notice and started searching for a position in a more structured environment.

Ewing Marion Kauffman, the founder of Marion Labs, offered his own personal twist to the talent equation with this advice to entrepreneurs: "Hire people who are smarter than you! In doing so, you prevent limiting the organization to the level of your own ability… and you grow the capabilities of your company." Kauffman also said, "If you hire people you consider smarter than you, you are more likely to listen to their thoughts and ideas, and this is the best way to expand on your own capabilities and build the strength of your company." Resist the urge to hire people just because they share your personality traits or background. You benefit from having different points of view to challenge yours and to develop your company into the future.

Recruitment

Recruiting qualified candidates can be one of the most difficult challenges for a life sciences or high-tech start-up company. Finding qualified candidates today is difficult because of

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global competition, changing work force demographics, and workers' values. Finding workers with the required technical skills to fill your positions is even more difficult due to the limited applicant pool. And finding workers who are willing to work outside the safety net of an established organization can be even more challenging.

Where to Find Qualified Workers

Just as you created a marketing plan to identify and communicate with your target market, so you need a hiring plan to pursue your target workforce. You need to define your market and learn about their work styles: What skills and behaviors are you looking for in ideal candidates? Where do they currently work? What are their interests? What have they achieved in the past? How do they work best?

Next, you need to identify the most efficient recruiting channels to reach your target market. If you sell computer chips for wireless audio systems, you wouldn't advertise in your local paper; you'd communicate directly with a company that produces wireless audio systems. Likewise, if your target employees don't read print media, then it is not an efficient use of your resources to place a classified ad in the newspaper.

Some proven recruiting channels for high-tech companies are:

Employee referrals – More and more frequently, companies are turning to their employees to find qualified candidates. Encouraging your employees to refer candidates to you can be a very reliable way to find the right people for the job. Employees rarely risk their own reputations by referring unqualified people. Many companies offer cash rewards for successful employee referrals.

University networks – For many high-tech and life sciences companies, universities can provide a pipeline of experts. Maintain your contacts with researchers and professors in your field. They may be able to point qualified individuals in your direction.

Placement agencies – If you don't have the time or resources to recruit on your own, placement agencies can be a successful way to fill positions. However, such agencies are fairly expensive – recruiters usually charge a fee ranging from 15 to 30 percent of the placed employee's annual salary. Weigh the pros and cons of calling on their expertise. Are your time and effort better spent in growing other areas of the business while they work on growing your staff? Do you have the expertise required to find the best candidates?

Investors – Many investors, especially those with a vested interest in your success, can recommend experienced individuals to fill positions in your management team.

Electronic listings – Using the web to find candidates is by far the hottest trend in recruiting these days. The advantages include access to an enormous pool of applicants, cost-effectiveness, and rapid posting and response. Disadvantages include restricting the applicant pool to Internet users, which may screen out certain segments of society, and the potential for an overwhelming number of unqualified, casual applicants. While you should post your job listings on the Internet, you don't need to blanket every job board. Target your efforts. Post on trade association sites and places where you know your target audience looks for appealing opportunities. It is advisable to use this method in combination with other recruitment methods to be sure to obtain a diverse applicant pool.

Tip

Post job opportunities on your company's website.

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Writing Classified Advertisements

Placing an advertisement on the Internet is a fairly cost-efficient way of reaching a large number of people. Here are some tips for writing a classified advertisement.

In order to attract qualified candidates for the position, your want ad should feature:

Headline – Usually the job title.

Job Information – A line or two enthusiastically describing the primary job duties, otherwise known as the "essential functions" of the job.

Company Information – Convey some sense of your organizational culture and values as well as what you do ("Fast-paced, results-oriented, growing").

Qualifications – Specify very carefully the level of education and experience required, as well as any needed skills. Remember that all qualifications should be clearly needed to excel on the job. If the relationship between the requirement and successful performance on the job is unclear, it may not be an appropriate qualification.

Compensation and Benefits – It is not advisable to actually list a specific salary, hourly wage, or benefit package. Leave yourself some flexibility down the road and simply state that pay and benefits are "excellent" or "competitive."

Contact Information – Make it as easy and inexpensive as possible for applicants to apply for your job, and give them alternatives such as fax and e-mail.

Conclusion – State that your company is an Equal Opportunity Employer.

Avoid any mention in your advertisement of preference for gender (for example, outside *salesman* or duties include manning an information desk) or age (for example, *young* or *recent* college graduates). You may only seek individuals of a specific gender or age in the rare circumstance when these characteristics are a bona fide occupational qualification, or BFOQ, such as when a production company is looking for a man to play a male role in a movie. In addition, be sure that requirements such as college degrees are truly necessary to perform the essential functions of the job, as requirements such as these tend to screen out some applicants.

Avoid blind ads that do not identify who you are. They are usually a turn-off for applicants. On occasion, you may have a compelling reason to do otherwise – if, for example, for morale or competitive reasons, you do not want anyone to know you are seeking applicants for a position.

How to Attract Qualified Workers

It is especially difficult to recruit qualified tech candidates. They are in high demand – and they know it. Attracting potential workers to your business is like marketing your product or service to prospective customers. You need to find out what is important to them and then demonstrate how your company can meet their needs. Exploit the uniqueness of your flexible, start-up organization. What can you offer the employee that more established companies can't?

Today's workers aren't always looking for the same thing out of a job that earlier generations did. They are seeking:

Quality of life – Work-life balance is especially important to a new generation of workers. In order to meet their needs, you may need to have daycare arrangements or flexible work rules, including job sharing, working at home, and flex-time. In the recruiting process,

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demonstrate to them that you are willing to help them meet their life goals as long as they are willing to serve your company's goals.

Challenging work and learning opportunities – Workers today don't build their résumés by documenting steady growth in an organization. Instead, they are looking to expand their skills, build their list of achievements, and learn new things. Working in a start-up organization will give them learning opportunities that they probably wouldn't have in a larger organization. Use this fact to your advantage when recruiting talented, ambitious workers.

Good management – The old saying is still true that employees join companies, but leave managers. At whatever level of the organization they find themselves, workers want managers who are clear in their expectations and supportive in meeting their goals. A job candidate won't want to work for a manager who didn't even listen to their concerns in the job interview.

Compensation – Rarely do workers list compensation as the most important element when choosing a company. With the other benefits your organization can provide to an employee, don't let your inability to offer the highest salary in the industry inhibit your recruiting process. On the other hand, keep in mind that you don't want to miss an opportunity to hire an excellent candidate because you aren't willing to share your success.

Hiring

Interviewing and hiring employees can be difficult and time-consuming. You can gain confidence in your final decisions by following some of these hiring guidelines:

Applications – Before interviewing applicants, have them complete and sign an employment application form, even if they have a résumé. As a legal document, the application form must conform to state and federal regulations. For example, it generally must specify if employment with your firm is at-will, which means that employment can be terminated at any time. The application form must give the employer permission to verify information submitted by the prospective employee. Human resources consultants can assist you with developing legal applications.

Tip

Résumés are not legal documents. Applications are. Many résumés contain false information that cannot be verified. Information on applications should be verifiable.

Screening – Save time conducting interviews by screening applicants beforehand using information provided on the application form. Look for unexplained breaks in employment, omissions on the application, career changes, and reasons for leaving other employers. Salary history, professional affiliations, and overall professionalism in completing the form can also give clues about the applicant.

Interviewing – Many entrepreneurs rely solely on a one-hour, traditional interview to assess the candidate. They assess technical skills and ask the candidate superficial questions or provide hypothetical situations for the candidate to solve. Don't rely solely on the interview as the critical factor in hiring. Research shows that human beings aren't very good at making judgments about people from interviews.

Determine what you are looking for in your staff and develop interview questions in advance. Develop behavior-based questions that ask interviewees to tell you how they have responded to real workplace situations. For instance, "Tell me about a time you disagreed with your manager," or "Tell me about a time when you realized you did not have all the resources needed for a project. What did you do?" *Behavioral interviewing* is based on the concept that recent or longstanding behaviors are most likely to repeat themselves. If the candidate has not demonstrated necessary behaviors such as flexibility, multitasking, strong initiative, and effective interpersonal skills, there is a greater risk of that person not succeeding in the entrepreneurial environment.

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Here are some steps to help you think through many of the key aspects of interviewing prospective employees. Remember that when you are interviewing candidates, they are assessing you, too. Make sure that you present yourself and your company in the best light.

Know the purpose of the interview.
- Are you there to recruit?
- Are you determining qualifications?

Know the job.
- Prepare a job description with the position's requirements, accountabilities, and competencies.

Plan your questions ahead of time.
- Ask the same questions of each candidate.
- Follow a structured, systematic approach.
- With multiple raters, establish who asks what.

Review the resume before the interview.

Set the stage for the interview.
- Prevent interruptions.
- Arrange seating to minimize barriers.
- Explain the process and that you will take notes.
- Ask for clear, concise answers to questions.

Stay job-related.
- Avoid factors unrelated to the job.
- Watch out for gut-feel reactions.
- Don't let a candidate take you on a forbidden path.

Listen more, talk less.
- Allow the candidate to do most of the talking.
- Keep your personal experiences out.
- Avoid rescuing a candidate.
- Listen for inconsistencies and omissions.
- Give the candidate time for questions.

Maintain control.
- You set the pace for the interview.
- Keep the candidate focused.
- Slowing the pace can help put a candidate at ease.
- Inform the candidate of next steps.

Take copious notes.
- Do NOT write on the resume.

Evaluate after, not during the interview.
- Rate all the interviewees' answers in a systematic way. Add up the scores.
- Use this scoring in combination with other information.

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Performance Interviewing – One of the best ways to determine whether applicants can do the job is to ask them to demonstrate that they can do it. Have writers take writing tests, have sales people simulate a sales call, and have managers make difficult case-study decisions.

References – Always check all references and see whether additional research can corroborate the information given. Studies show that about 30 percent of résumés contain some kind of false information. People who overstate or falsify their job qualifications may cause future harm to an organization or may be poor employees. A criminal background check can provide critical information about a prospective employee. A number of firms provide background checks on employment applicants for a fee.

The law prohibits businesses from asking potential employees certain questions or personal information on applications. Check with your attorney or human resources consultant about permissible questions. In general, questions should relate to the applicant's ability to perform the job. Document all reasons for not offering a position to an apparently qualified applicant. Maintain hiring records for at least seven years.

Independent Contractors

For many start-up companies, the idea of having a workforce composed of independent contractors can be very appealing. Besides the cost savings of not paying employment taxes, workers' compensation, or overtime wages, there is also the fact that independent contractors don't have expectations of employee benefits such as health insurance, a 401(k), or paid time off. It is very important, however, to evaluate the functions of the people who work for you and the amount of control you have over their work product to make sure that they are appropriately classified as independent contractors. The government defines independent contractors much more narrowly than many business owners do.

Both the Internal Revenue Service (IRS) and the Department of Labor (DOL) are concerned about the proper classification of the employee/independent contractor. The IRS is concerned that taxes are paid. The Wage & Hour division of the DOL is concerned as to whether the position is truly that of an employee and whether minimum wage or overtime considerations are being met.

Unfortunately, there is no black-and-white test for this classification. The following guidelines are based on the factors considered by the IRS in determining the correct classification. Significant judgment is required when considering the context of each situation. The presence of one or more of these factors does not necessarily qualify the person as an independent contractor and NOT subject to the control of an employer.

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Guidelines Based on IRS Factors

EMPLOYEE	INDEPENDENT CONTRACTOR
INSTRUCTIONS	
Employees may receive directions regarding when, where, and how to perform the work.	Independent contractors perform the job in their own way, with few, if any, instructions.
TRAINING	
Employees often receive training on how to perform the job.	Independent contractors are responsible for their own training. They use their own methods to perform the work and do not receive training.
INTEGRATION	
Work performed by an employee is usually a regular part of the employer's business.	Their services are usually a separate part of the employer's business and not integrated into the business.
SERVICES RENDERED PERSONALLY	
Employees do not hire people to perform work on their behalf.	Independent contractors are able to assign work to others and do not always perform the work personally.
HIRING, SUPERVISING, AND PAYING ASSISTANTS	
An employee may supervise someone, but that person is paid by the employer.	Independent contractors are able to hire, pay, and direct others to assist with their work. Payment is made by the independent contractor, and they are responsible for the work of the assistant.
CONTINUING RELATIONSHIP	
Employees are usually hired with no predetermined end point.	Independent contractors have no expectation of continued work.
SET HOURS OF WORK	
Employees can be directed to work during hours set by the employer.	Independent contractors can work the schedule they determine to complete the job.
FULL TIME REQUIRED	
Employees can be required to devote their work time to one employer only. In some cases, secondary jobs may be allowed, with one employer's needs being primary.	Independent contractors cannot be required to devote all of their time to one company.
LOCATION WHERE SERVICES ARE PERFORMED	
Employers can determine where the work is to be performed.	Independent contractors choose where they work. It may be in their own office.
ORDER OR SEQUENCE SET	
An employer has the right to control and direct the order and sequence of work.	Independent contractors have the right to determine the order and sequence of their work.
ORAL OR WRITTEN REPORTS	
Employees may be required to provide oral or written reports on the status of work.	Independent contractors are not required to submit reports updating the status of work.

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Guidelines Based on IRS Factors (continued)

EMPLOYEE	INDEPENDENT CONTRACTOR
PAYMENT BY THE HOUR, WEEK, OR MONTH	
Employees are usually paid by the hour or for a weekly, bi-weekly, semi-monthly, or monthly salary. Payment for hours of work frequently suggests employment. Paying vacation, benefits, workers' compensation, withholding taxes, and Social Security suggest an employment relationship.	Independent contractors are usually paid for a lump sum, for the quantity of work performed, or based somewhat on how much an independent contractor has to pay to complete a project. Note that failure to withhold taxes and Social Security, or to provide workers' compensation coverage or benefits, does NOT, by itself, qualify for independent contractor status.
PAYMENT OF BUSINESS AND TRAVEL EXPENSE	
Employees' business and travel expenses are paid directly or reimbursed by an employer.	Independent contractors may pay their own business and travel expenses without reimbursement.
FURNISHING TOOLS AND EQUIPMENT	
The tools, materials, and equipment necessary to perform work are provided and controlled by the employer.	Independent contractors normally determine and provide the tools, equipment, and materials needed.
SIGNIFICANT INVESTMENT	
Employees generally have little or no investment in the business.	Independent contractors have substantial investment in their business, with ongoing overhead expenses, for example.
REALIZE PROFIT OR LOSS	
Employees do not typically have the opportunity of profit or loss on a project. They are typically paid by the hour or by salary for services performed.	Independent contractors can typically realize profit or incur loss. They are not necessarily paid by the hour.
WORKING FOR MORE THAN ONE COMPANY AT A TIME	
Employees typically work for one employer at a time and may be restricted from working for other employers.	Independent contractors often work for multiple employers simultaneously.
MAKING SERVICE AVAILABLE TO THE PUBLIC	
Employees do not provide services directly to the general public except when offered by their employer.	Independent contractors advertise and offer their services directly to the public.
TERMINATION	
Employees can typically be terminated at any time.	If the work meets the contract terms, premature termination may be a breach of contract.
LIABILITY	
Employees may quit at any time without liability to complete a project.	Independent contractors may be liable for completion of a project. By quitting, they may be in breach of contract.

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A Positive Work Environment

Once you have your management personnel in place, your next step is to create a team that is committed to the goals and objectives of your company.

Employees recognize and appreciate your effort. When an organization's leadership demonstrates respect and effort in connecting to employees, sharing successes, and recognizing high performance, employees usually respond with tremendous effort and commitment.

To create a positive work environment, you must set your vision, communicate it clearly to employees, establish a learning environment that gives employees the freedom and support to meet the objectives of the vision, and reward and celebrate employees when they reach the vision's goals.

From Real Entrepreneurs **create a positive environment**

One entrepreneurial organization developed an environment where the employees would follow the CEO even in the middle of a funding crisis. They worked long hours at low wages and enjoyed a high level of camaraderie. However, another organization developed an environment of entitlement. Employees stayed only because they were highly compensated. Performance was low, and employees were miserable. The difference? The first CEO demonstrated respect for employees, helped them grow, explained how their efforts were connected to the overall performance of the organization, and rewarded performance. The second CEO was forced to buy the employees' loyalty.

Management and Organization Plan
///
Communication

Communicating Your Values

Your company's core values provide an important basis for making decisions. These values are a set of ideas or beliefs that you have about how the business will operate, its role in the community, and employee support.

You communicate your values through your personal vision as defined in Module 1. The vision outlines your lifestyle, professional, and financial goals. Building upon this framework, you can establish the particular criteria that form values for the entire company. When you present these values in a clear way, the people in the business will know how and why decisions are made.

Creating Clarity in the Organization

In his analysis of the successful growth of Ewing Marion Kauffman's Marion Laboratories, Gerald W. Holder attributed much of the strength of the organization to an entrepreneurial leadership team that focused significant energy on creating clarity throughout the workforce.

This focus enabled people to operate with a common understanding and purpose. It required leaders to establish clarity for themselves first, and then to implement a major communications and reinforcement effort to create it for the organization. Holder identified the following four clarities as critical to the success of Marion Laboratories:

Clarity of purpose – It is important that people know why the organization exists. People want to be part of an organization that is the first or best at something, does what no other organization has ever done, helps people solve problems, or helps people lead better, safer, healthier, or more productive lives.

Tip

When describing the vision, strategy, and objectives, be sure to clarify words that are subject to interpretation. For instance, "significant results" could be interpreted differently.

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Clarity of direction – With careful thought and communication, people know where they are headed with the business. They know the kinds of skills and talent they need to bring to the company.

Clarity of structure – People need to know their roles and responsibilities as well as those of others in the organization. This knowledge and confidence allows them to concentrate on their own job and give it their full energy while recognizing the interdependence of the employee team.

Clarity of measurement – Knowing how to measure the results in a business is essential. The entrepreneur should explain to people within the organization what is being measured, how it is being measured, and why it is being measured.

All too often, companies spend significant time and resources crafting a catchy mission statement that is not easily translated into objectives for day-to-day contributions by employees. In fact, many studies have found not only that employees did not know what their organization's vision was, but that senior management frequently disagreed about what the vision, strategies, and objectives were.

Providing Appropriate Reward Systems

Rewarding all employees appropriately for their efforts will contribute to a positive work environment. Effective reward systems include all forms of monetary compensation such as salaries, stock options, and performance bonuses. They also include less tangible motivators such as recognition, job assignment, growth and learning, additional responsibility, trust, authority, and autonomy.

BUSINESS PLAN

Management and Organization Plan
///
Employees Reward and Incentive Plan

Many people will be motivated by money – at least for a period of time. Many other people are motivated more by the work they do and the environment in which they work than by the money they earn. The ability to learn new skills or advance in the company may attract quality employees.

Reward systems should be closely linked to individual performance as well as organizational performance. Establish clear objectives for individual performance and hold employees accountable to meet these goals. Be sure to take time to document employee success as well as opportunities for improvement.

Recognition is a key factor in motivating employees. All employees want to be recognized for their abilities, hard work, and contributions. Demonstrating your appreciation for a job well done is a great way of inspiring performance.

Keep in mind that employees want to be treated as distinct and separate individuals. A reward system that works for one person may not work for another. Responding to individual needs will make it possible to create conditions in which an employee's dreams will mesh with yours.

Tip

Make sure people have access to the information that will allow them to measure their own performance. This freedom will cultivate healthy productivity.

From Real Entrepreneurs **provide appropriate rewards**

A computer manufacturing company had many hourly employees who received low- to mid-level salaries working on the assembly line. It was hard to give any substantial wage increases because higher labor costs made the product too expensive. The owner was always coming up with different ways to make employees happy without continually giving wage hikes. One of his most successful incentives was changing to a four-day work week, which gave employees a three-day weekend.

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Creating a Learning Environment

In order to build a scaleable, innovative organization, founders must be open to ideas from all sources. It's important to allow others to participate in decision-making, to recognize that successes can be born of many failures, and to share – not hoard – knowledge.

Any given outcome can be achieved a number of ways. In a learning environment, an entrepreneur encourages associates to experiment, to look for and try different ways to improve a task or solve a problem. When entrepreneurs acknowledge that they do not know all of the answers, the team is free to help find solutions. Such an attitude also sets the stage for creative change when an experiment is unsuccessful.

Organizations that create a learning environment recognize that learning is not finite. Continuous learning and, hence, change, must be embraced as a part of the culture.

Tip

When a project seems to drag on, be sure to take time out for a "temperature read." Recognize the achievements already met, acknowledge the remaining challenges and tasks, and remind employees of what they are working toward. This step can reduce some of the pressure and stress that inevitably build.

Celebrating the Victories

Remember to celebrate victories with employees. When you complete projects or reach certain milestones, your celebration can acknowledge the employees' efforts and re-energize them to achieve the next milestone. This recognition is important when you remember that you have asked employees to work toward your vision, not their own.

Good people want to be associated with a winner, yet employees are rarely given an opportunity to celebrate the victories of the business as a whole. When a company makes a big sale, secures a new account, or gets a new project from an important customer, everyone should celebrate. A wise entrepreneur celebrates not only individual achievements but also corporate successes. Employees who pursue one project after another, with no recognition of the completion of a project, will lose motivation.

From Real Entrepreneurs

celebrate the victories

Johnsonville Engineers regularly celebrates its victories – large and small. Victory parties are scheduled monthly to review the successes reached during that period by teams and individuals. One of the keys to success in celebrating the victories has been to make each event different in size and style. "We don't want anyone to begin expecting a certain kind of victory party," says entrepreneur Kim Lee. "So, we change the theme monthly. Sometimes we hand out cash gifts, sometimes gag gifts. Either way, we always celebrate and have fun."

Outsourcing

BUSINESS PLAN

Management and Organization Plan
///
Infrastructure

While a large corporation normally employs a wide range of professionals on its staff, many entrepreneurial companies cannot afford such luxuries; yet, highly specialized and technical advice is needed. Entrepreneurs learn how to use outside resources to supplement their infrastructure, especially in the earliest stages. This practice can be less expensive and time-consuming than hiring a big staff to do all the work. For example, most start-up entrepreneurs would rather hire an accounting firm than employ their own full financial team. That way, they get immediate access to a fully trained professional team but only pay for what they need when they need it.

Before hiring an outside resource, take time to thoroughly investigate the person or firm through your established network. Ask for references. Once you have hired the resource, establish a good relationship from the start and maintain that relationship through regular communication.

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Legal Professionals

In our complex legal society, entrepreneurs need competent advisers in a variety of areas of legal specialization. A wise entrepreneur starts with a good business lawyer who can provide general advice and help decide when specialists are needed. Technology-based ventures also need the services of intellectual property and financing specialists.

The process of selecting any lawyer requires time and effort. To find an attorney, business owners should ask friends, other entrepreneurs, and business contacts in similar businesses for recommendations. The lawyers should have considerable practical experience in similar businesses. Some entrepreneurs prefer to deal with large law firms because they employ a variety of lawyers ranging from tax experts to securities experts to litigation attorneys. Many of these firms have substantial power and numerous contacts. On the other hand, a smaller firm could give the entrepreneur more personalized attention at a substantially lower cost. For example, a large firm might charge $1,000 to $3,000 for incorporating a business, while a smaller firm may only charge $500 to $1,000.

If you intend to seek investor financing, the choice of an attorney is especially important. Look for experienced lawyers who have represented a number of similar companies over time. They will have developed working relationships with investors and investment firms who rely on their own business networks for access to well-positioned investment opportunities. Experienced lawyers are one of your best sources of such referrals.

After establishing a list of several potential business lawyers, you should make appointments and interview them. Get adequate information from an attorney to assess whether the relationship is a fit. In other words, interview attorneys to see who will be hired (and the attorney will be interviewing you looking for the same fit). These interviewing guidelines may help:

- Ask the attorneys to describe the nature of business and the size and types of work they have done for business clients.
- Find out how many years of experience they have working with entrepreneurial companies.
- Ask about their particular business expertise.
- Ask for references to other clients, and contact those references.
- Describe a routine legal matter in order to evaluate how they would handle it.
- Discuss their workload to determine how quickly they can respond to your needs.
- Ask about the fee structure.
- Pay attention to how well you relate to the lawyer being interviewed. You and your business attorney need to be compatible.

Reality

Seek professional legal advice from the inception stage. It could ultimately save you thousands of dollars that might otherwise have to be spent correcting mistakes. Always ask for a price quote prior to engaging a legal professional.

Tip

Once you have selected a lawyer, prepare ahead any assignment you will give him or her. Write down the questions you have. If, for instance, you are going to discuss a contract you are negotiating, determine what you want in the contract before going to the lawyer. Then the lawyer can draw up a formal contract based on the agreed terms, as well as suggest aspects that you had not considered. Generally, you will pay for legal services on an hourly basis.

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Financial Professionals

Tip

Generally, you will pay for legal services on an hourly basis.

Accountants

Just as with attorneys, the best references come from others in the same or a similar business and their professional advisers. Most entrepreneurs use smaller accounting firms in the early stage of the venture because they are usually more affordable. Excellent, one-on-one service can be obtained from small, local CPA firms.

Once the business is clearly high-growth, moving to a larger firm will probably be necessary. Large accounting firms can provide entrepreneurs with a variety of accounting and financial experts in one convenient location. Also, when seeking sophisticated private investment or when taking the company public, the investment firms involved will almost always want the comfort and assurance of having a national firm involved.

It's also important to recognize that, as the company grows, it becomes more and more necessary to have a Chief Financial Officer on board, overseeing the company's financial concerns on a daily basis.

Whether from a small or large firm, outside accountants can offer many financial functions to the entrepreneur, including:

- Setting up an accounting system.
- Preparing financial statements.
- Completing tax forms.
- Advising entrepreneurs on purchasing, financing, and other decisions.
- Analyzing financial information against industry standards.
- Helping to set financial achievement goals.
- Auditing financial statements for accuracy.

From Real Entrepreneurs get reliable accounting advice

During its start-up stage, a small multimedia publisher chose to work with a small accounting firm. But the company also had its financials audited by a large accounting firm because the founders had established an exit strategy of selling the business once it had reached $13 million in annual sales. The owners wanted to have reliable financial statements to provide to potential buyers. After years of hard work, the owners were able to exit the business, having met their financial goals.

Bankers

A banking relationship should be established early, as soon as entrepreneurs begin to build their new ventures. The bank can assist in setting up checking accounts, depositing employee payroll checks, and issuing credit cards. They also provide working capital funds or equipment loans, or they work with new enterprises to become bankable in order to qualify for a commercial loan. Banks provide capital in debt form to companies with an established track record such as a company history, historical financial statements, and a good collateral base. Business bankers can also provide general business advice, provide constructive criticism of business plans, and make quality introductions.

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Business Consultants

Entrepreneurs use consultants because they are usually less expensive than hiring full-time staff, especially when the entrepreneur needs a specific problem solved or needs an expert. Consultants are paid hourly or by a fixed project fee.

The important decision to hire a consultant should be made only after carefully researching and interviewing potential consultants. The best way to find consultants is through referrals from lawyers, accountants, other entrepreneurs, and business consultants. Entrepreneurs can avoid unsatisfactory consulting relationships by considering the following characteristics of consultants when seeking outside services:

Expertise – Is a generalist or a specialist needed? You may need several consultants for different aspects of the business.

Experience – Consider consultants' prior track records. Who else have they worked for and what services did they render? Obtain the names of other entrepreneurs they have worked for and call to verify the results of their performance.

Proposals – Ask for a written proposal. Evaluate proposals by looking for the outcomes and objectives the consultants say they will accomplish.

Attitude – Interview the consultants to determine whether you would be comfortable working with them.

Once you decide on a consultant, a written agreement should specify the consultant's responsibilities and objectives, including the timeline and compensation. The agreement should address in writing what will happen if either party wishes to end the relationship before the work is finished. It should also specify who owns the completed work product.

Marketing Consultants

Marketing consultants are particularly useful because many entrepreneurs do not have marketing experience. Advertising and public relations are two specialized marketing fields in which the entrepreneur often needs help. Determining the competency of advertising and public relations consultants can be a challenge. You should look at track records as well as their fees.

Some areas of marketing require specialized knowledge and skills that people outside the area typically do not possess. Perhaps nowhere is this as true as in the field of direct-response marketing, in which professional consultants and operational firms can execute an entire business-to-business, direct-marketing program at less cost and more effectively than a business can do for itself. Some firms will help business owners with total marketing plans, while others specialize in certain fields such as direct mail, research, regional studies, or product and brand positioning.

Business Development Consultants

For companies seeking strategic relationships with other companies, business development consultants or firms such as investment bankers may provide the specialized contacts and expertise necessary to engineer what are often complex transactions.

Reality

Partnering with other companies is often an efficient way to pool valuable resources.

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Others

Consultants of many kinds abound in the world of business. Hiring a consultant for advice on specific issues can be a very valuable use of resources. The following may also provide valuable insights:

Manufacturing subcontractors – Thousands of firms exist solely to produce goods for others. Entrepreneurs can concentrate on marketing and sales when an outside company is hired to manufacture the goods.

Manufacturers' representatives – A sales force can be expensive for a new business, so many entrepreneurs hire representatives. The Manufacturing Extension Partnership can help you find a sales representative who can promote specific product lines both nationally and internationally.

From Real Entrepreneurs

use manufacturers' reps

It costs Blue Sky Distribution $100,000 a year to keep a salesperson in the field. So, when a salesperson couldn't sell at least $1,000,000 worth of goods in a year, selling costs soared to more than 10 percent of sales – a cost that Blue Sky couldn't afford. After supporting an internal sales force for three years, Blue Sky restructured its sales department and started using manufacturers' reps with positive results.

Scientific or technical subcontractors – As technologies have become increasingly complex and difficult to fully develop with internal resources, specialized firms have arisen to handle such work on an outsourced basis. These firms may handle anything from relatively limited tasks, such as product testing, all the way to full complex initiatives, such as managing the clinical development of a new pharmaceutical compound.

Engineering or design firms – Engineers can be hired to solve a technical problem. Graphic designers can be hired to improve the packaging or look of a product and can also help create your logo and advertising materials.

Distributors – A distributor is an existing firm that will buy a venture's product and resell it to the intended market. It can save you time, money, and anguish.

Human resource consultants – Many entrepreneurs use employment agencies or executive search firms to find and recruit qualified candidates, write job descriptions, and provide other consulting services.

Lobbyists – Entrepreneurs with a product or service that needs governmental approval or restrictions lifted may need to contact a lobbyist to represent them on critical issues.

Import/export brokers – To bring goods into the United States, you must comply with customs regulations. Import/export brokers, or customs brokers, take the responsibility for such goods to clear customs. They charge a commission based on shipment price. You should hire a customs broker who has expertise in importing and exporting in the country where you are doing business.

Payroll service – Many entrepreneurs, especially in the early stages of the business, find the calculation of payroll, withholdings, the creation of the payroll checks, and the timely deposit of withheld amounts to be time-intensive. These tasks distract them from growing their business. A private payroll service relieves the entrepreneur of this necessary chore for a relatively modest fee.

Business incubators – Incubators assist start-up businesses with early development problems by providing access to management, financial, marketing, engineering, and legal assistance. They may also provide help with advanced technologies, financing, or flexible space at affordable rent.

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Protecting the Business and Your Intellectual Property

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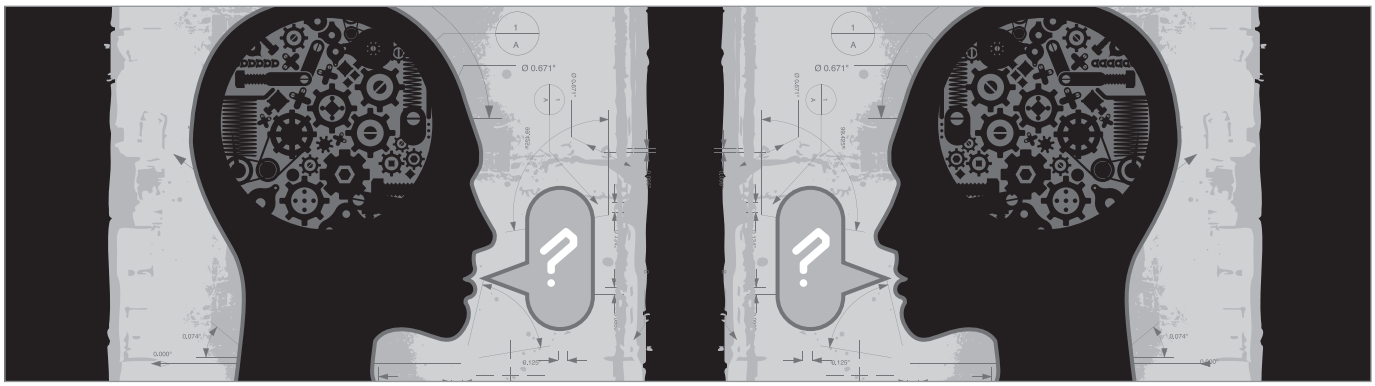

One of the many roles you will have to play in your business is that of security guard. You have to make sure that the company remains safe: nothing enters that could harm the business and nothing leaves that could reduce its value. The more you can use legal protections to safeguard your holdings, the easier this task becomes.

By exploring the legal issues of running a business, you will gain greater insights on how to safeguard your business's existence and how to protect your tangible and intangible assets. This module examines the following legal issues:

Confirming your choice of business entity – The legal framework you use to support your business can affect your tax payments, legal liability, and potential for future investment. Although your initial decision is not set in stone, it is wise to consider your alternatives and future plans before setting up the paperwork. But don't delay. If you fail to take legal steps to establish your business entity, the government will in essence do it for you by making assumptions that will be harmful in the long run.

Protecting your intellectual property – The creativity and innovation found in great abundance in the typical technology-based company generally lead to the creation of highly valuable property, both tangible and intangible. It is important to understand the different types of intangible, or intellectual, property and learn the appropriate legal means to protect these valuable assets.

Complying with governmental regulations – After all the hard work of launching and growing a business, you want to make sure that the government doesn't take it away from you because you failed to comply with its regulations. You should learn what your company needs to do to stay legal and compliant.

Outcomes

- Compare different business entities.
- Find out how and why you should protect your intellectual property.
- Consider the possible need for licenses, patents, trademarks, and copyrights.
- Identify governmental regulations that affect your business.

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Action Steps (Find online tools at **fasttrac.org/resources**.)

- ❑ Draft the section of your Business Plan titled The Company.
- ❑ Draft the Intellectual Property, Disclosure, Barriers to Re-Engineering, and Governmental Approvals sections of the Product/Service Plan section of your Business Plan.
- ❑ Refine the Executive Summary section of your Business Plan as you draft other sections.
- ❑ Continue to update and refine the data in your Financial Template.
- ❑ Continue to refine your Elevator Pitch.
- ❑ Read Module 9: Identifying Funding and Working with Investors.

Introduction to Business Entities

BUSINESS PLAN

The Company
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Legal Form of Business

Business must be done within some kind of legal framework. Choosing how to structure your business, in other words selecting what kind of *business* entity it will be, is based on a number of factors. Consider these issues when determining the best fit for your organization:

Control – Who is the decision maker? The decision maker will control management, determine who receives profits, decide whether to get loans or solicit investors, and be solely responsible for the company's financial losses. If control is important to you, choose a legal structure that protects your standing in the company.

Taxes – Taxes are a major concern for business owners. The amount of taxes your business pays yearly will change based on the business entity you select.

Liability – Liability is another key concern. Some legal structures do not protect your personal assets from business debts. If you do not want to personally pay the debts of your business, consider a legal structure that will protect your personal property.

Transferability of ownership – Depending upon the legal agreement, one person's ownership in a business may be transferred to another owner in whole or in part simply by the exchange of a piece of paper. Consider whether transfer of ownership is important to your business concept.

Longevity of the business – Not all business forms are perpetual. Some forms of business cease when the entrepreneur exits the business. Do you want the business to continue after you leave it?

Raising capital – Simple entities such as sole proprietorships and general partnerships are restricted in their ability to raise capital. If you expect to raise funds to grow your business, consider the legal structures that make investment attractive to others.

Most often, entrepreneurs are concerned with all of these important issues. The key is to identify the business entity whose legal structure best meets your needs and the needs of your business.

In an ideal world, you would understand every legal and tax implication before selecting a legal form for your business. The reality is that you must rely on the advice of attorneys and accountants to help you make this decision. They can anticipate your concerns based on their experience and on information you provide. Still, the legal structure of the business is your decision to make and live with.

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Characteristics of Various Legal Entities

The following are all legal entities for doing business:

- Sole proprietorship
- Partnership
- C corporation
- S corporation
- Limited liability company (LLC)

The characteristics, advantages, and disadvantages of each of these entities are examined below and summarized into key points.

Note: For most tech entrepreneurs, a C corporation is the preferred entity. It permits the transfer of a percentage of ownership, which is a must if your vision is to build a business that can be taken public or that can take on additional owners or investors.

Sole Proprietorship

A *sole proprietorship* is the easiest entity to form and maintain, requiring little to no paperwork or approvals to begin. You can either manage it or hire managers, but either way, you are the business.

Taxes for a sole proprietorship are relatively easy to file using Schedule C of the 1040 form. As a sole proprietor, you do not worry about double taxation, excessive compensation, or excessive retained earnings. In a sole proprietorship, you are liable for any debts of the business. Because the business and the business owner are the same, your personal assets are available to pay the debts of the business, and your personal obligations may be satisfied by business assets. You can sell a sole proprietorship as a business or close its doors and sell its assets.

The ability of a sole proprietorship to raise capital is limited. You cannot sell shares of the business. Generally, these entities obtain loans after fully collateralizing them with personal assets.

Tip

States typically view undeclared businesses as sole proprietorships or partnerships, leaving you personally responsible for debts and injuries.

Key Points about Sole Proprietorships

- Owned by one person and operated for their profit
- Owner alone controls entire business
- Owner is taxed on profit and is personally liable for debts of business
- Owner is personally liable for legal violations
- Can be sold as business or owner can close and sell assets
- No sale of shares or fractional business interest
- Ends upon death of owner
- Restricted ability to raise capital

Partnership

A *partnership* forms when two or more entities join together for a common business purpose. A partnership can be *general* or *limited*. Although no written document is required to form a partnership, for all partners' sakes a partnership agreement should be written.

Reality

A creditor will usually seek to collect from the partner with the most accessible assets. If you are that partner, seeking reimbursement from the partners who did not pay can be a long and sometimes futile process.

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This document should spell out matters such as:

- Division of profits.
- Division of assets.
- Dissolution of the partnership.
- Payment or performance of partnership obligations.
- Ownership of intellectual property.

The partners control a partnership according to their agreement. They have a great deal of flexibility. If they have no other agreement, the law assumes that partners share control equally. In a limited partnership, the general partner controls the operations and the limited partner is simply an investor.

Some experts recommend avoiding any form of doing business that splits ownership 50/50. What happens if the owners do not agree? Nothing. A majority cannot be achieved. Instead of a 50/50 ownership, a third party in whom the owners have complete trust could have a very small percentage of ownership or a written agreement to resolve tie votes. If the owners agree, that person never hears from them. If the owners cannot agree, this third party votes so the business can act.

Partnerships have a fairly simple tax structure. Income and loss earned by the partnership passes through to the partners, and they report it on their respective tax returns. The partners then pay the tax on their share of the profits. The partnership itself does not pay any tax on profits.

Some authorities strongly advise against using the general partnership form of organization for most types of businesses because liabilities are personal and unlimited. Moreover, each partner is fully personally liable for the actions of any other partner. In a limited partnership, only the general partner is personally liable. The limited partner's liability is limited to the amount of investment.

Since a partnership is a voluntary association, you or any partner can end it at any time. Partners can simply say they no longer wish to be a partner. Unless the partnership agreement provides otherwise, the death of a partner also automatically ends a partnership.

From Real Entrepreneurs **partnerships**

A health-tech partnership in California was initially funded by three equal partners. The partnership contracted to have the technology developed with a university partner. It then planned to sell the technology to a pharmaceutical company. The investment was primed to reap huge profits for the partners; however, when the development costs exceeded the initial estimates and the partners were called upon to make additional contributions, only one of them had the funds to do so. Since the partnership had already contracted with the pharmaceutical company, everything would be lost if they did not complete the project. The one with the funds purchased the interests of the other two partners for far less than their initial investment and made all the profit himself when the technology eventually sold. The partnership structure wasn't right for the two partners who had to sell at a loss. Under a different structure, they might have been able to maintain their share in the company and then had the entity raise the needed funds.

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A partnership is primarily dependent upon the individual assets of the partners to raise additional capital. Adding investors requires converting from a general to a limited partnership. It would create a new entity. Lenders will look for a fully collateralized loan to be personally guaranteed by the partners. Since limited partners are generally investors whose liability is limited to their investment, it is unlikely that they would be willing to personally guarantee a loan.

Key Points about Partnerships

- Owned by two or more entities in any combination (people, corporation, other partnerships) in either "general" or "limited" form.
- Controlled according to partnership agreement (law assumes equal control among partners if no agreement). In a limited partnership, the general partner controls and the limited partner is only an investor.
- Income and loss passed through to individual partners – the partnership itself does not pay taxes on any profit. Each partner may be separately liable for debts of the business.
- Each partner is legally liable for the actions of any other partner. In a limited partnership, the limited partner is liable only up to the amount of their investment.
- Can be sold as business or you can close it and sell assets if all partners agree according to a written agreement.
- A partnership agreement can provide for new partners, retirement, resignation, and continuation.
- Ends upon death of a partner unless otherwise provided for in partnership agreement.
- General partnerships are restricted in their ability to raise capital from external sources. Limited partners can invest.

Corporations: C Corporation and S Corporation

A *corporation* is a legal entity created under state law. A corporation can manage its own affairs, hold property, borrow money, and legally do nearly anything an individual can do. Stockholders may be, but need not be, employees, officers, or directors of the corporation as well. An advantage of corporations is that they insulate you from liability. If the corporation operates according to laws and regulations, creditors only have access to the corporate assets for business debts. The owners' personal assets are not at risk.

Primarily because of the ability to issue and sell ownership interests, corporations are the entity of choice for high-growth companies.

The law requires corporations to operate separately from the owner and to file all governmentally required reports and taxes. All too often, however, a one- or two-person corporation keeps inadequate records and fails to strictly segregate corporate and personal assets and liabilities. Failing to operate the business as a corporation separate from the owners results in a loss of insulation from liability.

Tip

If you're doing business as a corporation, follow the rules to maintain your corporate protection.

If a creditor can show that your business has not been properly operated as a corporation, the creditor can then reach both your corporate and personal assets. Corporate insulation from liability does not shield you from liability for harm to another caused by your own negligence. You may be liable along with the corporation. Nor does it prevent the corporate owners and officers from being sued. Even if you are not found to be legally liable, defending the action filed against you can cost thousands of dollars. For these reasons, many corporate owners and officers obtain individual liability insurance coverage.

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Corporations have a three-tiered control system. Stockholders elect the directors of the corporation. In turn, directors elect the officers. Other than electing directors and expecting dividends, stockholders generally have no other function. The directors make primary decisions for the corporation, and the officers direct day-to-day operations.

Some states permit one person to fill the roles of stockholder, director, and officer. Others permit only one owner but require two officers minimum. All states' requirements are based on the concept that the corporation is a separate legal entity from those individuals who own and operate it.

All corporations start the same. They obtain a charter from the state, generally the one in which they intend to do the most business. Unless the corporation elects to be treated as a partnership for tax purposes (the subchapter S election), it files a corporate tax return. After paying taxes, most corporations distribute money to their stockholders in the form of dividends. The stockholders must pay taxes on the income received. This practice results in double taxation.

Tip

Double taxation occurs when the earnings of a corporation are taxed twice, both as the Net Income of the corporation and again as the dividends distributed to the stockholders. Consult your accountant to advise you on ways to avoid double taxation.

To avoid double taxation, assuming certain requirements are met (no more than 75 stockholders, all stockholders are U.S. citizens, and all stockholders agree), your corporation may elect to be treated as if it were a partnership at tax time. In that case, the corporation pays no tax and the profits pass through to the stockholders, who pay income tax on what they receive.

- If you make such an election, your corporation is an *S corporation*, or a Subchapter S corporation. The S comes from the subsection of the Internal Revenue Code which permits this election.
- A corporation that has not made the election or is ineligible to make it is known as a *C corporation*. When contemplating an initial public offering, technology-based ventures will almost always be C corporations because of the unlimited number of stockholders permitted and because S corporations generally only allow one class of equity ownership.

Shares of a corporation represent ownership of the corporation. While you may restrict shares through the bylaws of the corporation, you may transfer ownership of all or part of the corporation relatively easily. A corporation can exist forever apart from its founders. When you want to sell your business, the corporation provides a much more salable package than a sole proprietorship or partnership. The corporation is the only entity that can deduct as business expenses many benefits such as health care and retirement plans. These expenses reduce the taxable profits of the corporation and give employees valuable benefits which are not taxed as income.

Tip

Not all companies are eligible to be every type of corporation. Some states require specific businesses such as banks, railroads, public utilities, health care, or law to be specific types of corporations. Consult an attorney and accountant before making a decision about which type of corporation is permitted and right for your business.

Incorporating a business carries many advantages. One of the most significant advantages is tremendous financial flexibility in raising capital. A corporation has the ability to provide you the capital structure you need to accomplish your goals.

Once investors, lenders, or stockholders get involved, you need to protect your own interests from those who might seek to take control, ownership, or profits. Even though you start a corporation, nothing guarantees you can continue as a director, officer, employee, stockholder, or even recipient of dividends. Nothing guarantees you will continue to be included in the inner workings of the business. You can be squeezed out in many ways, some direct and others very subtle. To recognize the various squeeze-out methods and protect against them, rely on an experienced business attorney. These professionals make sure your interests are protected before you commit to take on other owners or investors. Continue to consult an attorney as time passes and the venture changes; especially if it becomes more valuable.

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Key Points about Corporations

- Owned through shares of stock.
- Controlled by directors with officers directing day-to-day operations. Directors are elected by shareholders.
- Income and loss is held by the corporation, and the corporation pays taxes on its profit. Shareholders have no liability for the debts of the corporation. S corporations can be treated as a partnership for tax purposes.
- Legal liability generally remains with the corporation.
- Can be acquired or merged into other corporations, or assets can be sold in part or in whole.
- Shares in the corporation can be transferred or sold, and new shares can be issued.
- Continues until dissolution.
- Unlimited amounts of capital can be raised through sale of stock.

From Real Entrepreneurs **corporations**

Software Solutions, Inc. began as an S corporation. Within five years of starting the business, founders Alexei and Nina Vladimir wanted to go public – that is, issue and sell shares of stock to the general public. To do this, they had to give up their S status and become a C corporation. They will have far more than the 75 stockholders permitted by S regulations.

Limited Liability Company (LLC)

The LLC is neither a corporation nor a partnership. This type of business entity, when properly structured, is designed to combine the benefits of corporate liability protection with the "pass through" tax treatment and management flexibility of a partnership.

Tip

An LLC operating agreement, a critical document, should be written by an attorney. Its terms have a profound long-term effect and need to be carefully thought out.

Because it is the newest form of doing business, the laws concerning LLCs differ from state to state. You need to seek the guidance of an attorney before adopting this form of business.

To form an LLC, you must file articles of organization with the secretary of state. In addition, an operating agreement must detail how you will operate the business, share profits and losses, induct new members, and treat retiring and resigning ones.

The control of an LLC is in the hands of the owners, called members, and should be defined in your operating agreement. Members elect managers from among the membership or from outside. The operating agreement will determine not only how your management is selected but also the extent of the manager's authority. It could be that only day-to-day operations are within the control of the manager and that the members as a whole will make all other decisions. The required number of members varies from state to state. Some states require at least two members to use this legal structure, while other states permit only one.

One principal advantage of an LLC occurs at tax time. The LLC may elect to be treated as a partnership. Like a partnership, then, the income and loss earned by the LLC are passed through to the members and reported on their respective tax returns. If no election is made, the LLC is taxed like a corporation.

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The advantage of an LLC compared to a partnership is that the members' liability for the debts of the LLC is limited to the extent of their investment in the business.

Transfer of ownership in an LLC requires the unanimous consent of all members unless the operating agreement provides otherwise. Thus, you have maximum flexibility regarding accepting new members and withdrawing or retiring existing members.

LLCs do not exist perpetually. Unless the operating agreement provides for its continued existence, an LLC ends upon the death of a member. Most states require a stated period of existence.

Since it is a collection of individuals, an LLC suffers from the same limitations on raising capital as partnerships. It does, however, have a method to raise modest amounts by requiring initial contributions or buy-ins by new members if the operating agreement provides this option.

Key Points about LLCs

- Owned by one or more entities in any combination (people, corporation, partnership, or other LLC).
- Controlled according to an operating agreement which details such specifics as operation and sharing of profits and losses.
- Income and loss passed through to individual members. Each partner's liability for the debts of the company is limited to the extent of their investment.
- Legal liability generally remains with the company.
- Can be sold as business or can be closed and its assets sold according to the operating agreement.
- An LLC operating agreement can provide for new partners, retirement, resignation, and continuation.
- Continues until dissolution according to terms of operating agreement. Some states set a 30-year lifetime.
- The operating agreement may provide for modest amounts of capital contributions from its members.

From Real Entrepreneurs

Limited Liability Corporation (LLC)

A group of highly skilled and successful scientists originally formed a partnership. They liked the flexibility of management. None liked to be told what they could or could not do by others, but they were concerned about losing individual property because of the actions of one of their partners. Their attorney initially suggested they form a corporation, however, they decided against a corporation alternative, objecting to the designation of one of their members as "President." Today they are happy as an LLC. They have hired a professional manager who runs the company administratively. Their personal assets are insulated from liability and income is taxed only once.

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Intellectual Property

Protecting the proprietary materials and intellectual property of a company is critical to its growth, value, stability, and success. Intellectual property and proprietary materials give a company a competitive edge in the marketplace.

Proprietary materials are tangible items of property such as chemical and biological substances created during the normal course of research and development, prototypes, working models, and samples. Especially in the life sciences, the physical availability of such substances can be essential to establishing a functioning product, process, or service.

Reality

Protecting your intellectual property is critical to obtaining funding for the company.

Intellectual property is an intangible creation of the mind. It is typically the most valuable asset for information technology and life science companies in the start-up and emerging phases of venture-backed enterprises. Intellectual property can include legal documents (patents, trademarks, and copyrights), the knowledge and skills of your company's employees, or relationships with customers, suppliers, independent contractors, and consultants.

BUSINESS PLAN

Product/ Service Plan
///
Intellectual Property

It is particularly important to recognize what it means legally to categorize such things as "property" – it means that these creations can be protected by a "bundle of rights" with respect to title, control, possession, use, exclusion, and disposition. For example, a license agreement may include the transfer of one or more of these property rights to the licensee.

You must explain in your Business Plan how you intend to use and protect your intellectual property. Strategically using intellectual property can help to create new profit centers and increase the value of a company. Whatever your strategy, treating the intellectual property of the company as a valuable, if not essential, asset is critical.

Protecting intellectual property rights takes time and money, but defending those rights is what maintains their value for the company. Like any business decision, you must weigh the benefit of obtaining certain intellectual property protections against their cost. An intellectual property attorney and other advisers should be consulted to ensure that all appropriate protections are in place.

Note: The discussion that follows focuses on protection of intellectual property in the United States, and does not deal with foreign or international intellectual property rights.

Confidential Information

Confidential information refers to all information relating to business, research, development, and intellectual property which is of a confidential or proprietary nature. Disclosing such information outside the company would diminish its value or benefit. Confidential information includes concepts, techniques, processes, designs, cost data, clinical data, computer programs, customers, suppliers, and other know-how.

Tip

Most companies require their employees to keep confidential certain information related to the conduct of the company's business.

Confidential information generally excludes any information which:

- Becomes public information or is generally available to the public.
- Was received from one who is in rightful possession of such information and has the legal right to disclose it.
- Was legally in the possession of the receiving party prior to the time of the disclosure.
- Is required by law to be disclosed to a governmental agency.
- Is independently discovered or developed by another entity.

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The first three exclusions (publicly available, lawful disclosure, prior possession) are almost always found in confidentiality agreements, but, surprisingly, the last two appear with much less frequency. The advent of extensive litigation among technology companies and the requirements for disclosure to regulatory authorities have given rise to the need to be informed if your confidential information is being disclosed under a legal obligation imposed on the receiving party.

The last exception, independent discovery, is a critical exception for all technology-based companies. The exchange of confidential information between two parties working in similar technology areas leaves open the possibility of contaminating the knowledge base of the receiving party even if an independent project is undertaken. Therefore, an exception for information that is independently discovered provides some level of protection from allegations of misuse of another party's confidential information.

Confidentiality Agreements

You may need to share confidential information in order to advance business or financing transactions. Investors or partners will want to know about your technology before they decide to do business with you. Make sure that you safeguard your information with a confidentiality agreement or a non-disclosure agreement (NDA). Confidentiality agreements can be crafted as unilateral (only one party discloses to the other) or bilateral (both parties receive and disclose information).

Tip

Specific language should always be included in the confidentiality agreement in order to prevent the receiving party from using your confidential information for unintended purposes. This is the obligation of non-use.

Here are some typical situations where a confidentiality agreement is often used:

- An invention or business idea will be presented to a potential partner, investor, or distributor.
- Financial, marketing, and other information will be shared with a prospective buyer of your business.
- A new product or technology will be shown to a prospective buyer or licensee.
- A company or individual will be providing you with services and will have access to some sensitive information in providing those services.

In creating an agreement between your company and an outside party, it is wise to define confidential information as broadly as possible. This broad definition usually covers the content and nature of the proprietary and confidential information collected or generated by a technology company in its normal course of business. A well-constructed definition should also encompass all disclosures, by any means (oral, written, or electronic), in order to address even a casual exchange of information.

Know-How

One of the more intangible types of intellectual property is *know-how*. A thief couldn't physically carry it out of your building, but its loss could be devastating. Know-how encompasses all information, which is not generally known, but which is necessary or useful for research and development or commercialization of the product or service.

Know-how clearly can be considered both as confidential information and as a trade secret, and may even form the basis for a patented invention. In most contexts, know-how can usually be thought of as the processes and procedures frequently used to support commercial activities around your company, particularly the provision of services.

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Trade Secrets

Trade secrets are a form of intellectual property that has its own unique character and ways in which it can be protected. Trade secrets are generally protected under state law, which is based on the Uniform Trade Secrets Act.

Trade secret means business or technical information that derives independent, actual, or potential commercial value from not being generally known. Under the law of many states, a trade secret can exist in a variety of forms of business or technical information.

Types of information that can be protected as a trade secret include:

- Formulas
- Patterns
- Programs
- Devices
- Compilations of information
- Methods
- Techniques
- Processes

Tip

The legal definition of a trade secret is complex and contains many elements; therefore, any legal conclusion as to what constitutes a trade secret will depend upon the facts in each circumstance. A qualified attorney should be consulted if your company will be relying on trade secret law to protect its intellectual property.

Specifics can vary from state to state. In North Carolina, for example, project launch dates for new products, marketing plans, computer programs, negotiated price lists in a contract, and customer lists have all been found to be trade secrets. Many of these examples are of a type of information that cannot be protected through patents, copyrights, or trademarks. And, trade secret protection can potentially last forever, as long as they are kept secret and reasonable steps are taken to preserve their secrecy. Therefore, trade secrets can be an important element of any business enterprise.

To be a trade secret, the business or technical information must derive some commercial value from not generally being known to others. Trade secret information need not be limited to positive information, but can also include negative or inconclusive data. Surely knowing that a particular process will not work to produce an intended result would have value against a competitor!

Business or technical information that is generally known or readily ascertainable by independent means would not be considered a trade secret, since this information is not really secret. Once a trade secret is disclosed to the public, it loses its protected status. For example, describing your company's marketing plan in an annual report distributed on your website would prevent that plan from being considered a trade secret, as would taking public visitors on a tour of your facility and showing them your supposedly top-secret device for making widgets. Neither of these examples evidences any effort to keep the information secret.

Tip

Trade secret protection is often misunderstood. If you want to protect your intellectual property as a trade secret, make an affirmative decision to do so. Don't assume that confidential information that is not patented is automatically protected as a trade secret.

Protection of trade secrets requires that affirmative steps be taken to keep them confidential. Some steps are:

- Having employees, vendors, partners, and others with knowledge of trade secrets sign confidentiality agreements.
- Using passwords for computer-based information.
- Secured facilities for offices or laboratories.
- Conducting exit interviews for departing employees to remind them of their obligation to keep confidential the company's trade secrets.

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Since obtaining patent protection is the opposite of keeping trade secrets, it is not feasible to seek both patent protection and trade secret protection for the same thing. To secure federal patent protection, the patentee makes a bargain with the public – exclusive protection for a limited period of time in exchange for full public disclosure of the invention. So, once patent protection is sought, protection as a trade secret is abandoned because there are no longer efforts to keep the trade secrets "secret." Trade secret protection, however, can potentially last forever, as long as they are kept secret and reasonable steps are taken to preserve their secrecy.

Identical trade secrets owned by different companies can co-exist if they were independently created. However, there can be only one patent awarded among independently created but identical inventions, which will be owned by the first to invent.

A patent can be used to exclude any other person from practicing the claimed invention. However, one trade secret owner cannot prevent the owner of an identical but independently created trade secret from using it.

Tip

The U.S. Patent and Trademark Office has a website with information on obtaining patent protection. Perhaps the most popular feature is the easy-to-use search engine allowing anyone to search for existing patents or patent applications, including issued claims. Full electronic copies of selected patents can also be downloaded.

Patents

Patents are granted by the U.S. government to "whoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof." Patents are legally viewed as intangible personal property, and so can be bought, sold, traded, and/or licensed just as can any other item of personal property.

Patents provide only the "right to exclude" others from using the claimed invention. They do not provide the owner with the right to practice their own invention. Even if you obtain a patent for your invention, there may be patents owned by others that can block you from using your own invention. Consult a qualified attorney to assist you in evaluating the patent landscape for your business.

From Real Entrepreneurs **patents**

An inventor worked for two years in his basement developing a 3-D television. He was afraid that someone might steal his invention, so he would not discuss his product idea with anyone. When he decided that his working drawings and prototype were perfected, he contacted a patent attorney to start the patent search. During the patent search, the inventor found out the concept had been developed and tried four years previously and would not work. He wasted his time and money because he did not seek advice from the appropriate people early in the process.

Patent protection is available for machines, processes, articles of manufacture, and compositions of matter. The most familiar form of patent is the utility patent, which includes electrical, mechanical, and chemical types. The subject matter of patent protection has evolved as technology has developed and progressed. In recent years it has been established that living matter (non-naturally occurring forms which are the product of human ingenuity), software, and business methods may also be patented.

In the United States, the key statutory requirements for patentability are that the invention must be novel, useful, and non-obvious. The novelty and non-obvious standards often are determined by what is known in the "prior art." Whether an invention is obvious in view of

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the prior art is judged by whether the prior art teaches a workable version of the invention, not whether it is obvious to try to make the invention.

Getting a patent is a long and expensive process. A U.S. patent may cost from $10,000 to $20,000 and take 36 months or more to obtain. Patent applications are filed with the United States Patent and Trademark Office (PTO), which evaluates the patentability of the applied-for invention. The process includes a search of existing patents, preparing the application, prosecuting the application, and then issuance. To prosecute the application, the PTO assigns an examining attorney to engage in a written back-and-forth dialogue with the applicant regarding the scope of the application and other issues.

Patents in force or applied for before June 8, 1995, have a term of either 17 years from the date the patent issues, or 20 years from the date of application, whichever is longer. For patent applications filed on or after that date, the term is 20 years from the date of the earliest filed application. In some cases, the term of patents can be extended, for example, to take into account the time spent seeking regulatory approval of a new drug product. When a patent expires, anyone is able to use the intellectual property that was once protected.

United States patent rights will be lost unless a patent application is filed within one year after the invention is first sold, offered for sale, publicly used, or disclosed in a printed publication. This is sometimes referred to as the *one-year grace period*. There is no grace period for protecting your invention in a foreign country, so any public disclosure before filing your patent application can cause a loss of foreign patent rights.

Tip

It is unlawful to put "Patent Pending" or an abbreviation to that effect on a product unless you have, in fact, applied for a patent.

Tip

An entrepreneur should retain the services of a qualified patent attorney to determine whether an invention should be patented. Patent law is an exceedingly complex field that requires expert assistance. Not all patent lawyers or agents have the same expertise; they specialize in various fields. Most patent attorneys and agents have very specific degrees and experience reflected in their fields of specialization.

Patent infringement is the act of encroaching on the patent property of another. The power to exclude others from using a patented invention can be an exceptionally strong value driver for any technology company's intellectual property.

Some business owners argue that patents are not always worth the investment. Many companies will simply hire engineers and patent attorneys to design around existing valuable patents so the real core of the invention can be used and the original patent holder can do nothing about it. In addition, since many companies cannot afford to engage in patent litigation, some argue that it is not worth obtaining patent protection if you are not willing to enforce your patent rights. Overall, however, obtaining patent rights is a value driver for the entrepreneurial company. It will enhance your potential to obtain funding and is an investment in your future.

Patent Quality

Intellectual Property is often considered the most valuable asset for any new company, and therefore needs to be securely protected. Patents are one of the most frequently used IP protection tools, but patents can only be effective if they are of the highest quality possible. In order to successfully protect their IP assets, entrepreneurs need to understand what patent quality entails, how to ensure high patent quality, and how to utilize the new features offered under the America Invents Act (AIA).

The following topics will help expand your understanding of the AIA and patent quality, allowing you to develop the most effective and secure IP strategy, thus supporting your overall business goals.

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From Real Entrepreneurs ARTICLE ONE PARTNERS

While a successful patent strategy starts with the basic patent rules and guidelines, it also requires entrepreneurs to undertake practical research and gain insight into the relevant industry and technology areas. Article One, the world's largest patent research community, provides entrepreneurs an opportunity to practice their patent analysis and research skills in real-time while earning monetary rewards in the technology areas that they are working to develop. This type of research also allows researchers to learn more about the variety of technologies and entities operating in the most relevant industries.

The skills developed through an Article One study can allow any researcher or entrepreneur to make better decisions when evaluating their own intellectual property needs. In addition to developing a greater understanding of patent quality, this experience can be extremely valuable when filing for patents, launching a new company, and even evaluating the value and long-term strategy of a company.

What is Patent Quality?

Patent Quality refers to the level at which the invention is both novel and non-obvious. This is determined by an examination of both the patent application and any literature that may represent earlier depictions of the invention, also known as prior art. The exact definition of Patent Quality can be viewed in a number of ways.

In December 2009, the USPTO defined patent quality:

a. For which the record is clear that the application has received a thorough and complete examination, addressing all issues on the record, all examination having been done in a manner lending confidence to the public and patent owner that the resulting patent is most likely valid;

b. For which the protection granted is of proper scope; and

c. Which provides sufficiently clear notice to the public as to what is protected by claims.

R. Polk Wagner, a University of Pennsylvania Law Professor and industry thought-leader, defined quality similarly: Patent quality is the capacity of a granted patent to meet (or exceed) the statutory standards of patentability – most importantly, to be novel, nonobvious, and clearly and sufficiently described. Thus, a "low quality" patent is one granted for an invention that does not meet these standards.

Patent quality is established during the application and examination process. The patent examiner who reviews each application becomes a gatekeeper and sets a standard of quality by determining whether the claims of the application fit the requirements of patentability. To determine whether an invention is patentable, and therefore whether a patent can be granted, the examiner must consider both the language in the patent and any examples of that technology that may pre-date the application. Once a patent is understood to be novel and non-obvious, the patent can be considered "high-quality" based on two additional factors. First, the patent must objectively explain the unique elements upon which the monopoly rights are to be provided. Second, the patent must clearly describe the invention such that others can understand the key elements in order to avoid infringing upon the claims. Due to all of these factors, patent quality can be understandably difficult to measure.

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Why Care about Patent Quality?
Patent quality is considered important because intellectual property, which includes patents, provides a large amount of value for both companies and the economy as a whole. In 2009, USPTO Director David Kappos estimated that IP is worth approximately $5 trillion. It is also estimated that 80% of U.S. business assets are intangible, including IP, based on analysis by Marshall Phelps, the author of *Burning the Ships* (John Wiley & Sons, 2009) and a leader in the patent space. This value puts significant emphasis on the need for high-quality patents due to the negative impact that low-quality patents can have on all aspects of the economy.

Patents aim to encourage innovation and the development of new inventions by providing monopoly rights to the inventor. Low-quality patents can limit innovation and remove that incentive by increasing the risk of potentially infringing on broad, low-quality patents. Small businesses will have the best opportunity to grow if they are working within a system that supports and grants high-quality patents. At the same time, it is imperative that small business owners file and maintain high-quality patents in order to protect their investment. This protection allows both the company and its investors to continue investing in development by reducing the risk of losing their competitive advantage.

How can Patent Quality be Improved?
Whether during the patent application process, after the patent is granted, or even during research and development, a prior art search is the best way to increase patent quality and the confidence around a patent's validity. Researching technology related to an invention provides an opportunity to understand potential technologies that could invalidate a current or future patent. By identifying these paths early in the development and application process, a patent owner can avoid future problems, including a denied application or an expensive infringement lawsuit.

It is widely understood that prior art for an invention could range from U.S. and European patents, to journal articles and PhD. theses in Asia. A potentially invalidating invention could exist in any location, format, or industry, so it is very valuable for a patent applicant to understand the landscape around their invention. In many cases, early discovery of these similar inventions can help guide the development process to ensure that an invention does not infringe on another invention well before a patent application is submitted.

Preparation & Provisional Patents
Now that you have a general understanding of IP and patent quality, the first step to incorporating patents into your business strategy is to understand the immediate patent space. In addition to the rules and regulations, this means understanding how to read patents, tracking patent news, and practicing your skills in patents and patent research. By understanding the technical landscape around your business, you will be better able to quickly identify and plan for potentially relevant prior inventions.

The second step is to start protecting your inventions. Filing an application for a full-blown patent can require valuable time and resources that may not be available in the early days of a startup. However, there is still a need to formally protect the technologies that drive your early success. To fill this gap, a company can file for a provisional patent, which formally indicates ownership of the technology and creates a grace period after which the company must file an actual patent application. Provisional patent filings require little time and cost, with fees often less than $125. While the services of an attorney may be helpful early in the process, there are a number of online resources that can assist with these filings, including Google Patents.

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The America Invents Act

The America Invents Act (AIA) was officially signed into law on September 16, 2011, and most of the new rules went into effect on September 16, 2012. The AIA introduces a series of the most fundamental changes that have occurred in the U.S. patent system in the past 40 years. Arguably the most influential impact of the AIA is the shift to a "first to file" patent system. This not only aligns the U.S. patent system with other leading patent offices worldwide, but also opens the door to a variety of other updates that help to identify challenges to patent validity and make changes to patent claims. Updates to the definition of acceptable prior art and the processes for review and reexamination under the AIA put an increased emphasis on patent quality, both before and after the patent is granted.

This series of improvements will help to increase efficiency and quality throughout the U.S. patent system. As a result, there are now a number of new ways that third-parties can help to ensure that patents are of the highest quality, including the ability to provide a broad range of prior art and multiple opportunities to question the validity of a patent. These will support entrepreneurs, patent owners, reviewers and all other stakeholders as the U.S. patent system works to remain a leader in innovation and intellectual property protection. The following points are 5 of the most notable aspects featured within the AIA.

First to File – Starting on March 16, 2013, the U.S. patent system will transition to a "first-to-file" system, meaning that the first inventor to file for a patent or demonstrate use of the invention will be provided defensive rights around the invention. This puts an emphasis not only on the invention but also the practice of the invention, either through the filing of a patent application or through "Reduction to Practice," which is the demonstration of a more definitive version of the invention. When this transition takes place, the U.S. will be aligned with the other leading patent offices around the world, opening the door for more efficient collaboration and support of a globalized patent industry.

Expanded Prior Art Definition – The most immediate way that the AIA may impact patent quality is by expanding the definition of what can be considered as prior art. Any and all inventions can now be considered as prior art, including commercial use of the invention. While patents were typically the traditional source of relevant prior art, diligent patent applicants now benefit from more comprehensive prior art searches to ensure that they cover all of the new sources of potentially relevant prior art. This also includes examples of public use outside of the U.S., which were not previously considered prior art. The patent office also now accepts submissions of prior art by third parties, again helping to expand the pool of prior art being considered.

Changes to Inventor Filing – For inventors applying for a patent, prior art is required to be dated before a one-year grace period. This means that any literature or proof of public use published within one year of the filing date, including technical disclosures, journal articles, and promotional material, cannot be considered as prior art preventing the grant of the patent. Patent applicants are also able to question the validity of earlier applications based on knowledge that the invention listed in the earlier application came from the later applicant.

Inter Partes Review – Inter Partes Review (IPR) replaces Inter Partes Reexamination and provides an opportunity for a third party to question the validity of a patent, or any specific claims within. IPR is only granted if there is already a pending civil action between the two parties. IPR requests are based on patents that are more than nine months past when the patent was granted. Another change through the AIA is that IPR has a basic threshold of a "reasonable likelihood that the petitioner would prevail" on at least one of the claims within the patent. In many cases, businesses may use this option as a result of a pending

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infringement lawsuit. By asking the USPTO to reexamine a patent, there is a possibility that the patent office may find the patent to be invalid, thus eliminating the lawsuit.

Post Grant Review – Post Grant Review (PGR) is very similar to an Inter Partes Review, but is specifically based on patents within nine months of the patent grant. The threshold for PGR is more stringent than IPR in that the requester must demonstrate that "it is more likely than not" that at least one of the claims is not patentable. Only patents that have been granted within the new "first-to-file" system will be eligible for PGR.

By opening the door to more potentially relevant prior art and more opportunities for third party requests, the AIA helps to ensure that patents are subject to increased levels of review and scrutiny. As a result, there will be an increased level of confidence around the quality and potential value of any patent. These improvements allow businesses and inventors to receive even higher-quality patents from the patent office, thus increasing the protection of their inventions.

Patent applicants and owners now have the opportunity to strengthen the quality of their applications from the start, and thus increase the value of their overall portfolio and company. Increased protection over a company's IP not only increases the value of the patent, but also reduces some of the risk that a potential investor would face, making the diligence process more efficient. In addition to increased confidence among investors, the review options also act as tools with which a business can defend against lawsuits and other claims of infringement. By requesting a review (either Post Grant or Inter Partes), a business or inventor identifies the possibility that a patent should not have been granted in the first place, which could eliminate the threat of the lawsuit.

Overall, the changes enacted through the America Invents Act are meant to increase patent quality and improve efficiency in the U.S. and worldwide. These changes bring the U.S. patent system in line with the global standard of "first-to-file" and expand the protection available to patent owners. It adds a variety of improvements that will increase the efficiency of the patent office and the overall system, and opens new options for the investigation into the validity of a patent. When all of these components come together, the system will be better able to support innovation as the early founders of the first patent system intended.

Trademarks and Service Marks

Trademarks and service marks are excellent marketing tools. They distinguish the goods or services of your company from those of your competitors and they add value to a company as intellectual property. By identifying the goods with a trademark, a consumer associates the quality of the product with the mark, which builds goodwill and brand loyalty.

Trademarks (TM, ®) apply to goods, and service marks (SM, ®) apply to services. A trademark is any word, name, symbol, or device which is used to identify and distinguish the goods of one business from the goods manufactured or sold by others. Trademarks can be classified by the following types: arbitrary, fanciful, suggestive, descriptive, and generic terms. Generally speaking, arbitrary, fanciful, and suggestive marks are those marks that bear no or little relationship to the actual goods and services and are entitled to a relatively broad scope of protection. Descriptive marks – those marks that merely describe in some fashion the goods or services – are entitled to protection only upon proof that the relevant consumers associate the name of the mark with the goods and services provided by the owner of the mark. Generic terms are simply words that mean the associated goods, and are entitled to no trademark protection because they have become part of the everyday language.

Tip

The U.S. Patent and Trademark Office has a website with information on obtaining trademark and service mark protection. Trademark applications can even be filed online. In addition, the site provides an easy-to-use search engine allowing anyone to search for existing marks.

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Words, sounds, colors, logos, and fragrances can all be trademarked. Some well-known examples are the green color of John Deere tractors and the four-note sound for the computer chip maker Intel Corporation. Some subject matter cannot be trademarked, such as deceptive matter, scandalous matter, flags of nations, names, and portraits.

Service marks, like trademarks, can be any word, name, symbol, or device. The difference is that the service mark is used to identify and distinguish the services of one person from the services of others. Service marks are often slogans or phrases used to identify the provided services. A service mark is generally used in advertising, and trademarks appear on product packaging.

Tip

It is a good idea to file for trademark protection on your company's name as soon as possible. New companies should also seek to protect their names for use as an Internet domain.

Trademarks provide protection for an unlimited length of time. Trademark rights can be diminished, eroded, or lost, however, if the owner does not continuously use the mark or does not actively enforce its rights against known infringers, or if the trademark loses its significance in the market by becoming generic. A name can become so dominant that it takes on a generic meaning. For example, Kleenex, Xerox, and Band-Aid, although brand names, have become generic as a type of product rather than differentiating one brand from another. Many business experts believe that trademarks are far more valuable than patents in protecting a business's market share. Since trademarks continue for the life of the business, they build goodwill and brand loyalty, and trademark infringement can be prevented more easily than patent infringement.

An entrepreneur may choose to protect intellectual property with trademarks and service marks in a certain state or at the federal level. Federal registration is more advantageous because it gives nationwide protection and permits greater recovery of economic damages. Until the mark has been registered, one cannot legally use the ® symbol but may use TM or SM without the ® symbol.

Trademark and service mark rights may be used to prevent others from using a confusingly similar mark, but not to prevent others from making the same goods or from selling the same goods or services under a clearly different mark.

Registering trademarks and service marks with the U.S. Patent and Trademark Office is an affordable way to obtain protection for intellectual property. Usually, the cost is less than $1,000 in fees and it is simple to conduct a search of preexisting marks.

From Real Entrepreneurs **trademarks**

A newly formed start-up company developed a name and logo for its business. Rather than conducting a search to see if its selected name and logo was already taken by another company, the company filed an application for registration and then prepared letterhead, marketing materials, and signage for the office using the new name and logo. After one year of using the name and logo, the Trademark Office responded that the logo was already registered by another company. The start-up company had to stop using the logo and threw away thousands of dollars of printed materials. It should have conducted a search first, saving money in the long run.

Copyrights

Copyright protection is available for an original work of authorship that is fixed in a tangible medium and can be perceived, reproduced, or otherwise communicated. Literary, musical, dramatic, choreographic, pictorial, graphic, sculptural, audiovisual, and architectural works can all be protected through copyrights. Computer programs can also be copyrighted.

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Unlike patent protection, copyright protects expressive works from the moment they are fixed in a tangible medium of expression. There is no required registration or application process for the copyright to exist.

Registration of a copyright with the United States Copyright Office may be worthwhile, however, because it provides the following additional benefits:

- Registration is a prerequisite to filing a copyright infringement suit.
- Registration before infringement entitles the copyright owner to statutory damages and attorneys' fees.
- Registration provides evidence of the ownership of the work at issue.

Copyright protection provides an intellectual property right to the author of the original work. The owner of a copyrighted work has the exclusive right to reproduce, distribute, publicly perform, publicly display, or prepare derivative works of the original work. Copyright protection allows limited fair use of the work by others for criticism, comment, news reporting, teaching, scholarship, and research.

A copyright interest will not protect ideas, procedures, processes, systems, methods of operation, concepts, principles, facts, and discoveries. It may protect the original and creative way the idea or procedure is expressed.

For works created after January 1, 1978, the term of a copyright for a work created is 95 years from the year of first publication or 120 years from the year of its creation, whichever expires first. For works authored by an individual, the copyright term is the life of the author plus 70 years.

Every company owns copyrightable material developed within the scope of business. Many businesses include copyright notices on all such materials as a matter of routine practice. Copyright notices should contain all of the following three elements:

- The symbol ©, the word "Copyright," or the abbreviation "Copr."
- The first year of publication
- The name of the owner or company

For example, a copyright notice could read: © 2013 John Doe.

Tip

The U.S. Library of Congress is responsible for administering the federal copyright process and has a website with information on obtaining copyright protection, which includes the capability to file online.

Tip

When employees produce work for a company, the company owns the copyright on the materials. Work produced by an independent contractor belongs to the contractor unless the contract specifies that it is "work made for hire" and belongs to the company. Entrepreneurs must develop clearly written agreements with employees and subcontractors concerning who owns the copyright on the materials produced.

From Real Entrepreneurs — copyrights

Coca-Cola is an excellent example of a company that has protected its intellectual property.

- The artwork on the can/bottle is copyrighted.
- The brand name and logo are trademarked.
- The formula for Coca-Cola is a trade secret.

The formula for Coca-Cola could have been patented, but that would make it a matter of unprotected public record after the patent expired. Keeping it a trade secret for so many years has helped Coca-Cola preserve its dominance of the market.

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Proprietary Materials

Proprietary materials, such as chemical and biological materials created during the normal course of research and development, are a form of personal tangible property that can be protected under a variety of property law principles.

These materials are usually owned by their creator, and may be protected through patents. Some materials, however, may not be patented (or patentable). If they can't be reverse-engineered, the only viable means of protection for these materials is treating them as trade secrets.

Tip

Do not assume that the transfer of proprietary materials to another company is covered by a confidentiality agreement. Confidentiality agreements typically protect only information and its use. Use a separate agreement for the materials, or alternatively, modify the confidentiality agreement to include materials as well as information.

For the life sciences company, items such as molecular vectors, cell lines, and polymers fall into this category. Even small molecules, expression cassettes, genes, and proteins can fall into this category. Especially in the life sciences, the physical availability of such substances can be essential to establishing a functioning product or process.

Since they are a form of personal property, proprietary materials can be protected under commonly available legal rights, and can find a remedy under both criminal and tort law. Often, these materials are exchanged or disclosed under material transfer agreements (MTA). In these agreements, the receiving party is bound to keep secret the information and to use the materials only for a limited purpose.

In addition, the federal Economic Espionage Act (EEA) can be applied to proprietary materials to protect these items from misappropriation. This law is notable, as it includes:

- Acts by individuals or corporations and other organizations.
- Attempt and conspiracy.
- Provisions for fines and imprisonment.

A related statute covers acts by foreign governments, foreign instrumentality, or foreign agent(s). Overall the EEA covers both domestic and foreign entities.

Licensing Technology

Intellectual property, although intangible in nature, is nevertheless treated legally as any other form of personal property. It is very common for high-tech companies and companies in the life sciences to transfer intellectual property through licensing agreements. These transfers take three forms:

In-licensing – Acquiring (for a fee) the intellectual property rights to use or commercialize programs or products. Examples of intellectual property frequently in-licensed include technology, a promising drug compound, or a molecule. Companies may in-license technology to expand the business, improve product development pipelines, or broaden their product portfolio.

Tip

Many companies in-license technology or intellectual property that was originally developed at major research universities.

Out-licensing – Receiving fees from a third party for the rights to use or commercialize programs or products. A company's business concept may be to raise funds through out-licensing research products to other companies. In this way, they obtain a return on investment on their research and product development.

Cross-licensing – Some companies license their intellectual property to another company in exchange for a license to the other company's technology.

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Whether the licensee or licensor, entrepreneurs must carefully consider the contents of the license agreement. Here are some questions to ask:

- Will any money be paid up front for the license?
- What royalty will be paid? Will it be based upon time, units, or a percentage of sales or profits? Will it be capped?
- Will a minimum annual royalty be paid regardless of sales or use?
- What type of exclusivity will be negotiated? (In most cases, if entrepreneurs can find one licensee, they will probably be able to find more.)
- What level of involvement do the licensor and the licensee want in marketing the product, overseeing its production, or providing technical service?
- What is the duration of the license?
- Does the licensee have the right to assign or sublicense others?
- Who will own any modifications or improvements to the licensed intellectual property?
- Who pays for any further research and development of the intellectual property?
- Who pays to defend infringement of the property?
- Who will pay ongoing patent costs?
- What type of protection against damage is required?
- Which state's laws will be followed?
- How will disputes be settled?

License Grant

The license agreement should contain a grant section, or license grant, that says the license allows the licensor to "make, use, sell, offer for sale, and import" the licensed items. This language comes from the patent infringement statute, which states that those listed activities constitute infringement. So, the licensee is receiving permission to do something which otherwise would be an infringing act.

For the most part, the in-license to your company should be an exclusive one, with full rights to sublicense to others. Otherwise, your company will not have full and total use of the transferred technology, which could, among other things, leave it open for competition and therefore jeopardize obtaining venture capital investment.

Usually, the entity being licensed is referred to as the Licensed Product or Licensed Service. Licensed Patent Rights usually encompass the priority patent application(s), and include continuations, continuations-in-part, divisionals, reissues, re-exams, and the foreign counterparts of the priority application. Often, a license grant will include rights to any improvements made to the patented technology by the licensor. This can be a difficult subject to address, and it is up to the parties to define the nature of improvements and to then negotiate disposition should this arise.

The licensed item is often referenced in terms of what is covered or encompassed by a *valid claim*, usually defined as a claim in an issued patent, or one that is pending for a period of time, e.g., no more than five years. This construction permits the licensor to collect royalties on claims that have not issued in a patent.

The field of any license should be for "all fields" and in "all territories of the world" in order to ensure that the entire scope encompassed by the patent is licensed. Any attempt to tailor the license to the business of your company should be avoided as it could affect your ability to compete or raise venture capital.

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Fees, Milestones, Royalties, and Other Payments

A licensor often attempts to include an initiation, or upfront, fee. This is frequently viewed as a way to recover some portion of the costs for developing or protecting the licensed technology. For example, in licenses from universities this fee is targeted to the reimbursement of patent costs, particularly with an exclusive license. This can be an extremely challenging obligation for a new company, especially as fees of $20,000 to $40,000 may be incurred in the company's first year.

Milestone payments are almost always assessed and are usually triggered by significant developments (for example, first sale of a product) or regulatory events (for example, filing for FDA approval).

The sale of the licensed product or licensed service is typically the basis for the calculation of royalties. Royalties that run with the sale of a product or service (called *running royalties*) are always included. These are usually modest (1–5 percent of net sales) for an exclusive license. Royalties might be higher if the licensor has already demonstrated commercial viability of the technology or the technology is pioneering in nature.

Minimum annual royalties are often assessed and are generally creditable against actual royalties. Royalty stacking offsets are common where a product or service sold by the licensee is covered by patents other than the licensor's. Royalties may also be discounted for sales in territories where there are no patent rights. However, such royalties should be based on contract rights, rather than patent rights, to avoid allegations of patent misuse. Licenses to patented technology often run for the life of the patents, whereas non-patented technology is licensed for a set period of time, typically 10–15 years or longer.

Sublicense Rights

Most exclusive licenses will carry the right to sublicense to others. Non-exclusive licenses typically do not permit further sublicensing, on the principle that the licensor would prefer to enter into additional non-exclusive licenses directly. It is also possible to sublicense less than all the rights that are held by the licensee. For example, if the licensee has the right to "make, use, and sell," then a sublicensee might be granted only the right to "make" or manufacture the licensed article. Sublicenses are almost always required to be reported to the initial licensor.

One particularly troublesome provision in sublicenses is determining the obligation to pay royalties. Licensees typically pay royalties to the licensor on their own sales. Should a licensee pay royalties on what it receives from a sublicense, or on the basis of what the sublicensee sells? Most licensors will prefer to receive royalties that run with the sub-licensee's sales. However, on some occasions a royalty on amounts received by a licensee can be negotiated, particularly if the royalty rate is higher than is typical.

Patent Prosecution and Related Rights

In a university license, the university will almost always retain title to any licensed patents. However, which party controls patent prosecution can be negotiated. In any event, the party that controls prosecution will need to seek the timely advice of the other party, since both parties have a vested interest in the outcome of the prosecution. In a university license, the licensee will almost always be required to pay, in full, ongoing patent prosecution expenses.

Diligence

Exclusive licensees in particular will be required to meet certain diligence requirements before bringing products and services into commerce. You need to see that the licensed technology is exploited commercially to the benefit of the licensor.

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From Real Entrepreneurs

royalties

An optical lens manufacturer licensed one of its silicon-lens patents to a large marketing company for a 6 percent royalty on sales, plus a 4 percent royalty on production for the technology know-how to use the patent. The agreement could be worth as much as $100 million to the optical lens manufacturer's stockholders. The marketing company paid $3 million in cash as advanced royalties. Advanced or prepaid royalties mean they will be subtracted from future royalties.

Materials Transfer

The transfer of proprietary materials in a licensing context is something that must be dealt with separately from the grant of a patent license, although the appropriate provisions can be included in the same agreement. Materials are tangible, personal property whose ownership usually resides in their creator, or in their sponsor by way of assignment or operation of law. Materials obtained from a licensor can carry a degree of exclusive use, although the licensor will often require the right to continue to use them in its own research and development activities.

University Partnerships

Partnerships between universities and the private sector can exist in two contexts. Such a partnership can be the formal, legal joining together of two entities to form a new one, or it can be simply the informal coming together of two or more entities to cooperate for a joint purpose.

Perhaps a university has technology with commercial applications. That university will partner with a business to fund additional research, or it may license its intellectual property to a business.

A business may have intellectual property that needs to be improved in level or application. That business will engage a university to perform additional research, through a sponsored research agreement. The university may require Material Transfer Agreements (MTA), Confidentiality Agreements, or Option Agreements, as well as Sponsored Research Agreements that detail the work scope of the project.

Universities are increasingly encouraging their faculty to commercialize research by offering them a portion of the revenue it generates.

Barriers to Entry

Frequently, your intellectual property can give you a competitive advantage because it creates *barriers to entry* that can prevent new companies from competing with the same products or services or in the same market. Besides patents, entrepreneurs have other ways of creating barriers to entry and securing market share, including a company's experience, its track record of successful execution, and the expertise of its managers and advisers. Even well-financed competitors cannot buy or license experience and expertise, which are developed over time.

Being the first to obtain regulatory approval for a unique drug or medical device can, under some circumstances, be another way to keep competitors from getting approval for the same or similar products.

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Reality

It is often true that first to scale matters more than being the first to market. It is also sometimes true that having the best implementation or embodiment of a product or process brings more commercial value than being first. An established company's brand recognition, marketing strategies, and systems can diminish a competitor's efforts to establish itself.

Long-term, exclusive agreements with vendors, suppliers, customers, sales agents, distributors – anyone with whom the company might do business – create an effective barrier that prevents competitors from using existing operators and channels within the market. While the business may have to offer discounts and incentives (which might affect its profit margins) to entice others to sign long-term, exclusive agreements, the initial losses may be worth it. Long-term agreements effectively guarantee revenue streams, and guaranteed revenue streams attract investors who are seeking to minimize their risks.

Legal Counsel

The typical entrepreneurial company must rely on legal counsel for a number of different subjects. Since attorneys have come to specialize in different areas of the law, it is likely that you will have to deal with more than one attorney in order to obtain qualified legal representation for all your business activities.

The two primary areas of legal specialization are corporation law and intellectual property. Both types of lawyers will usually be sufficiently versed in contract law to assist you in this area, although you may want to retain additional counsel for certain commercial transactions, mergers, or acquisitions.

Choose a corporate counsel with experience representing venture-backed companies. Such individuals will be very familiar with setting up a corporation with articles of incorporation and bylaws and with setting duties for the board of directors. In addition, they should have experience with financing term sheets and with issuing and administering preferred shares for sale to investors.

Intellectual property issues can quickly become expensive and time-consuming. An intellectual property attorney can do much, however, to prevent problems. The attorney can spot intellectual property in a business, perhaps more readily than entrepreneurs, and devise ways to protect it. Certainly, attorneys can prepare the appropriate documents, but they can also advise on protective measures in matters such as:

- Implementing appropriate employee non-disclosure, non-compete, and invention agreements.
- Assisting with trade secret protection procedures and policies.
- Preparing form license agreements.
- Assisting in negotiation and documentation of key in-license and out-license agreements.

Prevention is often cheaper than the cure.

It is important to find attorneys or agents who specialize in the type of intellectual property law applicable to your business and who have considerable experience working with entrepreneurs.

Once intellectual property is properly protected, a company must guard and maintain its rights zealously. As a general rule, if a company does not defend its rights, they will be lost. If a company allows others to use its trademarks or copyrights without legal challenge, its intellectual property rights may slip into the public domain and become public property. Unfortunately, protecting intellectual property rights takes time and money, but defending those rights is what maintains their value for your company.

To find the right intellectual property attorney for your business, ask your general business lawyer and other trusted referral resources to recommend an intellectual property attorney or patent agent, and then interview candidates.

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In screening candidates, answer these questions:

- Can you and the attorney effectively communicate with each other?
- Does the attorney explain advice in terms you understand?
- Do you feel confident in the attorney's advice?
- Were the fees and billings procedures adequately explained?
- Is the attorney accessible by phone? How quickly are phone calls returned?
- What patents in your technical area has the attorney prepared and prosecuted?

Protecting Your Intellectual Property from Within

Your employees have access to confidential and proprietary information about your business. You should take steps to ensure that they don't intentionally or inadvertently reveal your secrets to competitors.

Employee Agreements

Creating written agreements is the first step in protecting your company's intellectual property. Legal documents can't prevent an employee from doing your company harm, but they do demonstrate that you are serious about protecting your intellectual property and that you are willing to prosecute those who betray your trust. Consult your attorney about creating appropriate legal documents for your employees and your industry.

Tip

Make sure that your agreements with independent contractors have a provision not to disclose or misuse confidential information. You should also include a provision stating that the company owns all intellectual property rights in the work product produced.

Your employee agreements may include all or some of the following provisions:

Non-disclosure agreements (NDA) – You should require all employees to sign a non-disclosure agreement. The best time to obtain such agreements is at hiring, although they can be enforceable if required at a later time. As part of the NDA, the employee should agree to not improperly use information of your company, prior employers, or third parties. When an employee leaves, require the return of all company documents containing trade secrets, such as customer lists and manuals. At such time, the employee should also be reminded not to violate the confidentiality obligations in his or her non-disclosure agreement.

Non-compete agreements – A non-compete agreement limits a former employee's right to work for someone who is a direct competitor of your business. Be selective about the employees who sign non-compete agreements; only those employees who truly possess inside information should be asked to sign them. A non-compete agreement cannot severely limit an employee's right to work. It cannot last too long, cover too wide a geographic area, or prohibit a former employee from engaging in too many types of businesses.

Reality ☑

Non-compete agreements are not enforceable in every state.

Non-solicitation agreements – A non-solicitation agreement prohibits employees, for a certain time period following employment, from soliciting other employees to leave the company and work elsewhere.

Assignment of rights – Your employment agreements should include a statement that all employees' work product and all intellectual property rights in that work are owned by the company and are not to be used by them personally outside work or by their future employers. If your employees are likely to develop ideas or inventions in the course of their employment, your agreement can obligate them to assign their patent rights to the company and to assist with the patent application process.

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Limiting Access to Proprietary Information

Your employees may unwittingly reveal your proprietary information to competitors. It's wise to institute a clear and thorough security policy at the earliest stages of your company's development to protect against these inadvertent leaks. Employees should get in the habit of taking all necessary precautions to safeguard your intellectual property.

Here are some actions you can take to limit access to your proprietary information:

Identify and label confidential information – Have your company's managers and engineers identify which internal company documents may be of value. Documents containing sensitive information may be designated by a "Company Confidential" stamp. Instruct personnel to display "[Company Name] Confidential" in headers or footers on electronic documents, slides, or other visual presentations of newly generated material. This will provide notice to anyone who comes into contact with the information.

Secure information – Instruct employees to store all confidential information securely. Prepare a list of documents containing trade secrets and keep both the list and the documents in locked cabinets with access limited to authorized personnel. Limit the photocopying or other copying of proprietary information. Make it a policy to shred documents before discarding them. Maintain a clean desk policy, in which employees have to remove from public view proprietary information, personal information (for example, rolodexes or PDAs), and computer access information (for example, passwords or networks).

Restrict visitors' access – Follow and observe visitor sign-in procedures, and ensure that visitors are restricted, escorted, or both.

Limit the information that goes in the public domain – To protect against inadvertent disclosure to outsiders, require employees to obtain approval from their supervisors before publishing articles or giving speeches that might include unintended disclosure of trade secrets.

Governmental Regulations

BUSINESS PLAN

Product/ Service Plan
///
Governmental Approvals

It is essential to comply with all federal, state, and local regulations and to obtain all required governmental licenses or permits of any kind before beginning operations. Most of these requirements were created to ensure that workers, sales, and property are accounted for on the various tax rolls, such as income tax, Social Security, workers' compensation, unemployment, sales tax, and personal property (inventory) tax. Other requirements were established to prevent people from doing dangerous or undesirable things.

Federal Government

Unless your enterprise plans to make or sell alcohol, firearms, explosives, pharmaceutical drugs, nuclear devices, or other controlled substances, your main concern at the federal level is with the Internal Revenue Service (IRS).

The IRS wants to know where a business is and what it does. Thus, you most likely must file form SS-4 with the IRS to register your business. If a sole proprietor has no employees, an SS-4 form may not be required. When you file the form, you will receive an employer's kit containing information about the types of taxes owed, when to pay them, where to pay them, and how to compute the amounts due.

You will also receive a unique Employer's Identification Number (EIN) (sole proprietors use their Social Security number) to identify your business. All communications with governmental agencies must include this EIN. The EIN is also needed to open business bank accounts and brokerage accounts and to deal with others who report your business's actions to any governmental agency. The government identifies your venture by its EIN, not by name.

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If your business has employees, you must withhold portions of each employee's earnings and contribute your share as well for payroll taxes. These funds are deposited to special accounts at designated banking facilities for the federal government. The regulations regarding withheld wages are very strict and must be complied with. Failure to make the required deposits in a timely manner usually brings swift action by the government.

Agents can padlock your business and arrest you until you make the deposits. The reason for such drastic action is that the money involved belongs to your employees and then the IRS. Your business is simply a temporary custodian or trustee of it.

You will also need to ensure that you are in compliance with Sarbanes-Oxley. This is particularly true if you see your company as an acquisition candidate at any time. Many public companies or companies that do deals with public companies are required to be in compliance with Sarbanes-Oxley and will only buy other companies that are also in compliance.

Finally, the Occupational Safety and Health Administration (OSHA) has very specific requirements concerning health and safety, which apply to many businesses. The enactment of the Americans with Disabilities Act (ADA) affects businesses with 25 or more employees both in hiring practices and customer accommodations.

Tip

You can find out more about the federal guidelines that pertain to your business from the Small Business Administration or a Small Business Development Center.

State Governments

While federal regulations are the same for everyone in the United States, each state has different regulations and may require additional licenses and sales tax collection.

The selection of the state in which to locate a business is not a minor matter. Where you choose to do business greatly affects the cost of operations, markets, and profits. Granted, circumstances are often beyond your control and force you to do business in a certain state. Still, you should be keenly aware of all regulations required by the state in which you do business.

Tip

Don't overlook your attorney and accountant when seeking help in complying with governmental regulations.

One of the primary requirements of many state governments is that businesses collect sales tax from their customers when the customer is the end user of a product or service. Although most states have a sales tax, the method of each state for handling the tax differs. Some states tax certain products and services differently. You can find out about your state's sales tax on the state's website, from local chambers of commerce, or from your closest Small Business Development Center.

If you conduct business in several states, your venture may have to be authorized to do business in all of them. Companies that plan to resell goods use a state sales tax identification number when purchasing goods that will be resold. This way, the company does not pay sales taxes, but collects them when it sells the product or service to the final user. The business must still pay sales tax on the things it buys to use, such as plant equipment, office supplies, and plant-maintenance supplies.

Sales taxes should not cost you anything. You collect money from your customers for sales tax at the time of sale, and you turn in this money to the state sales tax division. Some entrepreneurs get caught in the trap of spending the collected sales tax money before it is due. Then they must scramble to come up with additional funds to pay the sales tax division. All state governmental agencies frown upon this practice.

Many state governments also require a business to register with the secretary of state. Corporations file their articles of incorporation, while sole proprietors may be required to file a fictitious name registration.

Reality

Entrepreneurs who own 100 percent of their business do not realize that they still have what amounts to partners – the federal, state, and local governments.

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A quick call to the secretary of state's office will reveal the regulations for companies doing business in that state. Also, many states have established websites with answers to frequently asked questions about starting a business and links to the appropriate agencies.

Local Governments

Local governments (county and city) regulate licenses, permits, and zoning. When you apply for a local license, you will probably be asked to get inspected by the fire department, building officials, and zoning authorities. The fire department wants to know if you are doing anything that could be a potential fire or chemical hazard. It also wants to know if the building meets all fire codes. The building inspection department may inspect the property to make sure it is safe and up to code, and the zoning department will determine whether your intended use is permitted in the zoning classification.

Local governments can impose changes to existing and new buildings. For example, a new plant was forced to cut a large hole in the middle of its floor for another stairway from the basement, even though the basement was unused. The stairway added a significant expense of $9,500. Although the plant had been built to local building-code specifications, the local authorities still had the ability to order the extra stairway. A home-based business can sometimes avoid zoning regulations. Other entrepreneurs avoid such problems by locating themselves in rural areas or small towns without excessive requirements. A call to city hall or county government will reveal the requirements in your region.

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Identifying Funding and Working with Investors

STARTUP YOUR IDEA

9

Most technology entrepreneurs cannot launch or operate their business with just their personal finances, and this will probably be the case for your business. At a certain point, you will want to seek outside funding sources. This may mean having to give up some of your ownership and control of the business, which is never easy. But if you plan carefully, you can find the right amount of money, from the appropriate sources, on acceptable terms.

Of particular importance is the timing of the infusion of capital into your business. The longer you can delay seeking equity investors, the more value you can build into the business prior to selling equity. Bootstrapping (using your own resources plus running a frugal operation) and grants from federal (and other) agencies are "free" sources of funding – that is, no interest expense or loss of ownership results from using grants or bootstrapping to start and grow your venture. These sources allow you to achieve critical milestones in the company prior to seeking equity investment.

The more mature your company (having achieved critical milestones such as completing product development, making the first sale, or achieving revenue milestones), the higher the pre-money valuation at the time you solicit investment from angels or venture capitalists. A higher pre-investment valuation means the investors will purchase a smaller ownership piece of your company with their investment capital.

Caution: Postponing fund-raising to the extreme can cripple the company, especially when the window of opportunity is short (as is often the case in technology start-up companies). Talk with your business coach to create your fund-raising and financial plan and to determine when to begin work on this critical stage of business development.

In this module, you will examine all these issues in depth.

Outcomes

- Identify sources of non-equity funding.
- Learn about equity funding sources, how to raise money from equity sources, and how they determine the value of your business.
- Recognize pitfalls to avoid in raising money.
- Examine specifics of presenting to potential investors.

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Action Steps (Find online tools at **fasttrac.org/resources**.)

- ❑ Calculate dilution using one of the two Dilution Calculator files (Action Files tab).
- ❑ Draft the Investor Highlights section of your Business Plan.
- ❑ Draft your Investor Presentation (Action Files tab).
- ❑ Refine the Executive Summary section of your Business Plan as you draft other sections.
- ❑ Continue to update and refine the data in your Financial Template.
- ❑ Continue to refine your Elevator Pitch.
- ❑ Read Module 10: Managing Cash and Operating Your Business.

Non-Equity Funding Sources

BUSINESS PLAN

Financial Plan
///
Sources of Funding

Non-equity funding is capital received from sources of cash that can be obtained without giving up ownership shares of the company. Bootstrapping and grants are the primary sources of non-equity capital for technology start-up ventures. Bank debt is another form of non-equity funding but is normally not available to new ventures unless the founder has collateral outside the company that can be provided to the bank to assure repayment to the lender.

In the long run, successful ventures make equity ownership very valuable. From this perspective, then, all non-equity funding sources are inexpensive funds for starting ventures, because these funds either do not require repayment or can be repaid with minor interest payments.

Bootstrapping

Entrepreneurs can spend too much time worrying about balance sheets, revenue forecasts, and profit and loss statements. Cash is king – concentrate on how many weeks and months of cash you have to support operations. (This defines your runway, that is, how many months you can operate with cash on hand at the current rate of expenditures.) Many great ideas and technologies have been aborted on the launch pad because they did not have enough cash to get to the first gate of external funding.

Bootstrapping, getting a lot done on very little cash, is a common practice for early stage companies. For most start-ups, bootstrapping is an essential first stage because it:

- Demonstrates the entrepreneur's commitment and determination.
- Keeps the company focused.
- Allows the business concept to mature more into a product or service.
- Gives the concept a chance to be vetted by the market.
- Allows some milestones to be achieved.

Relatively early in the process, before you get deeply in debt, decide how far you want to go on personal financial risk (such as by depleting your savings, selling off your stock portfolio, liquidating your 401(k), taking equity out of your home, running up your credit cards, or pledging personal guarantees). This will help you know when to move beyond bootstrapping to finance the business.

Primary sources of the cash necessary for bootstrapping are from the start-up entrepreneur. These include:

- Cash from savings.
- Borrowing against assets, such as your home.
- The careful use of selected credit cards.

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- Keeping your day job, while starting the business in off-hours.
- Living off your spouse's wages while starting the company.
- Doing consulting work to provide start-up cash for the business and for living expenses.
- Rushing an early product to market to provide for early revenues and earnings.
- Running extremely frugal operations, allowing the company to grow on internally generated cash earned on the sales of products.

These are some tactics to stretch your bootstrapped cash runway:

- Lease or borrow the equipment you need to acquire new, such as computers.
- Buy fixed assets such as furniture used or from "fire sales."
- Go as long as humanly possible without paying yourself.
- Compensate advisers and consultants with equity, good will, and in-kind services. Salaries end up being the largest part of expenses and once you start paying, you can't cut them off. You will also end up paying FICA and other related expenses which drive up actual cash expenses significantly.
- Call in past favors and rely on personal relationships to get things done for free.
- Use lawyers and accountants to help you with judgment issues, not basic education issues. Negotiate the delay of payments for services until the company is funded. Use public sources to learn the basic parameters before starting the fee clock.
- Be frugal everywhere – drive instead of flying, choose cheap hotels, and use your personal computer and printer.
- Find out the real, unmet need versus shotgun marketing to drum up unqualified sales leads. Spend money on marketing only if you must.
- Post job openings and see who applies. Many will be unemployed people that will work for deferred compensation or equity with the hope of someday getting cash payment.
- Network everywhere to leverage connections and personal introductions by others.
- Get to know the people from whom you hope to get money before you desperately need it.
- Keep records of all out-of-pocket expenses. Once you raise money, you may be able to reimburse yourself first before taking a salary to lessen tax issues.

Continue bootstrapping as long as possible, but know when it's time to seek investors. Postponing fund-raising to the extreme can cripple the company, especially when the window of opportunity is short (as is often the case in technology start-up companies). Potential investors will recognize and value your bootstrapping resourcefulness in starting your company.

Governmental Grants

With a little effort in writing proposals and a fair amount of commitment to regular reporting to the granting body, grants and research contracts can provide an ideal source of funding for the early-stage tech or life sciences company.

Federal R&D awards provide more than half of all U.S. corporate research funding and are in excess of $75 billion per year. Of that amount, about $1.5 billion is dedicated to small businesses. Companies can apply for governmental funding through numerous programs. Two of them, the Small Business Innovation Research (SBIR) program and the Small Business Technology Transfer (STTR) program, are examined in detail below.

SBIR and STTR Programs

Governmental grants are neither debt nor equity. About one-half of all corporate research funds come from governmental grants. These grants support the research and development

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and subsequent commercialization of a technology, product, or service. Most prevalent are the Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR) programs.

SBIR and STTR programs offer:

- Funds reserved for small, innovative companies.
- Funds for high-risk projects.
- No dilution.
- Valuable credibility.
- A simplified route to obtaining federal R&D funds.

SBIR and STTR Objectives – These two programs have the same three objectives:

- Stimulate technological innovation.
- Strengthen the role of small businesses in meeting federal research and development needs.
- Increase private sector commercialization of innovations derived from federal research and development.

Small Business Eligibility – To qualify for SBIR and STTR programs, your business must have fewer than 500 employees, be American-owned and independently operated, and be for profit.

Each year the 10 participating agencies for SBIR and five participating agencies for STTR issue program solicitations describing the technical areas in which they are interested. The solicitations, their release and due dates, and submission instructions are available at each agency's website.

Evaluation Criteria – The agencies evaluate the submissions for SBIR and STTR grants based on the following criteria:

- Scientific and technical quality and innovativeness of the idea, and the significance of the scientific or technical challenge
- Ability to carry out the project; that is, qualifications of the principal investigator and other key personnel, adequacy of facilities and equipment, and soundness of work plan
- The impact as evidenced by technical and/or economic benefits, the likelihood that the work would lead to a marketable product, or the likelihood the project could attract further funding

Small Business Innovation Research (SBIR)

The Small Business Innovation Research (SBIR) program funds qualified small businesses to meet specific research and R&D needs of the federal government. The program was enacted in 1982 as part of the Small Business Innovation Development Act (and reauthorized in 2000). It requires that federal agencies with more than $100 million in extramural R&D allocate a percentage of their budgets exclusively for small businesses. This set-aside began in 1983 at 0.2 percent and is currently at 2.6 percent.

Three Phases – SBIR is a highly competitive three-phase program. Phase I is a feasibility study to evaluate the proposed project's technical merit. An awardee may receive a maximum of $150,000 for approximately six months for this initial phase. Phase II is the principal R&D effort that expands on the Phase I results. This two-year project may receive up to $1,000,000 in funding. Only Phase I awardees are eligible to compete for Phase II funds. Phase III is the commercialization of the Phase II results and moves the innovation from the laboratory to the marketplace. This private-sector commercialization of innovations requires use of private sector or other non-SBIR funding. Some agencies, however, do provide follow-up Phase IIB or matching funds to assist with commercialization activities.

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Small Business Technology Transfer (STTR)
The Small Business Technology Transfer (STTR) program was established by Title II of the Small Business Research and Development Enhancement Act of 1992 to foster innovation necessary to meet the nation's scientific and technological challenges of the future. This three-phase program provides the opportunity for qualified small businesses to work collaboratively with nonprofit research institutions on research or R&D projects. Federal agencies with more than $1 billion of extramural R&D must reserve 0.3 percent of their budgets for R&D small businesses and their partners. STTR was recently reauthorized through 2017.

STTR is much like the Small Business Innovation Research (SBIR) program. Its unique feature is its requirement that the small business work jointly with a nonprofit research institution located in the United States. A minimum of 40 percent of the work must be performed by the small business and a minimum of 30 percent by the nonprofit research institution.

Three Phases – STTR is a three-phase program of which two are federally funded. Phase I is a feasibility study to evaluate the proposed project's technical merit, for which an awardee may receive a maximum of $100,000 for approximately one year. Phase II is the principal R&D effort that expands on the Phase I results. This two-year project may receive up to $750,000 in funding. Only Phase I awardees are eligible to compete for Phase II funds. Phase III is the commercialization of the Phase II results and moves the innovation from the laboratory to the marketplace. This requires use of private sector or other non-SBIR funding.

Differences Between SBIR and STTR

	SBIR	STTR
Phase I Level of Effort	Minimum of 2/3 of the effort **must** be performed by small business Maximum of 1/3 of the effort **may** be performed by consultants and/or subcontractors	Minimum of 40% of the effort **must** be performed by small business Minimum of 30% of the effort **must** be performed by a nonprofit research institution
Phase II Level of Effort	Minimum of 50% of the effort **must** be performed by small business Maximum of 50% of the effort **may** be performed by consultants and/or subcontractors	(Same as Phase I) (Same as Phase I)
Subcontractors	**May** have subcontractors involved	**Must** have nonprofit research institute involved as subcontractor

Tip

Subcontracting can help shore up your project by adding important team members and equipment.

Project Duration	Phase I – Approximately 6 months Phase II – 2 years	Phase I – Approximately 1 year Phase II – 2 years
Maximum Award Amount	Phase I – $150,000 Phase II – $1,000,000	Phase I – $100,000 Phase II – $750,000
Number of Agencies Participating	10	5
Principal Investigator	**Must** be employed with small business	**May** be employed with either small business or nonprofit research institution. (This requirement varies among agencies.)

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Research Institution Eligibility – STTR requires that your company work with a nonprofit research institution. That institution must meet these requirements:

- Located in the United States
- Is one of the following types of nonprofit organization:
  - University or college
  - Domestic research organization
  - FFRDC (federally funded research and development center)

Do SBIR and STTR Programs Work for You?

SBIR and STTR programs offer small businesses a great opportunity to obtain R&D funding, but the proposal process can be long and complex. Therefore, you must be certain that the program is a fit with your business strategy.

Be sure that a grant fits directly into your business plan and is not just an interesting sideline. Investors are particularly wary of entrepreneurs who have funded the very early stages of the company with a list of federal grants and cannot focus on commercializing a single product. Pursuing a series of grants may be interpreted as an entrepreneur who lacks focus.

The first question to ask is whether the three-year project period fits with the timeline set forth in your business plan. If you have investors who have agreed to certain milestones, be sure that shareholders agree to the SBIR's extended timetable before submitting a proposal.

You must also consider whether the SBIR or STTR time frame is realistic for the proposed technology. Determine how far potential competition has progressed into the development phase. For instance, you may determine that a competitor could be able to go to market in only 15 months, while it may take you twice as long via the SBIR or STTR programs. If yours is a first-to-market strategy, the SBIR or STTR programs may not be the way to go.

Keep in mind, however, that there are many benefits to taking a slower development approach via the SBIR or STTR programs, including the credibility brought to your technology through a scientific peer review process and the equity benefits of the non-diluted funding.

A second question to ask is whether the business has the facilities, equipment, and other resources necessary to conduct an SBIR or STTR project. These resources include team members and cash flow funds to support business overhead needs before and after the SBIR project. Many options exist to develop the resource base that will be required to carry out a project. Just take the time to clearly define those needs before sitting down at the keyboard to write your proposal. Small Business and Technology Development Center (SBTDC) counselors can help tech companies assess potential blind spots when building a resource base.

Also keep in mind that proposal preparation itself is an investment. As with any project, there are opportunity costs involved with developing a winning proposal. Consider whether you have the team in place to devote 120–180 hours to develop the proposal and whether the team is willing to try again if the first proposal is initially unsuccessful.

Finally, consider whether you and your team have the desire to journey down the long road of commercialization following your R&D efforts. Keep in mind that the goal of these programs is to propel your technology beyond the testing and development phases. Thus, once Phase II is completed and the SBIR or STTR dollars have stopped flowing, your primary responsibility becomes that of getting your product or service out of the lab and into the hands of a buyer. You and your team must agree that selling your product or service is the end goal of all your hard work. SBTDC technology commercialization counselors can assist you in getting your product to market.

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How to Write a Competitive Proposal for SBIR or STTR

To gain a competitive advantage, your proposal should:

- Focus on one main idea or concept. Avoid the shopping bag of ideas approach.
- Involve an advanced concept related to an important scientific problem or opportunity.
- Show how your concept or idea is new and innovative. Describe the innovation effort concisely, quickly, and accurately. The proposal concept or idea cannot be an extension of an earlier work or already in the public domain.
- Address high-quality research or research and development. It must be at the cutting-edge of the subject to be investigated. Literature reviews or market surveys are not appropriate.
- Include work plan details. Your work plan must be adequate to satisfy your technical objectives. Show where you have the resources to support your work plan.
- Note the significant commercial potential. An idea or concept that leads to the penetration of many markets is most attractive. Describe who or what will benefit from the success of this work. Identify available sales channels and potential industry partners. Use your financial forecasting to estimate the profitability of your venture.
- Introduce future plans. Give an outline of where you plan to go after this project.
- Highlight project personnel. As principal investigator, you are responsible for the project. Convince the reviewer that you are the best qualified to carry out the project. Reference your prior publications, research, or hardware in the specific proposal area. Make sure that you identify and obtain support from at least one expert consultant and an industrial partner.

Reality

Creating a winning proposal is a laborious project. Make sure you provide sufficient time to develop, re-work, and review your project proposal before submitting it.

You should have a broad knowledge of the technical fields associated with the proposal concept or idea. Most successful proposals are completed according to a specified time schedule. Therefore you should:

- Provide sufficient time to develop a sound project concept.
- Adequately research background.
- Develop and rework research approach.
- Define technical objectives.
- Write a work plan that is adequate to satisfy technical objectives.
- Prepare a complete draft of the proposal and leave it for a few days.
- Review the proposal and make changes that represent significant improvements.
- Prepare the final draft.

And finally, don't forget about common sense:

- If you are not a real expert or you don't have a real innovation, do not waste your time. If you cannot reference prior publications, research, or hardware in the specific proposal area, you will not be perceived as a real expert.
- There needs to be a real company.
- Get to the innovation and significance of the effort concisely, quickly, and accurately.
- Accurately and fairly discuss what others have done and why the innovation is an improvement to the state-of-the-art.
- Deliver hardware or demonstrate the innovation in Phase I.
- Do not waste the reviewers' time with fluff and boilerplate.
- Do not clone proposals and/or reuse proposals.

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Common Proposal Problems

Many grant seekers feel that they are pursuing important new technology and are surprised when they don't win a grant. Remember, however, like with your Marketing Plan, that there are many more elements that make up your proposal than just your product or service. The details count, and people who don't win grants often forget to address these details. To improve your chances for success, avoid these common proposal problems:

- Poorly written and presented
- Principal investigator lacks necessary technical expertise
- Insufficient literature review
- Insufficient technical information
- Cannot be completed in six months
- Inadequate bibliographical information
- Lacks letters from consultants
- Research already done by others
- Too vague and unfocused
- Failure to indicate where project would go in Phase II
- Poor commercialization potential
- Doubtful economic prospects
- Inadequate detail in experimental plan
- Too much research done at university
- Need to engage consultants to add expertise in area where principal investigator is deficient

Debt Financing

Tip

Debt financing does not dilute the stockholders' ownership share.

Debt financing takes many forms. The essence of debt is that the borrower must repay the funds along with agreed-upon service charges such as interest and loan origination fees. If the money is not repaid as promised, the lender can start collection proceedings. This process can become very uncomfortable for the entrepreneur, who could stand to lose the business and any non-business assets pledged to secure the loan.

Reality

Borrowing money is like placing a bet. The entrepreneur uses the company to bet with the lender that he will be able to perform according to plans. If the plans are wrong, an entrepreneur can lose his company and anything else he has invested.

Seeking financing from an outside lender can be difficult. The process is made easier when the entrepreneur understands the lender's concerns. Lenders want to loan money to businesses that will provide a good return. They also want to do business with companies that pose little risk, which is why many technology and life science companies are not able to raise debt financing until they are down the road considerably.

Money should not be borrowed lightly. The borrower assumes a serious obligation. It is a basic lesson of finance that money should not be borrowed unless those funds will earn in excess of their cost. It is also important to consider that banks expect two forms of repayment, and entrepreneurs rarely have more than one.

Examples of debt include numerous types of loans:

- SBA-backed loans
- Long-term loans
- Line of credit
- Real estate loans
- Loans from friends or family

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The first three types of loans are examined in more detail below.

SBA-Backed Loans
The Small Business Administration has a variety of guaranteed loans. They have programs for both start-ups and existing companies; for working capital, inventory, and equipment; for minority- or women-owned businesses; and for loans in the nature of lines of credit. The SBA does not make the loans, banks do, but because the SBA guarantees a portion of the loan, the bank's risk is lessened.

Entrepreneurs who might otherwise be unable to find a bank willing to make the loan may be able to obtain an SBA-guaranteed one. The entrepreneur should seek out banks that are not just SBA-certified lenders but those that are actively seeking to make SBA loans. SBA loan interest rates are generally slightly higher than conventional loans, but if they are the only available source of funds, they should not be dismissed simply for the additional costs.

Reality

To request an SBA-backed loan, entrepreneurs with at least 20 percent ownership in a company must submit personal financial statements during the application process and personally guarantee that the funds will be repaid.

Long-Term Loans
A long-term loan usually has a payback period between one and five years. Depending upon the deal negotiated, these loans are normally secured (collateralized by assets) and guaranteed by the entrepreneurs. Rates and terms on long-term loans vary greatly based on the lending institution's policies and the business's age and financial status.

Collateral (personal assets) is pledged by the entrepreneur to offset the loss to the lender should the entrepreneur default on the loan. If a borrower fails to meet the terms of a secured note, the lender takes possession of whatever asset was pledged as collateral and sells it. The proceeds of the sale are then applied to the amount due on the note. The loss of collateral will not release the borrower from all liability on the debt if the collateral sale proceeds are not enough to pay off the loan and the lender's costs of retaking and selling the collateral. If the sale of the collateral is insufficient to repay the debt, the lender may then look to the guarantee provided by the entrepreneur for the remaining unpaid balance.

From Real Entrepreneurs **long-term loan**

One entrepreneur borrowed $20,000 from the bank, using his company's injection-molding machine for security. After several months, he realized that he couldn't repay the loan, so he stopped making payments. The bank went to court and proved that the note was legal and the entrepreneur was in default. The bank received a legal document from the court that allowed the sheriff to take possession of the molding machine. When the molding machine was sold, it only brought $5,000, some of which went to the lender and some to the attorney. The entrepreneur still owes the lender $15,000 in interest, legal fees, and court costs. This costly loan could have been avoided if the entrepreneur had done cash flow projections to determine the business's ability to repay the loan.

Line of Credit
When a line of credit is awarded to a business, the funds can be drawn upon whenever needed. Lines of credit are usually only available to entrepreneurs after they have raised equity capital as leveraging funds. Certain venture banks offer lines of credit to companies who have recently secured a round of equity capital.

Tip

Be sure you understand all the terms and conditions of the line of credit. Some banks require that the line of credit balance be paid down to zero at least once each year. Other banks will keep renewing the note without payment other than interest.

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This type of funding is appropriate to cover seasonal fluctuations in sales or regular cash shortages. The amount and terms of the line of credit are determined in advance based on the needs of the business and the policies of the lending institution.

In most cases, lines of credit are due to be paid within a year. Other policies may be imposed, such as not using the line of credit for two months after the balance has been paid. The rate will vary based on the institution and the business. In general, the rate for established companies is often one or two points over the prime rate, slightly higher for new businesses.

Equity Capital

BUSINESS PLAN

Financial Plan
///
Sources of Funding

Equity Capital Sources for Entrepreneurs

There are three primary sources of equity capital for entrepreneurs starting and growing new ventures: friends and family, angel investors, and venture capitalists. These investors make up a hierarchy of capital sources, that is, they provide a non-overlapping spectrum of equity capital, as is shown below:

Pre-Seed Stage	Seed/Start-up Stage	FUNDING GAP	Early Stage	Later Stages
Founder's Friends and Family	Angel Investors	Very few angel deals done above $1 million Very few VC deals done below $4 million	Venture Capitalist	
$0	$250K	$1.5 million	$4 million	$10 million up

Tip

Raising capital usually takes two to four months from angel groups and four to six months from venture capitalists.

Most friends and family rounds of investment tend to be smaller than $100,000 with individual investors rarely investing above $5,000. Rounds of investments from angels tend to range from $250,000 at the lower end to $1.5 million (rarely $2 million) at the upper end. While some solo private investors and boutique venture capitalists do invest in the funding gap between $1.5 million and $4 million, the total number of investments per year is quite small. The average venture capital round of investment is $7-8 million and the rounds size varies from a few million on the low end to hundreds of millions at the high end.

Devising a Capital Strategy for Growth

The existence of the capital gap requires that entrepreneurs determine the amount of capital necessary to grow the business and then carefully consider staging investments from the appropriate sources of capital. Entrepreneurs must integrate their capital needs with the ranges of capital available from these existing sources. Entrepreneurs who need $3.5 million to achieve positive cash flow must, for example, either establish milestones that can be achieved with multiple angel rounds of $1-1.5 million or revise their capital strategy to raise a first round of, say, $0.5-1 million from angels, and then plan to grow their business even faster, necessitating a $5 million round from venture capitalists later. Going to the capital markets planning to raise $3.5 million in a single round is foolish. There are simply too few investors funding rounds of this size to justify the effort.

A bit more on milestones: Entrepreneurs seeking equity investor capital must carefully consider the milestones that can be achieved with specific expenditures of cash. Investors are most interested in measurable achievements that can be completed with specific rounds

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of investment and leaving the company enough runway to allow time to raise the next round of capital without running out of cash. Examples of such milestones might be:

- First purchase order from a customer.
- Collection of cash on first order.
- Achieving $100,000 in bookings in a single month.
- Delivering $250,000 in product in a quarter.

Identifying and meeting these milestones is critical to raising both the initial and additional rounds of equity capital.

Understanding Friends and Family Investors

When Aunt Martha invests $10,000 in Nephew Jimmy's new business, she is doing so because she wants Jimmy to be successful in his new venture. Her understanding of the venture is usually sketchy, and she invests with little illusion that she will see any return on this investment. This financing is often a gift of friendship and love from a friend or family member. Aunt Martha probably has little understanding of business or entrepreneurship, but she fervently hopes Jimmy will be successful, for his sake. According to the Global Entrepreneurship Monitor, over $50 billion is invested annually by friends and family in start-up entrepreneurs, usually with few strings attached.

Tip

When networking, be aware that you may be talking to an angel investor and not know it.

Regardless of intent by the sources, entrepreneurs should think about those strings when the monies are received. Is this cash a gift? A loan? Or, is this cash an equity investment? Entrepreneurs should talk it over with Aunt Martha to determine whether she expects this debt to be repaid or, if the company is successful, she expects to be a substantial owner of the company. These are not matters that should be ignored. Subsequent professional investors (angels and venture capitalists) will require knowledge of the status of these earlier investors. There is no better time than when the money is received to settle these matters.

Understanding Angel Investors

Most angel investors are experienced businesspersons or exited successful entrepreneurs who invest in seed and start-up entrepreneurs as a part-time avocation. They invest both time and money in starting companies. While return on investment is an important metric of success in this endeavor, angels genuinely enjoy working with entrepreneurs and growing their businesses. Many angels remain engaged in running their own businesses while assisting new entrepreneurs with their start-up ventures. Other angels are semi-retired, mixing angel investing with travel and recreation. Six to 10 angel investors will fund a round of investment in new ventures, and then a couple of angels will continue to work with the company for several years as mentors, coaches, and directors. Only in emergencies do angels tend to jump in as full-time executives, and then only on a temporary basis. Most angels receive no compensation for their efforts, although it is not unusual for angels serving on boards of directors to be paid in equity for their efforts.

Individual angels usually invest $25,000 to $100,000 per company and, because this is very high-risk investing, wise angels tend to invest in eight to 10 companies at a time. Most angels invest 5-10 percent of their net worth in entrepreneurial ventures with the remainder in lower-risk accounts. Many consider their angel investments to be their "mad money," that is, money they might just have wagered at the race track or the blackjack table.

It is said that all of the return on investment from 10 angel investments tends to come from 10-15 percent of angel investments. It would not be surprising to find, then, that angels seek to fund companies that show the potential to scale rapidly, that is, grow quickly to $50 million or more in revenues over the first five to seven years of operations.

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Since 1995, angels have been forming and joining angel groups at quite a rapid rate. It was reported in 2005 that over 220 formal angel groups had been formed in the U.S., up from perhaps 10 to 15 groups a decade earlier. What explains this rapid growth?

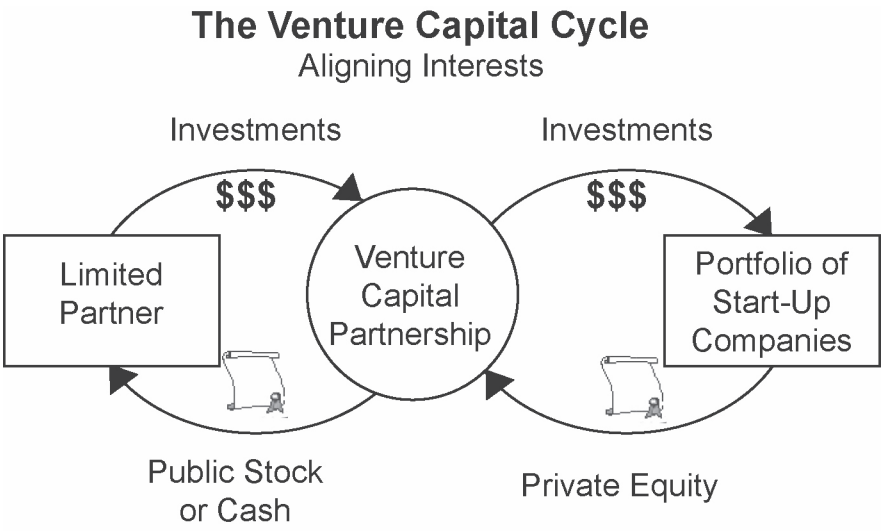
Solo angel investing is difficult, time-consuming, and lonely work. Finding deals, completing the necessary in-depth study of each deal (due diligence), and structuring the deal to meet the needs of investors and entrepreneurs alike can be quite intensive and laborious. By joining angel organizations, angels see more deal flow and can share the work of vetting and investing in each deal with like-minded investors.

Angel organizations tend to take one of two forms. *Angel funds* scrub deals as a group and then vote on making an investment from pooled funds. Companies earning a positive vote receive a substantial amount of funding in one investment. *Angel networks* are groups of angels who screen and scrub deals together, but then make their own decisions on investing. Some may invest $25,000, a few perhaps $100,000, while others may choose not to invest in a specific company.

Understanding Venture Capitalists

An investor's motivation is key to understanding his or her frame of mind in making investment decisions. Venture capitalists (VCs) manage other people's money, and consequently, their primary goal is to generate a competitive rate of return for those investors.

Venture capital firms invest from discrete funds. The firm typically raises a new fund every three to four years, spending the interim time investing that money in new companies. Venture capital firms typically raise their funds from large institutional investors, such as state pension funds or endowments. For those institutional investors, venture capital is one of many investment vehicles used to diversify their investment portfolios – venture funds are a high-risk, high-return piece of a complete investment puzzle.



The investors in VC funds are called Limited Partners in the venture capital partnership. For legal reasons, they are passive investors. The venture capitalists, called General Partners, make all investment and portfolio decisions. It is this venture capital limited partnership that becomes the shareholder in a portfolio company.

In order to compensate for the illiquid nature and higher risk of most venture capital investments, limited partners expect a very high rate of return. The higher the risk (for example, a very young company with unproven technology), the higher the expected return.

Venture capitalists diversify their own portfolios in order to manage risk and to achieve the high rates of return expected of them by the Limited Partners. Out of 10 investments, most venture capitalists can expect three to fail, three to neither fail nor be wildly successful (returning about what the venture capitalist invested in the company), and three companies to return the entire value of the portfolio, several times over. Those three investments must be grand-slam home runs, with annual rates of return greater than 40 percent.

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A key to the investor mindset is understanding that venture capitalists only invest in companies that they think will be home runs. If your company doesn't have the potential to return an investor's money many times over, you may not be an appropriate candidate for venture capital. The table below shows the effect of time on rate of return. For example, if it takes five years to exit and the investment returns five times its cost, the rate of return is 38 percent compounded annually. That same five times multiplied in two years would yield a 124 percent return. The shaded area of the table includes all values above 40 percent.

Venture Returns

The Time Value of Money

	Rates of Return Year to Exit									
X	1	2	3	4	5	6	7	8	9	10
1	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
2	100%	41%	26%	19%	15%	12%	10%	9%	8%	7%
3	200%	73%	44%	32%	25%	20%	17%	15%	13%	12%
4	300%	100%	59%	41%	32%	26%	22%	19%	17%	15%
5	400%	124%	71%	50%	38%	31%	26%	22%	20%	17%
6	500%	145%	82%	57%	43%	35%	29%	25%	22%	20%
7	600%	165%	91%	63%	48%	38%	32%	28%	24%	21%
8	700%	183%	100%	68%	52%	41%	35%	30%	26%	23%
9	800%	200%	108%	73%	55%	44%	37%	32%	28%	25%
10	900%	216%	115%	78%	58%	47%	39%	33%	29%	26%
20	1900%	347%	171%	111%	82%	65%	53%	45%	39%	35%
100	9900%	9000%	364%	216%	151%	115%	93%	78%	67%	58%

You should study venture capitalists, through online research and by asking friends and advisers, to find out which firms are most appropriate as investors for your business. Many venture capital firms have specific investment criteria, choosing only to invest in certain industries, geographical areas, or at certain stages in a company's life cycle. Just as you wouldn't ask a real estate lawyer to incorporate your business, you should only approach VCs who have an interest in investing in companies like yours. Generalists do exist in the venture capital world, but particularly in early-stage investing, you should be able to identify investors who regularly invest in your sector.

If you decide to raise money from angels and venture capitalists, remember that fund-raising takes time – more time than most entrepreneurs expect. High-growth entrepreneurs find that fund-raising becomes an integral piece of their job. You will find that almost everyone you talk to, from customers to bankers, is a potential investor, which means that you're always raising money. Every conversation can potentially lead to future funding.

The Process of Raising Money from Equity Investors

The fund-raising process can be short or long, depending on a variety of factors from licensing issues to competition between investors, but you can expect the total time to range from two to six months.

In preparing to raise money, you should begin with a business plan. A business plan not only forces you to think through strategy, but it also helps articulate your vision to potential investors. The executive summary section of your plan is of critical importance,

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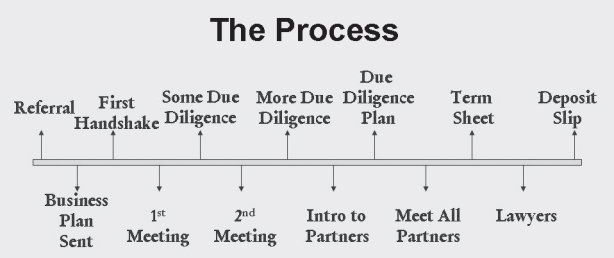
because many investors won't have time to read beyond it. Ensure that it includes key information and that the rest of your plan is organized to facilitate a reader flipping through to find data of interest.

If an investor becomes interested in your plan, you can expect a series of meetings, perhaps with one venture capitalist or angel, then with a larger team or the entire membership of the angel group or VC firm's investment professionals. Make sure to ask about each group's process so you can determine next steps and gauge how well you are progressing. As investing interest increases, these organizations will follow up with due diligence, doing background checks and making reference calls about you, your technology, and your market. Expect them to ask you to provide a list of references, and anticipate that they will also call people not on your list.

If an investor's due diligence validates the investment opportunity, the next step is a term sheet – a tentative investment agreement comprised of high-level, general terms agreed upon by you and the venture capitalist. As you move into negotiating the details of the term sheet, it is critical to have a good attorney. Many attorneys, particularly in entrepreneurial hotspots, specialize in representing entrepreneurs. An attorney that works with entrepreneurs on a regular basis is more likely to be knowledgeable about market trends with respect to valuation and other important deal terms.



The ultimate goal is to make it through the details of the term sheet, the drafting of formal legal documents, and then to the closing – when documents are signed and cash changes hands.

Tip

Obtaining the assistance of experienced start-up business attorneys at an early stage is crucial in helping a company avoid giving up too much control or too many preferences to investors. Such attorneys are familiar with market terms and can provide very useful data points, which an entrepreneur may use during negotiations.

Typical Terms

Entrepreneurs wonder which terms are most important to investors and which are negotiable. The easy answer is that investors are worried about all the terms. They are willing to find a fair balance between their needs and yours, but you can expect to negotiate most points. An experienced attorney will assist you in determining what and how to negotiate specific terms.

Terms can be divided into four main categories: Economic, Control, Liquidity, and Other.

Economic Terms – These terms refer to things that have the most effect on both the entrepreneur's and the investor's bottom line and that are usually heavily negotiated.

- *Preferred stock:* Preferred stock is a class of stock that is paid out before common stock is paid. Angels and venture capitalists almost always specify in term sheets that they will receive preferred stock. In the event of a liquidity event (good, like an acquisition, or bad, like a bankruptcy), holders of preferred stock take precedence over those with common stock. Preferred stock may also have a "participation feature" where, on a liquidity event, the investors get their money back, then "participate" in the remaining proceeds with the common shareholders.
- *Cumulative dividends:* Cumulative dividends accumulate like interest and are paid on preferred shares. Dividends on cumulative preferred shares are a company obligation regardless of the earnings of the company (unlike a dividend on common stock). Unpaid accumulated preferred stock dividends must be paid before the common stock receives any proceeds. They become part of the liquidation preference along with the original investment.

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- *Option pool:* An option is a right to buy stock at today's price sometime in the future. The option pool is the portion of common shares set aside for issuance to key employees at a later date. Particularly with an early-stage company, it is important to plan appropriately for an option pool, because future management will be partially compensated with those shares. Most term sheets specify that 15–20 percent of the company's outstanding shares will be set aside in an option pool. These shares usually come out of the pre-money value and are dilutive to founders only.
- *Anti-dilution:* This is a feature of the preferred stock which protects investors from issuing future stock at a price lower than what they paid. It is a mechanism for maintaining ownership percentage without the investor writing a check.
- *Valuation:* Valuation is one of the most important points of negotiation. It, along with the amount of money raised, will determine ownership of the company after the financing. Pre-money valuation is the value of the company just prior to receiving investor financing. Pre-money valuation plus the amount of funding received in a round of investment equals the post-money valuation at that time.

Reality

Once a term sheet is signed, it is very difficult for a company to re-open negotiations without risking a perception that the company is proceeding in bad faith.

Control Terms – These terms refer to things that allow the investors to influence certain events without owning a majority of the stock.

- *Board of Directors:* The Board of Directors oversees the management of the company and ultimately assumes responsibility for strategic direction of the company. It is typical for investors to dictate the size and composition of the board in addition to taking a seat on it. This is a way to carry out fiduciary oversight and monitor obligation to investors.
- *Protective provisions:* These provisions are designed to allow the venture capitalist to block certain transactions such as the sale of the company, the issuance of new securities, or expansion of the option pool, all of which affect the venture capitalist's ownership.
- *Other control terms:* The investors will have the right to financial and other corporate information on a timely basis. Additionally, they will have a right to invest in future rounds to protect their ownership percentage (pre-emptive rights). They will also have the first right to buy any stock offered by another shareholder.

Liquidity Terms – These terms affect shareholders' rights in the event of a sale or public offering of the company (a liquidity event).

- *Redemption:* The investors will require the company to purchase their stock after a certain period (usually five years) if the company does not otherwise have a liquidity event.
- *Vesting:* A vesting period is the period of time (usually four years) over which shares of stock or stock options become owned unconditionally by an employee or founder. If a founder leaves before the vesting period ends, the company has the option to purchase back the unvested shares. If the employee has stock options and leaves before the vesting period ends, the employee loses any unvested stock options. Investors use vesting as a management incentive – stock options vest over a period of several years so that managers stay interested in the company and its future.
- *Registration rights:* These rights provide for how the preferred shares will convert to common stock when on the open market after a public offering.

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Other Terms – These include miscellaneous other terms that relate to the process of negotiating with venture capitalists.

- *D&O and key person insurance:* Most investors will require that the company purchase D&O (directors and officers) liability insurance and key person insurance within 30 days of the deal closing. D&O insurance protects members of the board of directors and officers of the corporation from lawsuits filed by shareholders, former employees, and others. Key person life insurance is purchased for key members of the company to protect the company in the event of an unfortunate death.
- *Stand-still/No-shop:* Some investor groups will include a stand-still or no-shop clause, preventing a company from talking to others about funding for a period of time. Often, these are 30 to 60 day lock-ups during which the company is unable to speak with other potential investors. This allows the interested investor to perform due diligence without worrying about losing the deal. Entrepreneurs only agree to this term after they have agreed on all other terms and have signed a term sheet.
- *Non-disclosure and invention agreements:* These agreements assure that all intellectual property will be owned by the company and kept confidential. Most investors will not sign non-disclosure agreements; however, every employee should sign one of these agreements.

How Investors Determine Value

There is no magic formula that potential investors use to value a company. Most often, valuation is done through both objective and subjective measures. The subjective measures include the strength of all the individual elements of the business plan. The most important of these elements is management. A company with an experienced, complete management team is likely to garner a higher value than one with key members missing or inexperienced.

Large, growing markets can also add to a company's value, as can proprietary technology or a competitive advantage. If your company is solving a critical need in the market or addressing a market that is broadly regarded as up-and-coming, you can also expect the value to move a little higher.

Other general economic conditions can also affect the value. If more than one investor group is interested in funding your company, you may be able to extract a higher value. The most common method that investors use to value early stage deals is *comparables*, using market benchmarks by region to determine what deals are going for during specific periods of time.

Categories investors consider when determining valuation, from most important to least important, are:

- Management
- Financial
- Market
- Product/Technical
- Economic
- Regulatory

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Dilution and the Cost of Money

If you have devised a capital strategy, you know how much money you'll need to move your company through various stages of development. A key to raising money is to understand the value-changing milestones your company will achieve. The simple valuation formula will always remain the same:

$$\text{\% Equity Acquired by Investor} = \frac{\text{Cash Invested}}{\text{Negotiated Pre-money Value + Cash Invested}}$$

Example: $25\% = \frac{\$1 \text{ Million}}{\$3 \text{ Million} + \$1 \text{ Million}}$

Together, the cash invested and the pre-money value determine the percentage ownership of the company (as shown above). The only way to decrease the percentage ownership by the investors is to either increase the negotiated pre-money value or decrease the amount of money invested. So, it's in the entrepreneur's best interest to take as little money as necessary to reach significant value-changing milestones.

Your cash projection might tell you that your company will need $10 million over the next four years. You might also see that less than the full $10 million will get you to a significant milestone in Year 2, a milestone that could increase the value of your company. It may be smarter to take a smaller amount of money now, achieve the milestone, and then raise the subsequent money at a higher pre-money value later, thereby giving up less total ownership to investors.

Dilution of Ownership through Rounds of Investment

Round of Investment	Seed	Series A	Series B	Series C	Exit
Pre-money Valuation	$1.0	$4.0	$15.0	$75.0	
Investment	$0.5	$3.0	$10.0	$25.0	
Post-money Valuation	$1.5	$7.0	$25.0	$100.0	$550.0
Entrepreneur's Ownership	66.7%	38.1%	22.9%	17.1%	17.1%
Entrepreneur's Value	$1.00	$2.67	$5.71	$17.14	$94.05

A capitalization chart such as the table above allows you to view ownership through multiple rounds and evaluate how accepting investment at various stages of your company's development will dilute that ownership. As the table illustrates, you can either take less money and keep a higher percentage of ownership, or take more money and keep a lower percentage of ownership.

The Entrepreneur's Ownership percentage is calculated by dividing the Pre-money Valuation by the Post-money Valuation, and then multiplying the result by the Entrepreneur's Ownership percentage from the preceding round, if there was one.

The Entrepreneur's Value is calculated by multiplying the Post-money Valuation times the Entrepreneur's Ownership percentage.

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Pitfalls to Avoid

There are numerous pitfalls to beware of when raising money. Here are some important mistakes to avoid:

Unrealistic valuation or capital requirements – Entrepreneurs too often have unrealistically high expectations for the pre-money value of their companies or have not put sufficient effort into determining the amount of capital required to start and grow their companies. Talk to other entrepreneurs. Talk to your attorney, accountant, and other advisers who commonly work on venture capital investments. Review your plan with the local entrepreneurship center. Understand what market rates are for companies your size and stage, and have a reasonable understanding of what your company's valuation should be. Similarly, build a capital strategy to determine your capital requirements over time. Run estimates by your advisers before talking to potential investors.

A lack of understanding of your market and your place in it – Too often, entrepreneurs overestimate the size of their market, the ability to access it, or the strength of existing or potential competition. It is critical to have a clear and complete picture of the specific market sector served by the types of products and services offered by your company – and the slice of that market sector that is served by your company specifically. Entrepreneurs with unrealistic market expectations look unprofessional and naïve to investors. Get feedback from your advisers as well as key influencers in your market to paint an accurate picture of your market and achievable market share.

An unwillingness to build the best management team possible – The skills necessary to create a new technology and get a business started based upon that technology are different than the skills necessary to manage a growing company. Entrepreneurs often have one skill set without the other. Both are necessary to create and grow a successful company, but it is critical that entrepreneurs understand when they have built the company to a level that necessitates a new skill set to further grow the business. It is quite rare for one person to have all the skills necessary to create technology, start a company, grow that company, and manage an exit from that company. It is quite common for management team members, particularly founding CEOs, to move into other positions as the company moves into a new phase for which that person's skill set is not a match.

Technical risk – Early-stage investors are taking a risk with any company in which they invest. The entrepreneur who can eliminate much of that risk has an improved chance of landing financing. Investors are particularly uncomfortable with technical risk (the risk that the technology will not perform as advertised), and they will spend considerable time and resources in due diligence on your technology. Be aware of any technical risk you face and be prepared to answer questions about how you can diminish that risk.

A poor plan, presentation, or presenter – A face-to-face presentation is the best chance you have to convince investors to invest in your company. Make the best of the opportunity. Your presentation should be comprehensive, but concise. Your slides should be clear and easy to follow. Your speaking outline should follow a logical order. Dress professionally. Be prepared to hear critical feedback, and *don't* get defensive. Expect to spend 20 minutes maximum giving your presentation, including interruptions. Practice your presentation and get as much feedback as possible on everything from content to speaking style to handling of questions. Don't read your slides, and become so familiar with your presentation that you can deliver it without looking at your notes or slides.

Growing your company with good equity investors can be one of the most rewarding experiences of your entrepreneurial endeavor. Investors can add real value to your company with management guidance, a strong network of contacts, and sound strategic advice.

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Talk to other entrepreneurs who have started or are starting companies. Ask them about their experiences with various investors and who they would recommend. They know exactly what you're going through and are always willing to share wisdom – and war stories – with new entrepreneurs. Do due diligence on investor candidates prior to closing the deal. Background checks with their portfolio entrepreneurs will help you choose the right investors.

Private Placement

A private placement may take the form of debt, equity, or a combination of the two. This form of financing is exempt from scrutiny by the Securities and Exchange Commission (SEC) so long as companies do not use any form of public advertising and so long as the investors are fully qualified to evaluate the risks inherent in the enterprise and can bear the economic risks involved.

Private placement memoranda (PPMs) are used by brokers or dealers to assist entrepreneurs in raising money for a substantial success fee (from the proceeds of the investment). A knowledgeable investment lawyer or accountant should be consulted before attempting a private placement offer.

- A private placement memo may cost anywhere from $3,000 to $20,000 or more to prepare, depending on the complexity of the venture.
- Private placements can be done by the entrepreneur directly, but this is rarely done.

Entrepreneurs who intend to pursue angel or venture capital investment should not prepare a private placement memorandum, since these investors plan to conduct their own due diligence on investment candidates. PPMs are expensive and time-consuming to prepare, burning funds and energy that VCs and angel investors would prefer to see entrepreneurs expend in starting and growing their companies.

Presenting Your Business Plan

BUSINESS PLAN

Investor Highlights

The Business Plan can serve many purposes. In addition to being an evolving blueprint for the company's strategic progress, it may help you raise money, get a loan, negotiate terms with a vendor, convince a potential employee or management team member to join your company, solicit partners, or even apply to participate in a venture forum. The purpose of writing and sending the Business Plan will be different for each kind of recipient.

You should have at least four variations of your Business Plan: the full Business Plan itself, the Executive Summary, a slide presentation based on the plan, and your elevator pitch:

- The full Business Plan is the complete description of your business and is usually available in two forms, with and without appendices. Since the plan may be presented without appendices, be sure to include a summary of all appended information in the body of the plan.
- The Executive Summary is a two- to three-page synopsis of the complete Business Plan. Investors will never read your entire Business Plan after an initial introduction to you and your company, but they may read the Executive Summary if you have made a good impression. The purpose of the Executive Summary is to entice investors into meeting with you to discuss the investment opportunity. Carry copies of your Executive Summary with you at all times when seeking equity investments. Caution: Be sure that the Executive Summary covers all aspects of your plan and does not focus solely on the technology or on your product or service.
- The slide presentation based on your Business Plan is used at the first extended meeting with potential investors. The content of this presentation is discussed later in this module. See the topic, Make the Slide Presentation.

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- The elevator pitch is a two-minute statement of the high points of the Business Plan. Its purpose is to whet the appetite so the potential investor will want to know more about the investment opportunity. You have been honing your elevator pitch throughout this program so you can use it at networking events and other opportune encounters with potential investors. Your pitch should create sufficient interest that investors will request a longer meeting at a later date.

Presenting to Angel Investors and Venture Capitalists

Communication with potential investors must be carefully planned. Angel organizations usually have a website describing their application and investment processes. Venture capitalists, on the other hand, are difficult to get an appointment with unless you have a referral from a mutual contact.

From Real Entrepreneurs

presenting to venture capitalists

The story of Scott Cook's search for venture capital for Intuit is typical. He contacted 20 venture capitalists and was turned down by all of them. Only after raising money from friends and family, writing his own ads, and receiving orders was he able to catch the attention of venture capitalists and obtain funding.

Tip

When seeking a referral to an equity investor, do not overlook your attorneys and other service providers. These professionals often work on multiple transactions involving investors and have a built-in network as a result. It is not uncommon for an entrepreneur to consider the ability to utilize a service provider's network when forming a relationship.

Tip

Most angel investors seek investment in companies near their residences. Check the websites of angel organizations to confirm their geographical area of interest.

Target Investors

Before you try to get an appointment, make sure you're targeting the right investors. Carpet bombing, or the shotgun approach – sending unsolicited proposals to numerous investors – is rarely effective and can result in a loss of credibility. Do some research and target only those who are likely to invest in your company. Focus on those people and institutions that have invested in companies at your stage of growth, with your capital requirements, with products at your stage of development, in your industry, technical field, or market segment.

An angel group, for example, might be interested in early-stage, consumer electronics companies that need less than $1 million to commercialize products at the prototype stage of development. A later-stage venture capitalist might be interested in medical equipment companies with $100 million in sales that need $5 million to go public. Don't waste everyone's time by taking your proposal to an investor who is not likely to be interested.

Applying for Funding from an Angel Organization

Most angel organizations encourage entrepreneurs to apply for funding and describe the process on their websites. To find the location of angel organizations near you, consult the directory on the website of the Angel Capital Association at **angelcapitalassociation.org**.

Get an Appointment with the Target Venture Capitalist

Once you've targeted the right venture investor, you can work on getting an appointment. If possible, use your connections and networks to get a referral from a respected source. Make sure the source has had only positive interactions with the institution or individuals you're targeting.

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If you are able to obtain a referral, be sure to have a concise, one- or two-page Executive Summary ready before you contact the investor. The summary should be more than a reduced Business Plan; it should effectively and concisely emphasize the most striking and salient information that promotes your company as a potential investment.

Make the Slide Presentation

Investors are busy people and will want you to get to your main points as soon as possible. The most efficient way to think about your presentation is to focus on the big picture. The largest amount of your time should be devoted to the unique value proposition of the company, which should be clear, simple, customer-focused, realistic, differentiated, and exciting.

The main points of the presentation follow the content of the Business Plan:

- **Market need** – Define the primary market need and make a logical case for how your product or service meets that need.
- **Industry** – Examine the product's competitive environment and unique advantages. If your solution is the result of a significant new development (genomics or proteomics, for example), establish this fact quickly, in the beginning of your presentation.
- **Target market** – Your market analysis should include the past, current, and future size of the market and touch on qualities that will facilitate your company's entry and expansion strategies.
- **Features/Benefits** – Discuss the unique features and technologies of your product or service, but always in the context of your customers' needs. Features don't sell products, solutions do. What your product does is more important than how it does it. Provide a timeline of the product's development: where it is today and where it will be in six, 12, and 24 months.
- **Sales channels** – Explain details such as how products or services will be sold, who will sell them, who customers will interact with, and who will control those interactions.
- **Competitive analysis** – Identify any competitors that exist, in the broadest possible sense, in the general market space you have targeted. Explain how you will establish and defend your market position against these competitors, highlighting any intellectual property that accompanies your product or service, and any other steps you can take to protect your market share. One effective visual tool is to use a matrix that compares your company's features, customers, or other aspects to those of your competitors.
- **Management team** – Establish the credibility of your management team. Venture and private equity financiers invest in ideas, but more importantly, they invest in people.
- **Financials** – Explain your company's financial situation and strategy, but don't get bogged down in the numbers. Include the company's fund-raising history, current activities, future endeavors, and potential exit strategies. Provide a five-year projected income/cash flow statement that accounts for revenues, gross profits, operating costs (including development, sales and marketing, and administrative costs), capital expenditures, and annual and cumulative cash needs. When accounting for revenues, be sure to include product count, average selling price, and the launch of new product lines. For most early-stage deals, entrepreneurs should concentrate more on projecting expenses than revenue. Revenue is harder to predict. Expenses, on the other hand, will affect the burn rate and can be controlled. State the amount of money you're looking to raise from investors, and what you plan to do with it. Make sure your spending plans are reasonable, necessary, and responsible. Present all your financial information in a clear and easily comprehensible form, but have more detailed financial information available in case the investor wants to see it.

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A presentation to investors is in some ways a sales pitch: you are asking them to purchase a portion of your company. Always end your presentation by summarizing your company's top selling points. Ask the potential investors if they have any questions, and answer them honestly, deferentially, and to the best of your ability.

Don't expect a decision to be made instantly, but ask them what the next steps are. Investors complete a thorough due diligence process before they make a decision. If they are not interested, you may at least elicit an honest response that could help you improve your presentation for the next investor.

Once a relationship is established, keep potential investors updated about your progress and setbacks. The longer you can bootstrap the business, the more interested they might become. They may also be more interested in follow-on rounds once they see that other credible sources have invested.

Presenting at Venture Forums

Another opportunity for entrepreneurs is to participate in venture forums and other events where they can present their business plans to large groups of potential investors, service providers, and partners. Venture capitalists, bankers, and other interested people are invited to attend these conferences to hear presentations from selected entrepreneurs. Networking opportunities usually occur before, during, and after business plan presentations. Venture forums are produced by governmental, private, and nonprofit organizations. Many are sponsored by economic development groups, Small Business Development Centers (SBDCs), trade organizations, and networking organizations.

Presenting Through Consultants

Consultants can help you find investors, but they should be considered a last resort. They often charge steep fees but may not be registered broker/dealers and will not guarantee they will find investors for your company. They can put you in the room with potential investors, but legally, they cannot facilitate the deal. Make sure you have the intended results spelled out. Typically, registered broker/dealers receive a success fee of 5 percent to 10 percent of the total amount of an investment.

Caution: Angel investors and venture capitalist firms normally will not fund companies that have agreed to pay success fees to consultants or broker/dealers. The rationale is that angel groups and venture capitalists are relatively easy to find (but not necessarily easy to convince to invest), so no fee will be paid to those who claim to lead entrepreneurs to angels or VCs. Investors want to see all their capital used to build and grow portfolio companies, and not paid as commissions or finder fees. Entrepreneurs are advised to use consultants or broker/dealers only after they have exhausted their access to angel and venture capital investors.

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Managing Cash and Operating Your Business

At the heart of every entrepreneurial business opportunity rests a fundamental tension – available capital balanced against the capital necessary for a satisfying return on investors' money. Affecting this balance is the need to take the business into a self-sustaining stage of maturity. The focus on cash management in this module will help you achieve this financial balance.

The other focus of this module is on operating your business. Although operations concerns might seem premature to you now, the day will come sooner or later when such details require your attention, and so they are presented here for your consideration when you eventually need them.

Remember that, even if a business has a great product or service and a great plan, there is still considerable risk involved in entrepreneurship. Identifying and implementing appropriate control systems can reduce this risk.

Controls equip a business with a system of policies and procedures for business operations. When operations take place within this system of controls, it is easier for management to monitor and correct the operations.

With policies and procedures in place, managers can make sure the policies are being used instead of monitoring each employee's daily activities. The Operating and Control Systems section of your Business Plan contains policies and procedures for two major areas of the business, controlling operations and creating a contingency plan.

Outcomes

- Understand the importance of managing cash and burn rate.
- Identify administrative policies necessary to control the operations of your business.

Action Steps (Find online tools at **fasttrac.org/resources**.)

- ❏ Draft the Operating and Control Systems Plan section of your Business Plan.
- ❏ Draft the Growth Plan section of your Business Plan.
- ❏ Refine the Investor Highlights section of your Business Plan.
- ❏ Refine the Executive Summary section of your Business Plan as you draft other sections.
- ❏ Continue to update and refine the data in your Financial Template.
- ❏ Refine and rehearse your Investor Presentation.
- ❏ Read Appendix 1: Finalizing the Business Plan and Appendix 2: Next Steps and implement the actions they suggest.

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Managing Cash and Burn Rate

BUSINESS PLAN

Financial Plan
///
Sources of Funding

For most opportunities, particularly those involving promising but unproven proprietary technologies, the tension between available capital and the capital necessary for a satisfying return on investors' money is managed by breaking the required investment into smaller amounts that are aligned with successive stages of technology and business development.

In this milestone-driven model of venture investment, each phase of investment hopes to carry the opportunity to a future milestone at which the relative risk and value of the opportunity have progressed to a point that enough capital can be raised to cover the next phase.

The milestone model of investment places tremendous emphasis on several key success factors:

- An accurate perception of the value proposition at each milestone, including the final exit proposition, whether this coincides with product commercialization or an earlier liquidity event like an IPO or an acquisition
- An accurate if disciplined sense of the capital necessary to accomplish each milestone
- The company's ability to deliver the milestones despite uncertainties, surprises, and setbacks

Cash Management

Cash management, while a company advances its technology and builds its organization, is central to the success of the venture if for no other reason than that the only money the venture has is money it has been given (with strings, of course). There is no sales revenue for the early-stage venture.

Funding may be classified as revenue financially, but it comes either from investment, licensing or other commercial partnering, or grants. It is essential that you understand, display, and employ a sharp practical focus of your limited cash resources on those critical milestones that advance the business's ability to return to these sources of funds for more money.

As a result, a key skill of any entrepreneurial team is the exercise of judgment – distinguishing uses of funds that advance the company's milestones versus those that do not. Decisions commonly include:

- How much administrative support is necessary to allow the organization and key staff to function at good levels of productivity and efficiency?
- Which new scientific areas of investigation are core to the company's business objectives and which are not?
- How much spending is appropriate to create external visibility and awareness?

Burn Rate

The management team needs sufficient financial capability and accounting expertise to plan and monitor its burn rate accurately. The *burn rate* refers to how much cash a company consumes day in and day out, and specifically to the average reduction in cash-on-hand caused by expenses exceeding revenues. For a pre-revenue company, the burn rate is primarily consuming investor capital; hence, investors watch this measure very closely. Understanding and managing the enterprise's cash horizon is its single most important survival capability.

Important considerations include the following:

- Typically, general and administrative expenses that approach or exceed 20 percent of the company total are too high. Can staff type its own memos and book travel? Often, certain functions can also be adequately supported by part-time and/or external contractor support.

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- Is the science necessary to develop a successful product highly predictable? In novel areas, unexpected findings often present themselves. From a resource planning perspective, you must then determine whether the finding and further investigation lie along the critical path to target milestones, whether they represent a meaningful opportunity on a separate strategic pathway, or are scientifically interesting but strategically unjustifiable. Partnerships can often be an interesting way of minimizing the cash demands of such new avenues of exploration, but may compromise the company's proprietary interest in any resulting intellectual property.
- Every venture focused on novel technology will encounter unexpected problems or technical failures. Sophisticated investors understand this and support some flexibility built into the resource plan to respond to these challenges and cover potential delays. However, this budgeting slack is usually incorporated into forms of over-budgeting or contingencies rather than designating delays in milestone timelines.
- It is important to generate awareness of the venture in its target technical or scientific market and investment environment, but this invariably costs money. Scientific conferences have registration fees and associated travel costs. Which are critical to the enterprise? How many can be justified on the basis of competitive intelligence or scientific cross-fertilization if the company has no findings to communicate? How often does staff need this sort of exposure to stay current in the field?

  The new entrepreneur will be amazed at the number of opportunities there are to participate in "news" panels hosted by famous ex-celebrities, journalists, or politicians to present his or her story to various (usually highly diffuse) audiences like airline travelers – all for a certain fee to cover production costs.

  There are also businesses that sell the opportunity to attend conferences of certain key "influencers," and of course the many industry conferences themselves offer visibility and participation for a registration fee.

  There are also conference opportunities to present your company for a fee to an investment audience. Selectively, these give new companies a chance to gain a threshold of visibility that may facilitate future investment.
- Know your way around the accounts and financial statements if you want to manage your cash horizon successfully. Who on the management team knows which expenses are non-cash items, or which balance sheet items have a cash flow impact? Do you have vendors or contractors with delayed billing cycles that generate deferred expenses or surprises in accounts payable? Do you have significant lags in cost-reimbursement or milestone-based sources of revenue? Such phenomena can subtract months from your true cash horizon.

In well established entrepreneurial communities, there is a high ratio of service providers to venture-based companies. New entrepreneurs rapidly find themselves inundated with calls, correspondence, and introductions from businesses selling various forms of support and service, from graphics and web design to IT systems and communications, from public relations to staffing, some of which the new company can't survive without but most of which, once the company is under way, will be superfluous. Use your mentors and network to navigate this overwhelming array of offerings.

Many NIH grants operate on an electronic billing and payment system that minimizes delays in payment. However, these grants are also often based on cost-reimbursement, making two points important:

- Do you have enough working capital and staff time up front to wait for payment?
- Can you negotiate an appropriate overhead rate to recover more than just direct program costs? You will certainly employ more than just direct program resources.

Remember – you don't have the cash until you have the cash! There are many opportunities for interest and commitment to go astray before the bank transfer to your account actually occurs.

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Operations Controls

BUSINESS PLAN

Operating and Control Systems Plan

The purpose of this section is to build policies and procedures that support the overall goals of the company and help monitor the company's progress toward those goals. The policies and procedures will be built around the systems that support business operations. There are dozens of systems within every company such as receiving orders, billing and collecting, paying vendors and suppliers, and controlling inventory. Controlling these systems is critical to the profit performance of the venture.

In the Business Plan, you show that you understand the nature and importance of administrative policies, procedures, and controls. The Operating and Control Systems Plan ensures that every detail is considered and planned for. The goal of an operating plan is to make the business's operations work so smoothly that you spend very little time on daily issues, but work more strategically. The Operating and Control Systems Plan is an action document, in contrast to the rest of the Business Plan, which is essentially analytical and contemplative.

Receiving Orders

The marketing efforts are designed to bring about sales. When a customer places an order or buys the product or service, a standard procedure must be in place. It is important to ensure accuracy in the order as well as timely delivery of the product or service ordered. This process should also contain policies and procedures pertaining to the expected method of payment.

Billing and Collecting

Planning for billing and collecting from customers should begin even before a sale is made. Policies and procedures should include qualifying the account to make sure the customer meets certain standards or requirements. This includes checking bank references to assure reasonable handling of their accounts and calling references before giving payment terms to unknown customers.

Even with these procedures, it may be difficult to collect from some customers. There should be a procedure to handle collection from overdue accounts as well. Most commonly this will include procedures for sending statements, applying penalties, and making reminder phone calls. In addition, it may be necessary to establish policies for accounts that are difficult to collect. A collection agency may be hired to follow up with these accounts. Collection agencies usually receive payment for their services based on a percentage of the collected amount.

Paying Vendors and Suppliers

Many businesses offer discounts for early payment. Some offer extended terms and many offer frequent customer price reductions. To take full advantage of these savings, your business needs to have procedures in place.

Vendor and supplier accounts need to be processed and paid with efficiency to maintain your company's credit and good relations with other businesses that are critical to its ability to do business. Systems must be developed to verify that the payables are correct; that checks get written, signed, and mailed; and that the account is paid on time or in the time allowed to receive any discounts. The process must run with a minimum of supervision but with proper oversight control.

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Inventory Control

One of the financial goals of every company should be inventory control. There are many different methods of inventory control, some automated, some manual. Your accountant, trade association, or loss prevention consultant can be of assistance in selecting the appropriate system or combination of systems.

Inventory control involves not just what your business sells but also what it buys. Excess inventory represents tied-up cash that might be better used for other purposes. Inadequate inventory may mean sales lost and customer relationships destroyed. Your business needs a process in place that maintains a count of inventory, whether products for sale or supplies on hand; produces automatic reports of inventories that reach reorder levels; and alerts management to unusual shrinkage.

Handling Warranties and Returns

One of the areas you may have to consider is what warranties or guarantees will be offered and the procedure to be followed when claims are made. Customers need to know that your business stands behind its product or service.

The guidance of an attorney is necessary in establishing warranties and guarantees. Much legislation exists regarding warranties. Some warranties are implied in law, and those that are expressed are regulated in matters such as what they may say, how they must be stated, where they must appear, and what they mean.

It is important to make the warranties and guarantees available, but how you implement them may determine whether your business has gained a customer for life or lost one forever. Procedures must be enacted that make the process, from the customer's view, a no-hassle experience.

Service Level Agreements

Customers often rate the quality of a business on the basis of its service, regardless of product or service differences or price differentials. A cumbersome, unfriendly, or inefficient service department can drive away not only existing customers but also all of those they tell about their experience. In some businesses, such as new car dealers, the service department is the primary profit center of the business.

If the product or service requires maintenance or repair, you must determine policies, procedures, and controls to answer the following questions:

- Where it will be performed? At the business location, at a separate facility, or at the customer's location?
- Who will do the work? Your company's employees, independent contractors, or a separate business?
- Will service agreements be offered?
- What will be charged for maintenance and repair?

Security Systems

All businesses have much to protect. Your accounting records, customer data, trade secrets, personal property, inventory, and equipment should be protected by establishing policies and procedures. Security from natural disasters as well as from theft and loss by simply misplacing property must also be considered. While insurance can provide money damages for some losses, there are items that are simply not replaceable and that cannot be recreated.

Since many businesses now maintain most of their records electronically, a back-up system for those records and some off-site storage procedure must be established. The process must be virtually automatic and routine. Physical security for the location of your business as well as the personal safety of you and your employees need to be considered.

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Contingency Plan

Business plans are written based on many assumptions that you make. When reality hits and assumptions are proven wrong, problems occur. Since it is natural for some assumptions to be erroneous, it is important to have a contingency plan for the assumptions made. Contingency plans let business plan readers know that options have been considered for certain problem areas that the business might encounter.

You might face many problems as the company is established, and even more dangers appear as the company grows. The key to success is to anticipate these problems and identify a plan to solve the problems before they exist.

Reality

Potential investors want to know that assumptions are based on facts and that a contingency plan exists for assumptions that significantly affect success.

You should consider a contingency plan if any of the following problems is likely:

- Sales projections prove wrong.
- Unfavorable industry development occurs.
- Manufacturing costs become too high.
- Competition destroys the marketplace (price war ensues).
- Needed labor is unavailable.
- Supply deficiencies develop.
- Needed capital is unavailable.
- Government interference arises.
- Product or service liability occurs.
- Problems with management or personnel arise.
- Product or service development takes longer than anticipated.
- Union problems arise.

Program Conclusion

Having reached the conclusion of the FastTrac® TechVenture™ program, you are ready to start the business you have envisioned throughout this planning process or to refine your early-stage business so that it more closely matches your vision. Or maybe the process of writing your Business Plan is the first step in your journey through many business concepts until you find the one that best matches your personal vision. Even if you don't start a business right away, the planning process is a skill you can use time and again throughout your life.

Throughout this program, you have learned that:

- A competitive advantage is vital for long-term sustainability.
- Your role as entrepreneur must evolve as the business grows.
- Cash flow is paramount. Without it, your business cannot start or continue.
- Your business is a success if it helps you reach your personal, professional, and financial goals.
- The planning process is a proven way to think through all the various aspects of starting a business before you commit financial resources.

You have learned that successful entrepreneurs:

- Seek assistance from trusted advisers, mentors, and outside professionals.
- Communicate their business concept and plans clearly and concisely to their team, their customers, and their funders.
- Consider their exit strategy before they start the business.
- Set profitability goals and regularly measure the business's progress against them.
- Develop products and services that meet the needs of the market.
- Look for new opportunities on a continual basis.
- Involve the right people in their business.
- Help others individually or through the community.

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Appendix 1: Finalizing the Business Plan

By now, you have written at least a draft of all the major sections of your Business Plan – Executive Summary, The Company, Marketing Plan, Market Penetration and Sales Plan, Product/Service Plan, Management and Organization Plan, Operating and Control Systems Plan, Financial Plan, Growth Plan, and Investor Highlights. It's time to bring all of your information together and assemble the final document. This appendix provides tips and guidelines for finalizing the plan.

After the plan is put together, you should evaluate it for completeness and accuracy. A checklist is provided for easy reference. A trusted mentor and a spelling and grammar expert should also critique the plan, all in preparation for presenting it to others.

The Business Plan's Final Details

Harvey S. Firestone, the founder of Firestone Tire and Rubber Company, said, "Success is the sum of details." Don't overlook the final, important details when assembling your plan; they can make a big difference in the overall presentation of yourself and your company.

The following must now be finished and added to the plan.

Cover Page

The cover page is the front cover of the plan containing the name of the business, your name, and your contact information. The cover page is an opportunity to make a good first impression. You can create a professional looking cover page using the Business Plan Template. Include the name of the company, your name, and your title. Also include the company's address, phone and fax numbers, e-mail addresses, and website. If the actual address of the business is undecided, use your home address. Providing this key information makes it easy for investors and other readers to contact you.

The company logo should be displayed on the cover page along with the company name. Also add the date the plan was prepared. In addition to letting readers know when the plan was written, it will help you know whether you have the most recent version.

Reality

If a business plan lacks adequate contact information on the cover page, readers will not know how to locate the company or who to contact. Chances are they won't try to follow up with you.

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If the business plan is going to be distributed to several different investors or lenders, each plan should be numbered separately with the number displayed on the cover page. This will allow tracking of business plans that are out for review. It also may discourage recipients from copying or widely distributing the plan to others. It is advisable to include a statement, such as, "The contents of this plan are proprietary and confidential. It is not to be copied or duplicated in any way."

Consider having the recipient sign a non-disclosure agreement in which the reader agrees to refrain from revealing the contents or ideas of the plan to anyone else. By disclosing information without a signed non-disclosure agreement, you may lose your ability to protect the information through trade secrets, patents, or other types of protection.

Tip

If your company name does not describe your business, consider adding a descriptive tag line below the company name.

Table of Contents

A table of contents is an index by section and page number making it easy for the reader to find exactly what is sought. Every business plan needs a table of contents to help readers locate information. Start with the template, which lists all of the major sections, headings, and subheadings. Delete those lines that do not apply to a section of your Business Plan. For example, some service businesses would eliminate the section on Production. Go through your plan and verify the page numbers.

Tip

It works best to create the table of contents after the rest of the plan is complete. At this point, the heading and subheading titles are finalized and the page numbers should go unchanged.

Business Plan Appendix

The resources, authorities, résumés, and specifications referenced in the body of the plan are located in the appendix. The appendix allows you to include all supporting documentation without cluttering the actual Business Plan. While most readers will not look at every page in the appendix, they will recognize the planning and thoroughness that went into creating the appendix.

See the checklist found at the end of this appendix for a list of documents that belong in the appendix of your Business Plan. Determine which of these items are relevant to your Business Plan. The appendix will vary in length according to the amount of detailed information needed to support the claims made in the Business Plan. If the appendix becomes too large, it can be made into a separate document.

All documents can be included in the appendix just as they are. You should prepare a table of contents at the beginning of the appendix to identify the location and type of documents included.

Tip

Your credibility can be established or lost by the contents of the appendix. If references are accurate and complete, the reader will soon stop checking the assertions found in the body of the plan and accept them. If inaccuracies or missing data are discovered, however, the reader will question the accuracy of everything else written in the plan.

Assembling the Business Plan

Format and Design

Don't try to impress your reader with too many fancy fonts and multi-colored graphics. An easy-to-read font and a simple design work best for the Business Plan. A 12-point font in a *serif* style, such as Times, is the easiest for most people to read. Avoid using all caps and excessive use of bold or underlining. Gimmicks detract from the importance or significance of what is said. If a corporate identity has already been established, the chosen logo, fonts, and color scheme should be used.

There should be adequate white space on each page. White space makes the text easier to read and provides a place for taking notes. White space can be added by using wide margins (between 1 and 1.25 inches) and bulleted lists of information, whenever possible. Titles,

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graphs, and other appropriate graphics add interest and readability to the plan. Finally, each page should be appropriately numbered.

Printing and Binding

The plan should be printed using a high-quality laser printer and white or light-colored, standard size paper, 8.5 x 11 inches. Color can be used effectively for the headings, subheadings, and graphs. The main text should not be printed in color. Too much color can detract from the content of the Business Plan.

A binding that secures the pages and makes it easy to flip should be used. Three-ring binders or paper folders work well for business plans that will be used internally. This type of binding will allow for easy removal or replacement of pages as the Business Plan is continually updated. The Business Plan can also be shared electronically by creating a pdf file or by sharing the word processing document.

Business Plan Evaluation

Mentor Review

Trusted advisers should review the completed Business Plan. Their feedback can be immensely valuable in determining the strengths and weaknesses of the plan. If possible, someone familiar with the industry, technology, and investment community should review the plan as well. Make sure your reviewers check for the following:

Technology – Does the technology work? Is it protectable? Is it likely to be attacked as infringing upon already protected technology? Is it likely to be resisted by the targeted market or attacked by powerful stakeholders?

Market – Does the marketing plan accurately describe the potential of the market? Is the market of sufficient size to support high growth? Is the market penetration plan reasonable and affordable?

Financial – Are the revenues and expenses accurately portrayed? Are the projected rounds of financing reasonably projected and possibly obtainable? Is there an identified exit strategy? Is the rate of return sufficient to attract the necessary investors?

After such review, those weaknesses capable of modification should be changed and the revised plan resubmitted to the advisers.

Grammar and Proofing Review

It is important to have a qualified proofreader provide specific feedback about grammar, spelling, or other errors that might still exist in a completed plan. Someone other than the entrepreneur should review the plan to eliminate the following:

Grammar, punctuation, and spelling errors – If there are errors in the plan, readers will have less confidence in the writer as an entrepreneur. This Business Plan is a reflection of the entrepreneur's ability to start and operate a business. Some investors believe that a lack of attention to details in the writing of the plan may be an indicator that the entrepreneur does not pay attention to details while operating the business.

Reality

A well-written, grammatically correct, and properly organized plan is far more likely to be well received than a handsomely bound, well-illustrated plan that contains spelling errors, is poorly organized, or includes unsupported assumptions.

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Illogical flow of information – Information that is presented in an illogical order makes the business concept very difficult for readers to understand. Keep in mind that readers of the plan do not have the deep understanding of the business that you do. Entrepreneurs should explain the business to readers, taking care to cover the topics in a logical sequence and using language which does not require specialized knowledge peculiar to the business.

Use of "I," "we," or other personal pronouns – If entrepreneurs talk too much about "I," "we," and "me," in the plan, it can take the focus away from the business. Most statements that start with "I" can be rephrased. For example, the statement "I really want to start a business that meets the needs of the customers," can easily be changed to, "This business will be started as a direct response to the needs of customers." Therefore, the focus is off of "you" and onto the "business." When referring to themselves, entrepreneurs should write in the third-person, using their name, rather than first-person, "I" and "we."

Unsubstantiated facts – Include the sources of facts. Neglecting to include the sources reflects negatively upon the writer of the plan. Facts should drive decisions in the business planning process. If the facts are not substantiated, the Business Plan lacks the foundation it needs to be a sound planning document.

Negative words or phrases – The Business Plan should be a positive plan of action for a business. Whenever possible, the entrepreneur should avoid using negative words such as "however," "but," and "can't." These words can set the wrong tone for the reader of the plan. Consider how these words are used in the following phrases:

- The service is easily marketed. However, a subcontractor has not yet been found to provide the technical services.
- The break-even point is 5,000 units. But, the company has not been able to produce more than 3,000.
- Customers demand a combination of products and services. Our business can't do this.

The following statements still convey the same message, but in a more positive way:

- Marketing will begin as soon as a contract is signed with a subcontractor that will provide the technical services.
- With current production personnel and facilities, 3,000 units are produced monthly. The break-even point is 5,000 units per month.
- Currently the company is offering a single service. Based on customer demand, opportunities exist to expand this service to include products.

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Business Plan Checklist

The following checklist provides criteria for each section of the plan. By evaluating your plan against this checklist, you will find changes that need to be made to your plan. These changes will make your plan more readable, concise, complete, fact-based, and error-free.

OVERALL READABILITY

YES	NO	
❑	❑	Language is concise (does not read like novel or term paper).
❑	❑	Each section stands on its own and clearly defines and satisfies its objective.
❑	❑	Facts are supported with sufficient documentation.
❑	❑	Conclusions drawn from facts are reasonable.
❑	❑	Contents are supported with sufficient charts and graphs.

OVERALL SPELLING/GRAMMAR/MATH

YES	NO	
❑	❑	Spelling is correct.
❑	❑	Grammar is clean.
❑	❑	Math is error-free.

OVERALL FORMATTING

YES	NO	
❑	❑	Font choice is readable.
❑	❑	Spacing between lines is sufficient.
❑	❑	Plan contains headings and subheadings.
❑	❑	Formatting on headings and subheadings is consistent.
❑	❑	Plan includes page numbers.
❑	❑	Formatting on page numbers is consistent.
❑	❑	Plan contains enough white space for readability.

DISCLAIMER AND NOTICE OF CONFIDENTIALITY

YES	NO	
❑	❑	Contains company's disclaimer and confidentiality notice.
❑	❑	Company attorney was consulted for proper wording.

COVER PAGE/TABLE OF CONTENTS

YES	NO	
❑	❑	Cover page contains name of business.
❑	❑	Cover page contains chief executive's name.
❑	❑	Cover page contains address, telephone and fax numbers, e-mail, and web address.
❑	❑	Cover page contains company logo.
❑	❑	Page numbers in table of contents correspond correctly.
❑	❑	Appendix includes a table of contents.

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Business Plan Checklist (continued)

EXECUTIVE SUMMARY

YES	NO	
❑	❑	Does not exceed three pages and wholly describes the new venture.
❑	❑	Describes the unique features and benefits of the product or service.
❑	❑	Identifies the management team and supporting infrastructure.
❑	❑	Explains the opportunities found within the industry.
❑	❑	Contains plans for targeting a market segment and penetrating it.
❑	❑	Specifies how much money the company needs and how funds will be obtained.

THE COMPANY

YES	NO	
❑	❑	States the company's name and location.
❑	❑	Describes required facilities.
❑	❑	Discusses the legal form of business.
❑	❑	Describes required employees, how many are needed, and their skills.
❑	❑	Outlines the company's history, including specific milestones achieved.

MARKETING PLAN – INDUSTRY PROFILE

YES	NO	
❑	❑	Focuses on current size and growth potential of the industry.
❑	❑	Discusses industry trends and the opportunities associated with each.
❑	❑	Addresses geographic locations, seasonality, and industry profit characteristics.
❑	❑	Identifies the existing distribution channels.

MARKETING PLAN – COMPETITIVE ANALYSIS

YES	NO	
❑	❑	Identifies direct, indirect, and future competition.
❑	❑	Contains matrix to illustrate competitive position in marketplace.
❑	❑	Describes competitive advantage.

MARKETING PLAN – MARKET ANALYSIS

YES	NO	
❑	❑	Contains customer profile.
❑	❑	Contains target markets and size of each.

PRODUCT/SERVICE PLAN

YES	NO	
❑	❑	Describes product or service in plain English (not too technical).
❑	❑	Describes product or service in specific terms (not too broad).
❑	❑	Identifies unique features.
❑	❑	Identifies special benefits.
❑	❑	Provides evidence that the product or service is technologically feasible.
❑	❑	Includes a value proposition for consumers.
❑	❑	Describes the ways intellectual property will be created and protected.
❑	❑	Lists requirements from regulatory agencies.

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Business Plan Checklist (continued)

PRODUCT/SERVICE PLAN (continued)

YES	NO	
❑	❑	Wholly explains product/service limitations, and potential solutions.
❑	❑	Wholly explains product or service liability and potential solutions.
❑	❑	When applicable, identifies production process and facility plans.
❑	❑	Provides backup suppliers and subcontractors.
❑	❑	Anticipates future related products or services and spin-offs.

MARKET PENETRATION AND SALES PLAN

YES	NO	
❑	❑	Fully illustrates the image of the company.
❑	❑	Describes plans to reach the market, including customer service, location, sales force, licensing, and distributing.
❑	❑	Addresses plans for advertising and promotion.
❑	❑	Includes plans for marketing through technology, including the Internet.
❑	❑	Discusses other penetration strategies, including publicity, telemarketing direct mail, and trade shows.
❑	❑	Describes plans for evaluating market penetration effectiveness.

MARKET PENETRATION AND SALES PLAN – PRICING

YES	NO	
❑	❑	Addresses pricing strategy.
❑	❑	Contains price list.
❑	❑	Includes volume and special pricing information.
❑	❑	Contains the company's pricing policies.
❑	❑	Includes break-even analysis.

MANAGEMENT AND ORGANIZATION PLAN

YES	NO	
❑	❑	Lists key management positions, including primary job responsibilities.
❑	❑	Identifies the board of directors/advisory board members, including primary contributions expected.
❑	❑	Documents the process of recruiting and selecting employees.
❑	❑	Clarifies the compensation and employee reward systems.
❑	❑	Establishes credibility of the management team.

OPERATING AND CONTROL SYSTEMS PLAN

YES	NO	
❑	❑	Demonstrates understanding and importance of control systems.
❑	❑	Identifies administrative controls to safeguard proprietary information, physical assets, and personnel.
❑	❑	Identifies key goals and allows sufficient time to accomplish them.
❑	❑	Identifies uncontrollable variables.
❑	❑	Provides honest assessment of the downside risks involved.
❑	❑	Addresses legal liability issues.

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Business Plan Checklist (continued)

FINANCIAL PLAN

YES	NO	
❑	❑	Sales and profit projections appear to be reasonable.
❑	❑	Assumptions and projections are wholly supported.
❑	❑	All operating expenses have been included.
❑	❑	Hidden costs have been identified.
❑	❑	Cash requirements are in line.
❑	❑	Financial documents are mathematically correct.
❑	❑	Figures on various documents are consistent.
❑	❑	Sources of debt or equity financing are appropriately identified.

GROWTH PLAN

YES	NO	
❑	❑	Identifies the significant new products or services planned for continued growth.
❑	❑	Identifies the marketplace for new products or services.
❑	❑	Identifies the financial requirements for the new products or services.
❑	❑	Identifies management personnel needed to support growth.
❑	❑	Addresses how growth plan will enable owner and investor exit.

INVESTOR HIGHLIGHTS

YES	NO	
❑	❑	Presents compelling reasons why the investor should invest.
❑	❑	Describes the terms of the investment.

APPENDIX

YES	NO	
❑	❑	Contains résumés of the management team and key personnel.
❑	❑	Contains all employee contracts, stock option plans, retirement plans.
❑	❑	Contains personal financial statements for each of the principals.
❑	❑	Contains financial statements for the company, including Income Statement, Cash Flow, and Balance Sheet.
❑	❑	Contains patent and copyright approvals.
❑	❑	Contains such agreements as partnerships, sales, distributor contracts, non-compete/non-disclosure, and corporate bylaws and other legal documents.
❑	❑	Contains copies of product and service brochures or other advertising samples.
❑	❑	Contains copies of all logos that have been developed.
❑	❑	Contains copies of recent reference letters, recommendations, and endorsements.
❑	❑	Contains copies of market studies or articles from trade journals or other media.
❑	❑	Contains professional photographs of the product.
❑	❑	Contains detailed outlines of the operating and control systems.
❑	❑	Contains customer-signed orders or letters of intent.
❑	❑	Contains documents that support the industry study.
❑	❑	Contains a detailed description of high-tech products.

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Appendix 2: Next Steps

Running your own business is an incredible journey. Your Business Plan serves as your road map. At times, you will be able to follow the plan exactly. Other times, you will need to adjust the plan to fit the current or anticipated environment. Throughout this journey, remember to celebrate your successes and learn from your mistakes.

Periodically check your progress against your plan. Planning helps you understand details and analyze how they affect the success of the business. Dedicating time to planning lets you work *on* your business, not just *in* it.

From Real Entrepreneurs

adjusting the plan

While evaluating whether to open a computer repair business that would provide onsite service to consumers and small businesses, Scott Revare pinpointed several weaknesses in his business concept. The potential for a large competitor entering the market led him to abandon that concept and instead co-found Smart401k. Revare and his partner, a financial adviser, developed a computer-based system to provide customized retirement investment recommendations for employees with retirement plans through their workplace. While Smart401k continues to grow and attract customers nationwide, Revare's original decision to abandon the first concept was confirmed when the megastore Best Buy® entered the onsite computer repair market in Revare's community. "I was bothered by the nagging thought that a more established company could easily move into this business. I wanted to find a niche that would stay unique at least until we established ourselves. I'm glad I listened to that small, nagging voice."

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Thriving in Your Entrepreneurial Role

As you lead your business from conception to start-up to ongoing success, consider your role in the organization. In addition to operating your business by following your plan, you need to consider ways to avoid pitfalls, stay in touch with key advisers, and evaluate opportunities to give back to the people and communities who have helped you succeed.

Avoiding Pitfalls

If you are starting a business, realize that others have been on the same path and their experiences can help you as you make decisions each day. Learn from them so that you can avoid these common pitfalls:

Business Plan – One of the biggest pitfalls is running a business without a plan. Without a plan, the business is run by default – whatever happens each day becomes the plan. Businesses that don't have a sense of direction may bob and jerk on the waves of good luck for a while, but why take that risk? Following a plan helps decision-making, motivation, goal-setting, and hiring. It also provides the basis for mid-course corrections. Not knowing what to expect wastes time, money, and energy – all very scarce resources for a new venture. The point is that you should not put the plan you have just written on the shelf once your business is in motion. Business plans are living documents that can help you plan your course, but they should be revisited, revised, and renewed as your business evolves.

Sharing the Plan – Another pitfall is that you never implement the plan. Whether the plan is on paper or in your mind, sharing it with others in the business is essential. If your personnel are unaware of the plan, they can be working at cross-purposes. The staff knows a lot about your business and can contribute ideas to improve decision-making along the way.

Process Standardization – Another potential pitfall is not developing processes to standardize quality, cost, and customer service. Financials, customer satisfaction, and morale can be the strengths of your business if you take the time to develop and communicate the way these things should be handled each time tasks arise.

Documentation – A business can be the most substantial investment you own. But if you never document its functions, processes, and operational procedures, it is as if you stock inventory that you can't prove exists. If a key person leaves or should be unavailable for work, that person's assignments may not get done, which – in the worst cases – might bring the business to a halt.

Revenue versus Investment – Your view of your business can make a big impact on how it is built and run. If you view the business as a revenue stream, you may be driven by immediate crises or by the next sale. You might overlook planning, delegating, and managing. If you view your business as an investment, however, you will watch, research, and care for it to achieve the return you expect for the risk you take.

Key Measurements – Another potential pitfall is not monitoring key success measurements. Finding out how the business is doing annually or even monthly is not enough. Key measurements can quickly reveal the financial impact of a variety of business activities. For example, you don't have to wait for the monthly sales figures to come from the accounting department to know how well your sales team is doing. Monitoring the number of sales calls per day, the number of proposals each week, and the close ratios of these proposals can tell you immediately how well it is going.

> **Tip**
>
> Spend time on your business. Don't compromise your long-term vision for short-term gains by seeing your business as only a revenue generator instead of an investment.

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If a salesperson's key measurements are faltering, you can make corrections before the impact on revenue is past recovery. Develop and monitor the key measurements for your business.

Duties – As a business grows, it requires additional staff. Every day, businesses are adding staff without written job descriptions or performance standards. Think about how inefficient that approach is and how much more smoothly a business operates if everyone knows what is expected of them. You need to feel comfortable that when you are off site, your business is behaving as it should – that job descriptions and performance standards are in place to control the flow of work.

Team – A management team works best when it is made up of people with complementary styles and skills. When a team becomes dysfunctional, the business can lose its focus. The value of a complementary team is that business operations will be balanced, but it can also be the source of significant friction from the clash of complementary skills with different approaches. Take time to understand the perspectives of your management team and encourage communication.

Success Steps

The planning time you have invested in this program will help you avoid many of these pitfalls. You can change the top 10 reasons businesses fail into positive reasons why your business has a great chance of succeeding. When you complete the planning process, you will be able to say that these are the top 10 reasons for your success:

1. I have experience in entrepreneurship and business planning and am developing a personal network of peers, mentors, and advisers.
2. I will raise the money I need through debt and equity sources.
3. I know and understand the opportunities and threats that the competition presents and have clearly identified my competitive advantage.
4. I have a plan to control and manage inventory to make the most of my money.
5. I am planning for growth.
6. I will research to seek the best location or distribution channel for my business.
7. I will purchase only the assets needed to produce the revenue projected.
8. I will seek good credit terms with my suppliers and give standard terms to my customers.
9. I will implement my marketing plan to achieve the projected level of sales.
10. I will complete and implement my business plan for success!

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Getting Support

Throughout this program, you have bounced ideas off of others, shared your excitement as your plans progressed, and expressed your disappointment when results did not match your expectations. If you take the initiative, this peer network can continue to help you by providing support and advice throughout your entrepreneurial journey.

The Aspen Institute conducted research on how to strengthen small businesses in the United States. Their research showed that what separates new entrepreneurs from success is often access to industry knowledge and insider networks. Developing this knowledge often begins with the guidance of successful, experienced entrepreneurs. They know where the pitfalls are and can help you avoid many rough spots. Using mentors, advisers, and community resources can make the difference between success and failure for your business. They can serve as a sounding board, provide you with information, and help you make contacts at critical points as you start your business.

Mentors

In Homer's *Odyssey*, Mentor is the character who teaches and nurtures Odysseus' son while his father is away. The word mentor has evolved to refer to an experienced person who develops a one-on-one relationship offering advice and nurture to a less knowledgeable person. An effective mentor can be an experienced entrepreneur in the same type of business or a professional who works with entrepreneurs and understands what is required for success.

In addition to the relationships you are able to develop on your own and in this program, you may find other programs that pair entrepreneurs with a mentor. It's worthwhile to check whether any formal mentoring programs exist in your community or find an online mentoring program.

Formal mentoring programs – Some formal mentoring programs may be available to you through organizations that serve entrepreneurs in your community. The organizations offering formal mentoring typically pair a successful entrepreneur with a less experienced entrepreneur. The match is usually based on type of business, goals, stage of business, personality, and other relevant criteria. Most formal mentoring programs specify the types of businesses they wish to assist.

Internet mentoring programs – A mentor connected to you via the Internet can help you understand your type of business without threatening potential competitors. For example, the Aspen Institute offers an online MicroMentor program for very small business owners, or microentrepreneurs, in underserved communities. This program matches a microentrepreneur with a successful entrepreneur, often in the same industry.

Informal mentoring – Informal relationships are set up directly by the mentee and the mentor. The informal relationship may grow out of casual contact, such as membership in the same chamber or industry association, or through community volunteer work, or it may be facilitated by another person, such as a peer or relative. It is appropriate to ask others if they would be interested in helping you as a mentor and explain what you would like in a mentoring relationship. Realize that not everyone has the time or inclination to be a mentor.

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To be most effective, the mentoring relationship should have some agreed-upon structure and focus. The mentor and mentee should discuss these parameters:

- What are you going to focus on during the time you spend together?
- How often will you meet?
- How will you meet and communicate – in person, over the phone, online?
- How long will the relationship last?

Community Resources

Small Business Development Tech Centers, chambers of commerce, entrepreneur groups, colleges and universities, and libraries are some of the community resources that may be helpful to you as you launch your business. Counseling, classes, research, referrals, and peer groups are other resources from which you may benefit. As you build your network, be sure to include persons who offer community resources for entrepreneurs.

Tip

The most successful entrepreneurs take advantage of multiple resources.

Many states and communities have agencies and offices to help entrepreneurs start a business. Some have one-stop shops where you can obtain how-to booklets, forms, and guidance. Most states have websites designed to assist in starting a business with forms to download, step-by-step guides, and links to appropriate governmental offices and agencies. Browsing the Internet using "business assistance center" or "starting a business" and the name of the state as search terms should help you locate the proper site.

Building Your Entrepreneurial Network

Fair or not, businesses often succeed or fail based on the contacts the entrepreneur has, not on the business concept, the entrepreneur's technical expertise, or even the drive of the entrepreneur. The right person appears at the right time to provide a valuable resource to the business. Rarely, though, does this happen without effort. If you stay within the confines of your current relationships, the probability of meeting the right person is lessened. Those odds can be dramatically increased by a concerted effort to get to know and become known by others. Networking is a progression, because every new contact has a different network to which you gain access. By adding one new acquaintance, you may gain another dozen or so contacts.

Leveraging the Board of Directors and Advisory Board – By the time an entrepreneur begins raising equity capital, one or both boards should be in place. You can start networking with and through your mentors and advisers rather than just at formal meetings of the full boards. Invite individual board members to breakfast or lunch. Tell them your needs and follow their suggestions. Talk about what they are doing and find out whom they can introduce you to. Use their experience and knowledge as well as position in the business world to the advantage of your business.

Building a Network – Have a plan to constantly increase your network. Attend meetings of entrepreneurial groups, venture conferences, chambers of commerce, and industry associations. Broaden your network to include competing and complementary industries.

Reality ☑

Do not be drawn into criticism of others. Such statements have no positive effect and can come back to haunt you.

Be prepared to introduce yourself in a way that leaves a favorable, lasting impression. The person you just met may be the person who will become an important source for your venture's success. For more networking tips go to **coffeelunchcoffee.com** and view Alana Muller's *Coffee Lunch Coffee* webcast at **fasttrac.org/authors**.

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Managing the Investor Pipeline – Potential investors may not match your immediate needs at the time you make initial contact with them. Stay in touch with them; let them know how your business is doing. Discuss milestones achieved and setbacks suffered. Perhaps they may be right for your business in the future. They may know someone with whom you will fit. When they cash out of existing deals they may have the funds to invest in your venture. If you have been in touch with them, you can reach them with ease when the time is right. Just knowing investors can be of benefit. They are in the business of financing companies; their knowledge and possible introductions to others can be of great benefit.

Giving Back

In mentoring and advising relationships, you are the recipient. You get advice, support, and encouragement. As an entrepreneur, you also have the ability to give back. You can shape your community – not only through how you conduct your business and how you treat your customers and employees, but also through supporting the community as a whole. Most entrepreneurs are passionately motivated to share their success by giving back.

Ewing Marion Kauffman believed that giving back was the highest form of citizenship. Kauffman said that his work in philanthropy was the most fun he had ever had. He applied his time, energy, and resources to the things that gave his life meaning. The first lesson of Kauffman's life is that one person can make a difference.

You don't need a fortune to give back in meaningful ways. Today, emerging philanthropists are discovering the power they have to improve people's lives by giving back to entrepreneurship, from mentoring, teaching, promoting innovation, and serving on boards to contributing financially or through their companies. As one entrepreneur-philanthropist put it, "The joy of giving back is unbelievable. It's like watching your children grow and be successful."

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Appendix 3: FastTrac® TechVenture™ Toolkit

Launching and running a company takes a lot of hard work. To save you the time and effort of creating all of your business documents from scratch, we have assembled a toolkit of valuable resources for you. These resources include templates, assessments, action files, guidelines, and sample documents, many of which you'll customize to your business.

To complete many of the Action Steps for each module in this manual, you will need to use files located online. You can access these downloadable resources through the following website: **fasttrac.org**. Once there, choose the FastTrac® TechVenture™ Toolkit. You will need to have a special login and password to access this site.

The tools are listed on the next page, categorized in the same way as you will find them in the online toolkit. The parenthetical reference following each tool title indicates the module in which the tool is first introduced. Several tools will be used in more than one module.

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Templates

Business Plan Template (Module 1)

The Business Plan not only helps you formulate and develop your business concept, but also helps you present your business to potential investors. You should assess and revise your Business Plan frequently. As the market changes and as circumstances within your business change, you need to update your success strategy. As you answer the guiding questions in this template, you will complete all sections of your Business Plan.

Financial Templates (Module 1)

There are two Financial Templates, both of which will save you hours of time in producing projected financial statements for a business plan. As you answer questions and enter data, both templates automatically prepare financials statements for you.

3-Year FastTrac® TechVenture™ Financial Template (Module 6)
In this template, most entries are made manually for each month over the three-year forecast period. While this can be tedious, it also allows the user to forecast sales and costs according to any method that makes sense for that particular business. It allows for detailed cash budgeting over the three years and is particularly useful for businesses with seasonal or industry revenue fluctuations. In some ways, although it requires more entries, it is a simpler template. The instructions are embedded. Many of the worksheets lead the business owner through a series of questions designed to minimize errors.

6-Year FastTrac® TechVenture™ Financial Template (Module 6)
This template requires fewer manual entries and projects further out, an obvious advantage for the technical business that may not see profit for several years and wants to show future rounds of financing as the technology progresses. To use this template, the user forecasts what percentage of the total market will be captured and the per-unit direct costs for each product or service. Changing basic assumptions is easier with this template, as it does not require changing monthly entries for every year projected. However, this template does not produce as precise a cash flow projection. Most items will be averaged over four quarters, not allowing for seasonal fluctuations. This will be of more or less importance depending on the industry and the amount of fluctuation expected. Year-end results are not affected by this constraint.

6-Year Financial Template – Instructions (Module 6)
This resource provides specialized instructions for using the 6-Year Financial Template and helps clarify the particular ways in which it differs from the 3-Year Financial Template.

Assessments

Entrepreneurial Readiness Assessment (Module 1)

This is an interactive diagnostic file that helps you assess your team, technology, business model, and capital strategy. It will help you determine your readiness to launch or to continue developing a high-growth company.

Business Concept Feasibility Assessment (Module 4)

This is a checklist that allows you to assess aspects of your business concept in comparison to a model business. This checklist will help you determine the commercial feasibility of your venture.

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Technology Feasibility Assessment and Plan (Module 4)
This assessment allows you to determine your progress in testing and securing your technology. After completing this assessment, you will develop a plan to further test the feasibility of your product or service and to protect your intellectual property.

Action Files

Business Concept Statement (Module 1)
Entrepreneurs need to be able to describe the precise nature of their business in a brief document of one to two pages. You must formally state what business you are in, what you sell, and who comprises your target market. This resource's step-by-step approach helps you flesh out your idea and write a clear, succinct concept statement.

Dilution Calculators (Module 9)
Two dilution calculators (in Microsoft Excel® workbooks) are available online for your use. They are both designed to help you understand the basics of dilution, that is, how the percentage of ownership is usually reduced for each class of stockholders upon each new round of financing.

Dilution Calculator – Simple (Module 9)
This calculator shows the dilution effect of one investor per round. It does not include the impacts on dilution of other equity instruments such as the stock option pool or warrants issued in debt financing. The layout is simple and requires few entries. It is recommended that you start with this calculator and move to the Advanced calculator as you become more familiar with the concept of dilution.

Dilution Calculator – Advanced (Module 9)
This calculator shows the impact of equity set aside for management in the form of stock options. It also shows the effect of more than one investor per round. It does not cover all possible equity instruments, such as warrants issued in debt financing, and it does not distinguish between common and preferred stock.

Elevator Pitch (Module 1)
An elevator pitch is the distillation of the most important points in your business concept and business plan. Not lasting any more than one or two minutes, or the length of an elevator ride, it should be compelling, well-conceived, and very well-rehearsed. This resource guides you through a series of questions to help you develop your elevator pitch.

Interview Forms (Module 7)
Finding the right people for your company is one of the most important things you can do to make your enterprise successful. This resource features lists of sample key questions to ask and to avoid in an interview, a form for taking notes as you interview each potential employee, and a matrix to help you objectively compare candidates. This form is a sample only. Actual forms should be developed with assistance from your attorney.

Investor's Due Diligence Questions (Module 9)
This resource provides a detailed listing of questions investors might ask about any business plan they read and presentation they view. By writing out your responses to these possible questions, you will ensure that you have carefully considered each point and are prepared to respond appropriately when any of these questions arise.

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Investor Presentation (Module 9)
A face-to-face presentation is the best chance you have to convince a potential investor to invest in your company. This resource helps you prepare a clear, concise, 10-minute Investor Presentation for your business that addresses all the risks associated with it and highlights the investment opportunity your company represents. It also lists likely questions an investor will ask during the presentation session. This list of questions helps you get into the mind of investors and understand what they look for as they study your company's potential.

The Partnering Proposition (Module 9)
Before offering a partnership agreement to another party, it is wise to organize your thinking and consult with your attorney. This tool will help you and your attorney outline the key elements of the mutual value proposition as well as anticipate and address questions that will likely be posed by your prospective partners. This form is a sample only. Actual offers should be developed with assistance from your attorney.

Personal Vision Statement (Module 1)
The Personal Vision Statement expresses your own criteria for successfully starting and operating a business. This statement includes personal, professional, and financial criteria. The guiding questions in this tool help you to discover your definition of success and to develop your statement.

SWOT Analysis (Module 3)
An important early step in the planning process is to examine the internal and external business environment. A SWOT analysis can help you identify Strengths and Weaknesses, and examine the Opportunities and Threats you or your competitors may face. This resource offers two templates: a SWOT Analysis and a SWOT Analysis Comparison.

Lean Canvas (Module 2)
The Lean Canvas is a perfect way for you to think creatively about possible business models, prioritizing where to start, and track progress. Remember, this is an iterative process. You will not have all the answers when you start. You have an idea what the problem is, a potential solution and perhaps an idea of who your customers might be.

Why Products Fail: **spark59.com/why-products-fail**

20 Minute Lean Canvas Challenge: **spark59.com/leancanvas/20-minute-challenge**

Guidelines and Sample Documents

Application for Employment (Module 7)
Remember that a resume is not considered a legal document, so you must have all job candidates complete a job application. You can download this sample job application to use as a starting point for discussions with your attorney to develop an application to use in your business.

Capital Structure for Entrepreneurs (Module 7)
This resource presents a discussion of how ownership can be distributed in a company. It focuses first on allocating equity when starting a company, and then presents a series of examples and formulas for determining the amount and effect of dilution that might be caused by accepting varying amounts of outside financing.

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Commercializing a University Technology (Module 8)
Commercializing university technology can be an excellent way to build value around a new technology. It is also a complex process in which the needs and constraints of very different individuals and entities intersect and potentially conflict. This detailed explanation tells you what you need to know when approaching a university's Tech Transfer Office and meeting with your attorney.

Employee Agreement (Module 8)
Creating written agreements is the first step in protecting your company's intellectual property. Legal documents can't prevent an employee from doing your company harm, but they do demonstrate that you are serious about protecting your intellectual property and that you are willing to prosecute those who betray your trust. This document is a sample of a Proprietary Information, Inventions, Non-Competition, and Non-Solicitation Agreement and can be used as a starting point for discussions with your attorney.

License Between Individual and Company (Module 8)
This sample license allows a company to use data, discoveries, inventions, technical information, or know-how created by an individual. This form is a sample only. Actual licenses should be developed with assistance from your attorney.

Non-disclosure Agreements (NDAs) (Module 8)
It is often desirable to share confidential information with persons or entities outside the company in order to advance business or financing transactions. The information shared will be subject to a contract and is usually protected with a confidentiality agreement or a non-disclosure agreement (NDA). Confidentiality agreements can be crafted as single (only one party discloses to the other) or mutual (both parties receive and disclose information). These forms are samples only. Actual agreements should be developed with assistance from your attorney.

Non-disclosure Agreement – Single

Non-disclosure Agreement – Mutual

Option Plan Guidelines (Module 7)
This resource provides a detailed overview of option pool management from the entrepreneur's perspective. It features practical advice on actual scenarios you may face. However, the information provided should not be relied on in and of itself, since it does not constitute legal advice, which can only come from a licensed professional.

Sample Business Plan (Module 1)
This resource shows a completed business plan based on the Business Plan Template.

Sample Financial Statements and Ratios (Module 6)
This resource contains one year's worth of sample financial statements – Balance Sheet, Income Statement, and Cash Flow Report – from the 3-Year Financial Template. It also contains samples of the four types of financial ratios.

Sample Patent (Module 8)
A U.S. patent for an invention is the grant of a property right to the inventor(s). To get a U.S. patent, you must file an application in the U.S. Patent and Trademark Office. This sample shows the detailed text and diagrams included in a patent.

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Sample Stock Offering Memorandum (Module 9)

This sample shows the level of detail that can be contained in a stock offering memorandum. This document is presented as a sample only. An actual offering memorandum should be developed with assistance from your attorney.

Term Sheets (Module 9)

The sample term sheets provided online will help you gain a better understanding of the basic terms that a venture capitalist may propose before investing in your business. Each page outlines principal points that may arise when negotiating with investors, but the documents do not constitute the only possible arrangement between entrepreneurs and investors. The term sheet usually undergoes negotiation before it is signed. **In any venture capital negotiation, it is important to retain legal counsel, and these documents should in no way be used to substitute for such counsel.**

Term Sheets from the Entrepreneur's Perspective (Module 9)
This resource provides detailed explanations of terms proposed in venture capitalist term sheets. It discusses the effects of these terms on the entrepreneur.

Term Sheet – Series A (Module 9)
This sample term sheet for a Series A round of financing details the major points of a hypothetical investment deal for a first-round "Series A Convertible Preferred Stock" financing by a venture capital investment firm.

Term Sheet – Series B (Module 9)
As an enterprise grows and requires additional capital, the subsequent rounds of preferred stock issued to investors are called Series B, Series C, and so on. This is a sample term sheet for a Series B round of financing.

Case Study (Module 9)

The four files that comprise the case study feature three developments in the life cycle of a fictitious high-growth company, "BioMatrix." As the company grows, the CEO and counsel of "BioMatrix" will negotiate a term sheet with a venture capitalist, a partnership agreement with a strategic partner, and an acquisition offer with an acquirer. The foresight you gain from studying these scenarios will help you avoid common pitfalls that snare entrepreneurs when dealing with investors.

Case Study 1 – Overview

Case Study 2 – Term Sheet

Case Study 3 – Partnership Agreement

Case Study 4 – Acquisition Offer

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