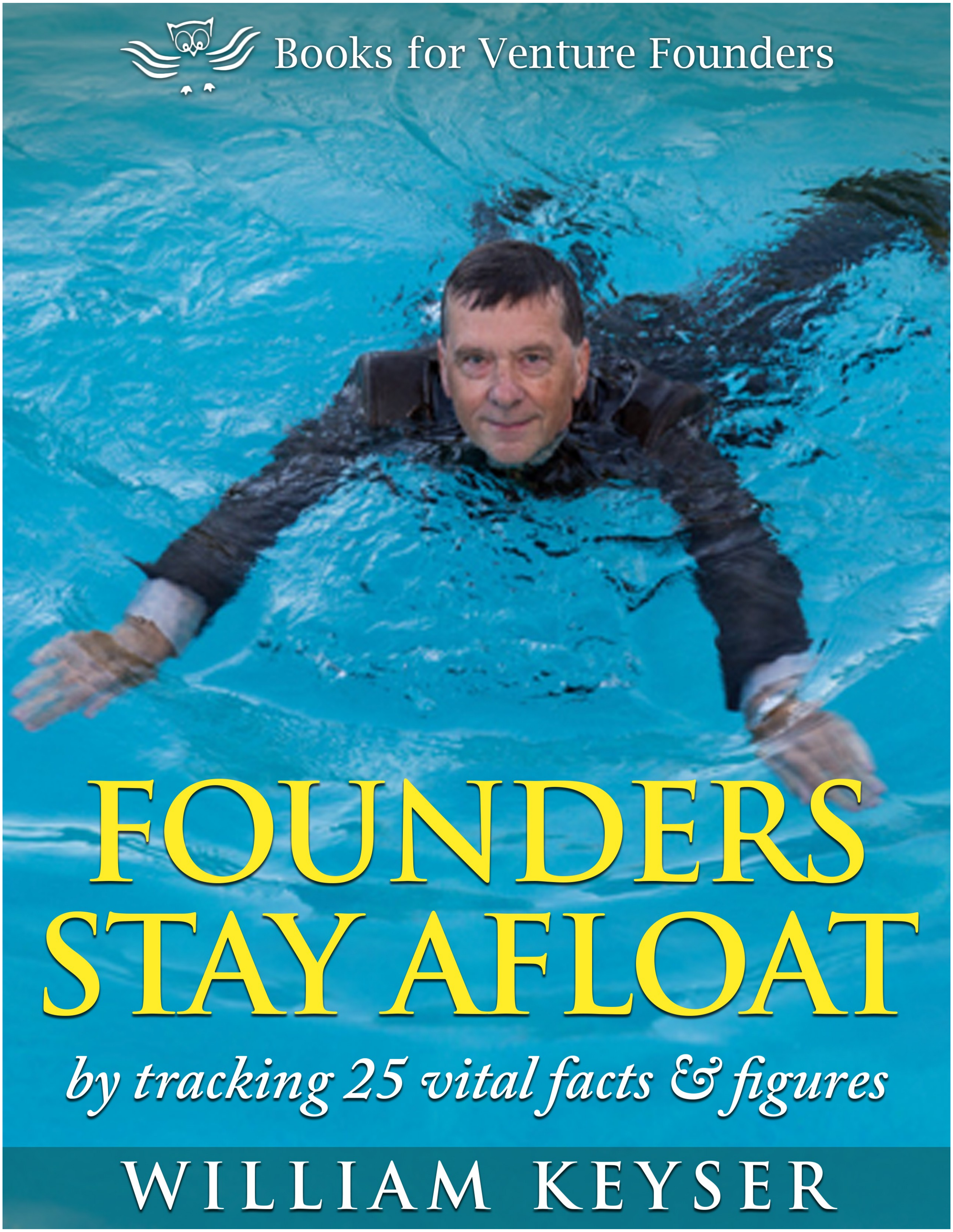
Books for Venture Founders
FOUNDERS
STAY AFLOAT
by tracking 25 vital facts & figures
WILLIAM KEYSER

Books for Venture Founders are aimed at people wanting to start a business or a nonprofit and those at an early stage of running their enterprise. The focus is on practical solutions to issues and dilemmas frequently faced by budding entrepreneurial types, as well as imaginative ways to help new ventures thrive.

1st edition

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Founders Stay Afloat: by tracking 25 vital facts & figures

Preface

Why read this book— and what this book is not

Founders Stay Afloat—by tracking 25 vital facts & figures is basically a handbook that helps founders keep their fingers on the pulse of the business and avoid surprises, thus mitigating risk.

Many first time entrepreneurs, myself included, are both passionate about their business and run off their feet. They often find setting priorities to be an almost impossible task. They are generally much more interested in doing, than watching.

However, what is vital is that we keep our passion, while at the same time tracking our progress to keep ahead of the game. Most of the data we need to track are financial, but a few are still numerical, but not about money directly. This book will help you with both without getting bogged down in detail, or worse, leaving the data tracking to someone else.

You are not going to use every means of tracking described in this book. You will be selective. Use the ones that make most sense to you.

This is not a bookkeeping course, though bookkeeping is involved. It will not teach you accounting, but it will help you keep your accounts in order, and avoid bewilderment when things go off the rails. I have often heard entrepreneurs say, "… but our sales are going through the roof, how come we are short of money?" I've frequently heard them ask, "… and why won't the bank extend our line of credit, business is fantastic?"

This is the kind of shock we want to avoid, without getting overwhelmed with data. This book is about the data you absolutely must know regularly—to keep your startup on track, and to keep afloat in the future.

Foreword

The book I wish had been written before I started

If I had this book on day two of my startup, I could have saved myself a lot of painful time. It was as if I had had someone telling me to jump, but not until I had jumped, did they tell me how high.

Keeping an enterprise going is as tough a job as can be imagined, especially when you know that only half of all startups survive past five years. The failure rate of nonprofits is not much better: of those that obtained tax exempt status five years ago, 64% are still listed by the IRS.

All successful founders share the ability to learn very quickly. Even if they know their products and markets intimately from their prior business lives, what they could not have experienced is the reality of being in business for themselves—as any one of them will tell you.

When I have described the purpose and contents of this book to relatively new entrepreneurs, all of them have said that ‘if only’ they had had access to such information and guidance before they started they would have saved an immense amount of both time and heartache.

So, I hope that *Founders Stay Afloat* will fill that void.

Introduction

The difference between lagging/performance and leading/input indicators

New entrepreneurs often look at what they conceive as critical numbers in the rear-view mirror: lagging indicators (or performance/outcomes). The essence of this book is not only about using them to forecast likely outcomes in the future, but also making sure to look through the windshield to see what lies ahead.

In the public economics arena, one of the most common lagging indicators is the unemployment rate. This is so because employers more frequently hold off hiring until the economy shows real signs of having improved. The reverse also tends to be true. When the unemployment rate is rising, it's generally the result of poor economic performance.

On the other hand, a leading indicator (or input/direction) is anything that signals a brighter economic future. You will have noticed that people assume the housing sector will do well in the future when they notice a rise in the number of building permits issued. Commentators normally suggest that a rise in new business orders suggests an improvement in consumer markets.

To avoid nasty surprises, the business founder should be savvy about the differences between the two. There is no set of rules by which you can set your leading indicators, since they will vary company by company. It is vital that you decide what are the business factors, inside and outside the company, that suggest how things will go.

Since lagging indicators are performance/output oriented, such as revenue and expenditure and so easier to measure. However you can't go back and change them. You can only *infer* future performance from them. On the other hand, leading indicators are typically input/direction oriented, and therefore tough to measure, but making decisions in the light of them is easier.

Most functions of your business will have both lagging and leading indicators. In the sales function, actual sales booked or delivered will be a lagging indicator, whereas numbers of sales calls, inquiry rates, or values of business proposals made, will be leading indicators.

In the production function, likewise, units manufactured, parts delivered, or labor costs will be lagging indicators; leading indicators would be work in progress (WIP) data, downtime-to-operating time, or on-time delivery rates.

There are many other ways to look at data described in this book. To help you decide which data are critical, take a look at the Strategy Map in Chapter 13; it is a graphic and convenient way to inspire your decision on the key indicators to track. There are more ideas in Part Four: The Finger on the Pulse (Chapters 19-24).

The last chapter, *Staying* Afloat in the Future, may be the most important one in the book, since it may well inspire founders to reassess how to think about their venture over the long haul.

Acknowledgements

The biggest thanks are due to all those with whom I have worked over many years, and especially those who worked with me in my first startup between 1982-1993.

I have also learned a lot from two other places: my business failures and my seven years of teaching entrepreneurship on an MBA program over seven years. Students are exacting and you cannot hide, but I thank them too,

Most of all, my friend Robin Fuller has played a special role in helping me with the text. Robin qualified as a chartered accountant (what we call a CPA in the US), and for many years, was an entrepreneur, more than a bean counter. In 1999, he co-founded Economy Power in the UK. The company was successfully sold to E.On Energy in 2005. He went on to co-found eco2 (they initiate, develop, finance and operate renewable energy projects throughout the UK and Europe), where he is still a Board member. He not only applied his wide-ranging experience as an entrepreneur, but also made many suggestions for textual improvements. His input was both valuable and appreciated. You'll see, too that I quote him directly at various points in the book. This is a man to respect.

Part One
What's To Be Expected?

Chapter 1: Real And Funny Money

Personal Investment, Equity, Loans and Bootstrapping

If you are using your own money, you will obviously be watching it like a hawk, as you usually do. The money may come from a bulging checking account, a personal loan, or mortgage, credit cards, or pennies in the cookie jar.

The source of funds might be salary, liquidation of savings, a CD, a 401K, or a gift from an indulgent maiden aunt. In each case, you will be transferring the cash to the business account that you opened as soon as you registered the business. Naturally you'll keep going back to the cookie jar, because your first attempt at a startup budget was wrong. But here's the thing: set limits on crediting the business account, or you'll wake up one morning with an empty cookie jar and wonder why the business can't pay creditors.

Frugality is a vital behavior at the pre-startup stage and, probably for the first year or so after. There are exceptions if the startup involves a large building project, or if an entire plant has to be built, but most startups should be started with as little money as possible, spent with inordinate care.

Don't try to run too fast, too soon. It's easy to blow your investment if you don't fully understand the nuances of the market you've decided to enter. There are legions of stories of businesses that have tried to grow too quickly without fully understanding their market sector and what potential trip-me-ups are specific to that. This can happen quite easily if initial sales are relatively easy to ramp up (aka 'over-trading'), and at the same time, if applicable, there is the perceived need to please outside investors with positive early news.

Whatever the source, keep separate tabs on each bundle of money, and how it is spent. Your own personal investment will be sunk money that will produce nothing until there are profits. The profits will only come after break-even (see Chapter 9), which may be a long time in the future, and once they are being generated, you will tend to keep them in the business. In my startup, we did—for reinvestment, but you could also use retained earnings to pay down debt. But there will come a time when you want to raise money from outside. At that point, whether the sources are for equity or loans, the people who supply the money will want to know how much you have invested, and whether the money was spent on assets, raw materials, operating expenses, or what.

If you are wanting to raise loan money, there will be a big difference between expenditure that has resulted in something of value that can be used as collateral, by comparison with expenditure that has been spent on wages or consumables.

Equity

If you have attracted equity money from others, either friends, family, crowdfunding, suppliers, angels or in a few rare cases, venture capitalists (about 0.0005% of startups are VC funded), all of them will need numbers relating to what is represented by your investment now, in such a way that they will be able to use the information as part of the means by which they will value the company and hence the shares they are going to buy.

The valuation of your company to determine the value of individual shares is complex and not discussed in this book—and you will be well advised to involve a specialist.

However, there are three main valuation methods. The first is the income approach that considers expected future earnings; the second is the market approach that compares your performance to other similar businesses in your sector/locality; the third is the asset approach that considers the cost of replacing the assets of the business.

No matter how you determine the equity value, you will need to revisit the valuation process as the company progresses, in order that the investors can track the potential increase or decrease in the value of their stake.

This is why quoted companies do reports. You will be unlikely to find it necessary or useful to go through that process quarterly like the big boys and girls, but half-yearly would be good. And it will be good not only for your shareholders, but for you, too. This will be another way of tracking how you are doing and considering changes or pivots (see Chapter 24).

You will keep track of equity investments by family and friends, not only through the bookkeeping route (both P&L/Income Statement and Balance Sheet), but also I would suggest, by keeping a separate file of who has put what into the business and when. When the investment was first made, there will have been an equity purchase agreement (a term sheet sets out conditions in the case of an angel or VC investment). The terms will stipulate the conditions, including what happens in the case of a liquidation.

Plan to value the business every two years, or more frequently if you are growing super fast. Have your own preferred means of doing the valuation, even if an outsider has a different method. Of course, your valuation is entirely speculative until you have someone willing to buy equity; their valuation will most likely be much less than yours, but if you have your own valuation, it will give you a base line for negotiation.

Loans

If you are seeking loan money, the providers, whether individuals, banks or other financiers, will want to see your 'skin the game' in terms of your own money (and thus personal risk) and what it may represent as collateral, or at least to convince them that they are not alone in taking the risk of advancing money. Bankers will only be really interested in liquid or near liquid assets - things they could sell if you went belly up.

If you do seek loans from friends or family, however much they love or trust you, you should draw up a loan agreement, normally called a promissory note, which apart from anything else, will protect parties from the IRS considering the money a gift. A promissory note must include the following:

- The amount of the loan: the amount that is borrowed and owed.
- Repayment dates: the date payments are due and by when the whole loan must be fully repaid, including interest.
- Also consider how the repayment of the loan sits in terms of priority relative to other loans – eg, after the bank loan but before the owner's loan
- Interest: the amount of interest accrued on the life of the debt and terms for late or missed payments, if applicable; you may pay interest and capital monthly/quarterly, or roll up either with a 'balloon' repayment at the end of the term.
- Default terms: what happens if you fail to repay the right sums by the specified dates.
- Security: list the value of what is used as a guarantee and what happens if you default.

Having a promissory note is not a stranglehold, but rather a way that avoids negative relationship consequences if you are stuck for repayment. Of course, grandma can decide to waive clauses, or even tell you that the loan does not have to be repaid, after all, but this keeps everything clear. Think about at least paying family members interest at the rate of a money market account at the bank, or a CD. If the loan is from friends, think about a rate a bit higher to provide an incentive (that generally is the case in P2P lending through a platform like Prosper.com, LendingClub.com or newer entrants to the field). You don't need to rush to an attorney, unless you feel insecure, but I suggest that you get a promissory note template from Nolo.com, docstoc.com, or rocketlawyer.com and adapt it to your needs.

Loan/Equity Hybrid

There is another route that you might have chosen when taking a loan from family or friends. The promissory note could make the loan convertible into equity under certain specified conditions that you agree with the lender. Most likely you will have used an attorney to draw up the promissory note. Promissory notes can be considered ‘securities’ and thus come under one of the sets of rules of the SEC.

You will be well advised to seek advice to avoid a convertible promissory being considered a security. If it is you will be required to register it with the SEC. “Under current law, whether a note is a security depends on whether the note looks like a security. I know this is not very clear or helpful but it is a starting place in our analysis. In general, under the federal Securities Acts, promissory notes are defined as securities, but notes with a maturity of 9 months or less are not securities.” This comments comes from A O Headman, an attorney with Cohne Kinghorn.

This is but one of the sources of a changing share ownership structure of the company. You may also be issuing shares to partners and staff. Assuming your company is an LLC, make sure to keep your share register up-to-date. Most States require you to maintain at your registered office, lists of the full names of all managers and their mailing addresses, and all members (shareholders) and their mailing addresses together with each member’s contribution to the LLC and their shares of profits and losses.

Checklist of What to Track

1. Amount of money put into the business by source and date.
2. Uses of cash, equity and loan money.
3. Regular valuation.

Chapter 2: Business Plan Or Not

"Great plan. Could we get some more details?"

Bells & Whistles or Back of the Napkin + Budgets and Forecasting

You will have a business plan, like it or not, even if you have written nothing down. You will have thought about it intensely. The big questions are (a) what will your business plan physically look like; (b) what process will you use to create it; and (c) for whom are you writing it?

There is an apocryphal story about Herb Kellner, the founder of Southwest Airlines and how he put three dots on a napkin, connecting them up in a triangle, naming them Dallas, Houston and San Antonio—a vivid business plan for his new airline. Or think of Vinod Khosla, the founder of Sun Microsystems and the eponymous venture capital firm. He says, "a short and simple business plan of about six pages is all you need." The mission he set in his first business plan was to, "Develop, manufacture, market, and support graphics workstations for OEM CAD/CAM marketplace. Evolve a family of compatible graphics workstations. Maintain lead with best cost/performance product on the market." In those three short and succinct sentences, he almost needed to say no more. Of course he did, with clear data and even handwritten appendices.

On the other hand, you can produce an all the 'bells and whistles' 50-page plan, full of endless projections and appendices, but please don't. And most of all, even if you use business planning software, do not subcontract the preparation of the business plan to someone else. It must be *your* document. Chances are high that if you use a template, it will indicate that you have not really thought through *your* business.

The process of preparing the plan is best done with co-founders, colleagues, and/or a mentor. The old adage of 'two heads are better than one' certainly applies. When I teach new venture creation, I make sure business plans are worked on by teams of students, not individuals. Even if an individual does a first draft, the plan will fail without a lot of feedback from other relevant people.

Frequently people starting business are so in love with their product or service, that they simply assume they just have to offer it and orders will flood in. A business plan of some sort lies behind startups big and small. The best business plan is a good list of paying customers. If you have them, it's evidence that the plan is realistic.

I believe that there are 10 essential components to a business plan:

1. answer the questions, "why do it?" and "why *you* can succeed at it?";
2. define the problem and your solution—the value proposition;
3. know the market opportunities for your product and who your customers are;
4. ensure a workable business model—how will revenue come and where from;
5. create a clear vision—to steer by and make course corrections when needed;
6. search for what and/or who is missing—evaluate necessary resources;
7. set achievable targets—you won't fool anyone, even yourself;
8. establish quantified goals—you need some idea of scale;
9. state *realistic* numbers and timelines: a roadmap—it's vital to have something to aim for;
10. be honest on downside risks—do a SWOT analysis and keep doing it.

At the stage of talking with potential investors/banks, they may have been in flexing the assumptions to see, for example, at what point the business broke even, or by how much sales could fall with the business still remaining cash positive. You might have used spreadsheets on Excel, with a number of flexing parameters, eg sales volumes, sales values, ditto purchases, slow/fast rate of growth in sales. This would have guided their decision-making, but the outturns can then be compared against those numbers as the business progresses.

However, what actually goes into anything written will depend upon the audience. If you really think you want to seek angel or VC investment, then you will have to be very convincing about the scale of growth expected.

If you are seeking a founding partner, then it will have to appeal specifically to the kind of person you seek. In other words what goes into a written agreement, will depend upon the input you seek to achieve from the co-founder—for instance from working in the business, or bringing other assets, partnerships, or connections, for instance.

However, probably the most important audience is YOU and any co-founders, as a means a) to check that the whole business proposition hangs together; b) a document that you can share with others to get feedback; c) to serve as some kind of benchmark against which you can check progress, once you have opened for business.

I kept our business plan on my desk for the first nine months of the business and frequently checked progress against the assumptions we'd made. When you write the plan, the numbers you assembled will be wrong—not maybe, but ***absolutely***. Even if you had been very diligent at collecting the best data, your business has so many variables that are hypothetical, until the rubber meets the road.

If you do not have both the numbers and the assumptions connected with them written down, there will be no way to check either how well you are doing, what was wrong with your assumptions, or to put the situation right.

Our business plan in 1981 aimed US multinational subsidiaries in the UK. This core ambition resulted in our first customer being Mars, a great reference for later attracting many others, but this objective could have gone badly wrong if we had not kept our eye on the ball and checked that we were indeed, signing such customers.

Budgets and Forecasts: Be Sure of the Difference

Your business plan will have been written before you open for business, and though it will involve budgets and forecasts (whether by sticking your finger in the air, or by minutely calculated spreadsheets in several appendices), but once your doors open, reality will set in.

What's the difference between budgets and forecasts? Budgets are amounts that you allow for particular items (and are mainly derived from historical data or quoted prices for things), whereas forecasts are your best estimate of what the items will cost or what sales you will achieve in the future. Both require estimates, but I would say that estimates are cold calculations that do not leave any room for the application of judgement. Forecasts, since they always concern the future, will be filled with judgements (with uncertainties!) about outcomes.

Think about sales. You know you sold 100 last period, and given similar circumstances for the next period, it would be reasonable to budget selling 100 next period. However in the next period you are exhibiting new products at a big trade show and so you might forecast selling many more than 100 in the following period. Monitoring both will help you check out-turns against what you budgeted or forecasted.

You will find that budget numbers will likely be conservative, while forecasts may be more likely to be tinged with optimism. For more on the difference, or variances, between your forecasts and actual results, see Chapter 7. Sometimes you will hear people talk about planned expenditure or income. Plans seldom work out, as I have said. So it's best to stick with budgets and forecasts.

Many entrepreneurs ignore or forget the other half of the budgeting. Budgets are often wrangled over when they are being set and then promptly forgotten. Variance analysis allows you to reflect on why there was a difference between what you thought and what actually happened. Sharp founders not only practice variance analysis on monthly accounts, but they take prompt action in the light of what the analysis reveals.

COGS—Cost of Goods Sold

The Cost of Goods Sold summarizes the aggregate of all the costs it takes—including inventory, raw materials, labor, and wages—to bring your goods or services to the market. It is sometimes tough to assign costs to particular budget lines. You want to monitor COGS, nonetheless, so that you can measure whether the pricing of your products and services is appropriate for the market, given both competitor prices and your own customers' reactions. What you check is the beginning inventory *plus* inventory purchases *minus* end inventory, which equals the cost of goods sold.

Of course, this is not a profit and loss account, since there are costs not included, like the boss's salary and other general overheads, though it will include the pay of those who make the goods or deliver the services, and the cost of utilities used to do so.

It is important to track these numbers so that you have a better understanding of the contribution of each of your products or services.

Fixed and Variable Costs

Fixed costs include things like rent or insurance that do not vary with differing levels of output/activity. Variable costs include materials that go into production of the finished product.

Fixed costs are not always as *fixed* as you assume; nor are variable costs as *variable* as you might assume. You might consider your production machinery or kitchen equipment as fixed costs. On the other hand you might assign a unit of cost to a machine that applies to producing each unit, thus it might become variable. So, be careful when you make such decisions.

It is important to know what parts of your costs only get incurred when you make or sell something and which ones you're committed to anyway. When your management team sits down to review your month end figures, you need to know these numbers to avoid increasing or cutting the wrong things.

Before and after the launch of the business

Budgets and forecasts are an essential management tool for any business, but especially so for startups or early-stage businesses, as you travel through uncharted waters. Your business plan numbers will be just fine for the early months. Don't avoid recasting them after say, 3-5 months, because you'll have real information to work with.

There is a huge caveat, though. Don't be changing budgets or forecasts every month, because you will lose your compass bearings. When I was on the board of a regional venture capital company, I had oversight of one of our investments, and the company's financial executive changed the budgets monthly, thinking he was going to be able to make them more accurate, but actually put me in a position, where I had no idea how the company was doing—and no more did he.

On the other hand, you can keep the annual plan as the fixed statement against which actual results can then be compared. Then, alongside that annual budget (if you have the staff to do the work!), you can re-forecast every month and enter all the actuals, to update the forecasts from that point. Each month, you can create a new file, so as not to lose track of how the results evolved. As the year progresses, you would then end up with a series of files. It might sound complicated, but it need not be, using the P&L template so that a large part of the job is just cutting and pasting.

In terms of revenue forecasts, be sure that you do not let your excitement run away with you. Over optimism will have two likely outcomes. First, you'll be disappointed. Second, you may be tempted to spend money you don't have. That's where the concept of the order pipeline, described in Chapter 5, is so important.

Checklist of What to Track

1. A business plan—both words and numbers.
2. Budgets and forecasts—check variances of income and expenditure when reviewing monthly accounts.
3. Consider COGS as well as fixed vs variable costs for spending decisions.

Chapter 3: Look Forward, Not Back

	Year 1	Year 2	Year 3	Year 4
Revenue	0	15,000	21,000	35,000
Costs				
Manufacturing	5,000	7,000	11,000	16,000
Marketing	1,000	2,000	2,500	2,500
G&A	3,000	5,000	7,000	9,000
Total	9,000	14,000	20,500	27,500
EBITDA	-9,000	1,000	500	7,500

Income Statement/Profit & Loss and Balance Sheet

Remember that when you look at the monthly accounts, they tell you what *has* happened, not what *will* happen (with a few minor exceptions).

The numbers you should watch very carefully every 3-6 months are those that will tell you whether you are adding or depleting value. When you do look at monthly report and accounts, start with the balance sheet, watching for current liabilities (how much you owe to others, such as suppliers of goods and services plus sales taxes which might be considerable; short term loans, like lines of credit) and current assets (cash, inventory, what others owe you). This is a good discipline to compare with your cash flow forecasts (Chapter 6) and variance analysis (Chapter 7). Even if you look at nothing else, these two numbers will give you a smell of whether there is enough cash in the business to keep trading in the future.

In the first two years, people will tell you simply, “cash is king”, and it’s true. In our case, cash was the thing that dominated our financial attention in the first three years. It was all about survival. The next couple of years it was growth that preoccupied us. Why? Because we needed the resilience to keep going, to withstand the inevitable ups and downs in our fortunes. Around year five, we finally began to say, “Hey, we’re still here. Amazing. Wouldn’t it be good to be better located? Maybe we can start looking for business overseas.” And things of that nature. We also considered that we had to build the inherent sustainability and profitability of the business. Profits would allow reinvestment, some profit-taking by the founders (or putting money into pensions), and further development. By the way, Amazon only became profitable after nine years.

It sounds as though the overworked entrepreneur has too many things to watch in addition to creating wonderful products that delight people. It is true, I am sorry to tell you, but there’s a but.

The but is that watching all these numbers is a learning process, as is almost everything else with a new and early-stage business. You know yourself that founders are nothing if not learners. What you will find is that after a bit you will almost be able to ’smell’ your numbers. I am hopeless at math, but what I learned to do quite early in my business career, was to be able to smell my numbers. You look at a balance sheet or a P&L and certain numbers will jump out at you. When I was doing ratios, percentages, or even adding up a column of figures, I could tell if the result was not right and proportions were off, and I could go back and do the calculation over.

In the same way as a captain on a big ship or a chief engineer at a power plant can look at lots of dials and digital displays and just know if things are right or wrong. My wife once found herself in front of an ATM and could not remember her PIN number, try as she might. So what she did was to close her eyes and let her fingers remember the number—it was only four digits, after all. Hey presto, out came the money.

That's how it will be with the numbers in your business. I am not asking you to become an accountant or even a bookkeeper. I am asking you to make sure that you have the numbers and can interpret them well, progressively.

Profit & Loss/Income Statement

Income statement measures financial performance over a particular accounting period: your revenues and expenditures, as well as the difference between the two. I prefer the name profit and loss, even though it may sound like it indicates either success or failure. But that is not really the case, especially in the early stages of a business. Of course, there are startups that are profitable from the get-go. But more often that is not the case as you crank up the engine of your company. Losses are not failure. On the other hand, no cash almost certainly **is** failure.

If you have cash in the business it will not sustain you for ever, but in the short term it will mean that you won't go out of business, today at least. Profits are going to be what you progressively strive for.

So as you monitor your profit and loss account, there are some specially important numbers to track. The first is probably your Gross Margin, or gross profit. This is the amount of money you have left after you have subtracted the direct costs from the selling price of your product or service. The higher your margin the better, because you need to have enough left over to pay your indirect costs or overhead (things like salaries, rent, advertising, telephone, and utilities). If not, what could than mean?

The reason for your tough cash position can be attributable to insufficient gross margins. The reasons why gross margins are not big enough, could be that the direct costs of your products are too high, maybe because the price you pay for raw materials is too high, or the way you manufacture produces too much waste. On the other hand it may be attributable to the sales price being too low.

Figuring out a 'good' gross margin is pretty much a matter of trial and error. In general it's true that if you sell services rather than physical products, your gross margins are likely to be higher—sometimes as much at 90 per cent. Such a high gross margin may seem *gross* to you, but at the same time you might still be making a net loss.

When I was in management consulting, we used to say that we sold *vaporware*. Maybe others would say we sold hot air. In any case, our big costs were not our raw materials. Paper and pencils were all we needed.

The significant cost was time and since consultant salaries tend to be high, they are a greater proportion of total costs than would be the case in manufacturing, for example. The best consultants also have the best salaries. Our rule of thumb for cost per hour (and sometimes charge out rate) was two and half times salary, plus employment cost (insurance, healthcare and so on).

It may sound outrageous to the client if described that way, but a consultant is not productive (fee earning) all the time. The consultant cannot be charged out to a client for every hour of every day, unlike a manufacturer who can build in the full cost of a lathe operator’s time to the cost of the product he makes. So a consultant will have sales time, and personal development and training—so as to improve competence.

Balance Sheet

Personally, I think that the small business balance sheet has limited use at the early stage of the startup. Unless, you have a large amount of external money in the business, or you have heavy investments in real estate or physical plant.

About two years in, we did start monitoring the balance sheet monthly, but only to check nothing glaring was wrong. Any accountant will tell you to do so, but they are not typically founders of startups. Of course you are likely to have prepared balance sheets pre-startup, but then as I have said in the previous chapter, they can only be guesses at that stage. When the business model is really stable, then you will want to go back to the ritual.

What is vital is to decide exactly what numbers you are going to track monthly. When you have finished reading Sections 1 and 2 of this book, I think you will have reached your own conclusions for your own special case.

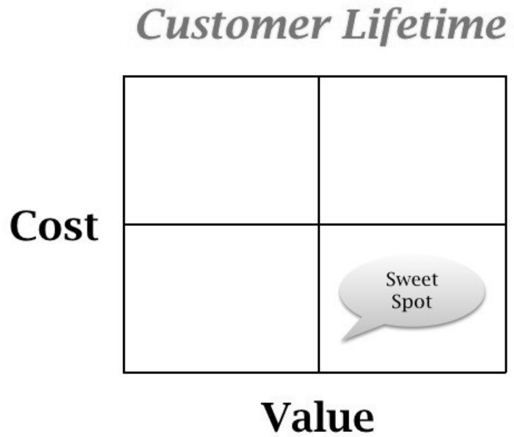
Checklist of What to Track

1. Profit & Loss Account—to have a handle on the big picture.

2. Decide what to track monthly and review the list regularly to be sure you are on top of the numbers you need.

3. Numbers could include: outstanding orders, stock sold but not delivered/invoiced, work-in-progress specific to firm orders, new sales booked in the month, gross monthly payroll numbers/cost, for instance.

Chapter 4: Making It Or Losing It



Are Customers Coming or Going and For How Much

Day one and you're all excited, rubbing your hands together at the prospect of customers rolling in. On day two, when the phone does not ring, you start pacing. But as soon as you start signing customers, you are going to begin learning interesting things that you had no way of knowing before you opened for business.

We were lucky to start with three customers on the books, but that is the exception. Try to do it if you can, but don't despair if you don't succeed. But when you are open, you are going to want to know a lot about customers and what they represent from a financial point of view.

With the exception of the first of these tracking mechanisms, a startup is not likely to use them monthly, since the ratio of effort-to-reward may be low. I'd suggest that quarterly would be fine. However, if you are in a fast growing tech business, especially an internet-based one, you should ignore this advice. In the tech business chances are high that you will be scrabbling for traction and your sales activity on the web needs to be very effective.

In the next chapter, you will read about customer pipeline building. It fits with determination of the cost of acquiring your customers. In a simple example, you might spend $1,000 on Internet ads and achieve 500 site clicks, but no customers are gained yet. From those 500 site visitors you might get a 5% visit-to-lead ratio, then you might convert those 25 leads into 2.5 customers. Hence they would have cost you $400 in promotional costs to acquire. But you might want to add a proportion of the time of a sales person or sales processing costs to get to the real total investment.

Customer Acquisition Cost (CAC): Measurement

The cost of getting business is going to be important both at the beginning and over time. This metric has been growing in use, especially with the growth of internet marketing and the ability to track expenditure and conversion rates.

It is a pretty crude tool, and like so many metrics, it is dependent upon how you set the parameters. Basically you tot up your marketing spend and compare it in a given period with numbers and or sales to new customers. But be aware that you have to use your head, since the cold numbers don't talk without you thinking about what they indicate.

For instance, in your industry there may be a long sales process between enquiry and contract, so promotional expenditure in month one may be unlikely to result in revenue before month five. In any event what you should be doing is to consider how much the acquisition of a single customer costs. The trouble is that all customers are not created equal. Some types of customer may be more expensive to acquire, but may spend more, or others may come quick but not be repeat buyers.

Likewise, you may want to cut the data into different bits, such as by different kinds of marketing media or promotional activities. For instance, are trade shows more productive than online advertising. Also, you may want to look at sales effort required; if a sales person has to make one or four calls per sale, or per dollar of sale. Chances are high that the bigger the unit of sale, the more sales time will be required.

From my own experience a big sale will take more time than a small one, but the big customer may be more valuable over time. Certain kinds of customer have more complex order approval procedures—some I have known have different rules for different sizes of purchase.

In revenue terms, customers can be looked at by gross revenue a year, repeat business rate (see Churn Rate below), referral rates (free customer acquisition), location (customer density), cost of servicing and other slices of the data depending upon your particular circumstance.

In the tech world, investors watch these numbers very carefully, since they extrapolate them to see an investment's rate of traction (the quantitative evidence of customer demand).

Customer Acquisition Cost (CAC): Improvement

Lowering customer acquisition costs is desirable in all cases, but achieving it may be difficult. If you consider that the lifetime value of a customer is the way to go, then you will certainly have to have a plan to improve your performance and increase customer satisfaction. That is likely to be constantly rising, as innovations appear on the market from elsewhere or expectations rise.

The obvious thing to tackle is the effectiveness of your marketing and promotion efforts, for instance by reducing wastage of spend. Likewise, you can improve perceived user value and that may not have much of an additional cost. For example, if you are in a B2B market, you could hold user conferences, that enabled customers to learn at minimal cost from other users, in terms of the way they use your products. This can be a very powerful way to reinforce customer retention, not least because by coming to such events, the customer is validated and feels more convinced herself through being with others who have made the same choice.

In a B2C marketplace, there are many ways you can add value rather than increasing advertising spend. In my own experience, Apple has been particularly good at this. If I ask for a call back from customer support by completing a simple online form, when my phone rings, the person says, “Hello Will, how can I help you with…”. There is none of that “if x, press y” stuff. That increases my likelihood to stick with Mac computers and has a very low cost to Apple. Canon is a company that’s not far behind. With them, if your printer dies (and they do), you are offered a discount to replace it and they the customer can return the old printer at no cost, for recycling.

CRM, or Customer Relationship Management (see Chapter 5) makes sense for varied reasons, but among them is to improve CAC. A CRM might involve the sales team using a cloud-based sales tracking system, email marketing, blogs, loyalty programs, or other means that increase customer loyalty.

Customer Retention

The goal has to be to create Life Time Value (LTV) through customer retention. Apart from anything else, LTV brings more than just money and cost-saving. It will likely have a significant referral value, too. A customer who is committed long term will be more likely to recommend your product, if not directly, simply by telling others,“I have driven Fords for the last 40 years.”

Calculating and forecasting LTV can be done by using this formula: (Average Value of a Sale) X (Number of Repeat Transactions) X (Average Retention Time in Months or Years for a Typical Customer). Of course it can only be approximate, since the inputs make all kinds of assumptions.

However, once you have made that rough calculation, you can begin to figure out how much it’s worth spending to acquire a particular type of customer. For the kind of customer you think will produce a large revenue stream over time, you will feel more confident to spend time and money of landing that customer in the first place.

Here’s a means of tracking what you may have done intuitively before. Paperclips themselves may not merit this kind of analysis, but if you are selling a range of office consumables, you may take a different view about upfront investment. I knew instinctively that to sell the big ticket services we offered, building a relationship far outweighed banging on about service features. We needed to build a trust relationship in order to gain LTV.

Revenue Run Rate

Even after the first few months, trends will help you understand what corrective action may be necessary. I have suggested that cash is what is critical from the get-go, but so is the rate of customer acquisition. One simple method to measure this is the revenue run rate. This is a way to check on how sales are running and the extent to which your forecasts are likely to pan out or not.

Take revenues from your last month and multiply them by 12. Naturally, ‘one swallow doesn’t make a summer’, but as you do this quick back-of-the-envelope sum every month, you will begin to build a picture. Be aware of the risk of kidding yourself. For instance if you are heavily dependent on seasonal sales, let's say in the third quarter (summer) and you do a run rate of those sales, you'll get a false reading. When you created the annual budget, you should, of course, have accounted for seasonality by month.

The kinds of things that will be shown up include: when seasonality, or other sales patterns are playing a role, indications of pricing opportunities or problems, impact of new sales staff hires, or promotion.

Churn Rate

This sounds horrible, but you need to know how sticky your customer base is. There are some products or services that are one-offs, but what you are most likely looking for is repeat business.

Here you need to be concerned both about absolute numbers, such as frequency of purchase and length of time over which purchases are made, but also the trend of customer retention versus customer defection.

You may also want to look at profit by customer, sales by channel and then plot the churn variables against those variables.

When your churn rate rises, it's likely that customer acquisition costs will be rising, too. Be careful: don't include new customers in your churn rate calculation, since if you are doing the calculation by the month, the new customer cannot show up as lost business.

There is no 'acceptable' churn rate. Only you can decide what rate of attrition is tolerable.

Checklist of What to Track

1. Customer Acquisition Cost—decisions based on this affect both marketing costs and customer profitability.
2. Revenue Run Rate—a quick and easy ratio, but use it as an indicator, not a definitive tool.
3. Churn Rate—this is a critical indicator, not only for revenue, but also for customer satisfaction.

Chapter 5: What's Coming Down The Pike

Sales Pipeline, Customer Acquisition Cost, and Collection Periods

The Sales Process

Forty years ago I had a client who owned the biggest deep-sea fishing fleet in the UK. I was in his office when one of his skippers came in after his catch had been auctioned on the dock, to get paid off. This huge man had been at sea in Arctic waters for six weeks and had come back to port with the biggest catch of cod on record. As the skipper took the bulging envelope of cash and was turning to leave, the trawler owner bawled at him, "…and now go and catch some f…..g fish!"

In other words, you are only as good as your latest catch. I modified the expression with my sales staff as soon as they announced their latest sale, by reminding them that NOW was the time get back 'on their bike' to make the next sale. Why is that? Simple. Because sales don't just happen the order process takes place over time, from the moment you get the vaguest intimation that somebody might be a customer. In your startup, this lesson may take a while to learn, so better start the monitoring the process from the get-go.

The principle is to think of the sales process in terms of:

suspecting ➪ prospecting ➪ engaging ➪ negotiating ➪ closing.

As you begin to sell, the people you contact can be considered 'suspects', since you suspect they could become customers. Then as you engage with them they may become 'prospects', because you have qualified them as being prospective customers. As you negotiate, it will become progressively clear whether the prospect will move forward to the next stage. During the closing part of the process, you may feel confident enough about negotiations to assign a date to when contracts may be signed.

This is a simplistic way of describing the process, which will of course vary by sector and sales channel. It is enough to illustrate the point that you need many more ‘fish’ in the prospecting stage, ensure you have a full ‘net’, when it comes to ‘landing’ the catch. Over time you will learn how long that sales cycle is in your particular case and how many ‘suspects’ you need. This is why you need to monitor the numbers.

Monitoring the numbers will yield higher sales, bigger orders, as well as helping to smooth the whole process of sales acquisition. Your sales forecasting is likely to be more accurate as well. By recording numbers from early in the building of customer relationships you are less likely to face so many ups and downs in sales numbers, because you will be able to take action early, rather than arriving at work one day and finding that your order backlog has dried up.

The Sales Funnel

Think of the process as a funnel, with lots of Leads at the top, with Paid Invoices falling out of the bottom, with plenty of attrition on the way. For any given time period, such as the month or YTD, it might look something like this:

Sales Stage	Number
New Leads	1500
Suspects	750
First Contacts	400
First Meetings	150
Prospects	75
Negotiations	50
Proposals	45
Evaluations	20
Verbal Orders	10
Signed Contracts	8
Invoices Issued	8
Deliveries	7
Paid Invoices	6

Of course, this is not a representation of your reality, but you will know that it goes something like this, and the more you log the numbers, the more accurate your forecasting will become, so that you can spot problems early and prevent horrible gaps in your order book. Knowing lead intakes and conversion rates will keep you on track or enable evasive action if the numbers start to droop.

The sales funnel table shown above is a simplistic view of reality to show how the sales process works. Remember though, that you have to avoid just logging the numbers. My experience, for example, is that leads from big companies take longer to convert and close, simply because the customer’s buying process takes longer. So you might need to have funnels for different customer or product types.

Big company sales may take longer for two main reasons: a) because more people will be involved in decision making on the customer side; and b) because it is likely that the customer company has an established routine, which has to be followed. In a smaller customer business, it is more likely that if the boss says, “buy it”, that’s it—the sale is made.

In the same way, big sales will take longer to close than small sales, simply because they are big. Think about your own decisions. ‘Which cereal’ can be decided instantly while you’re in the store, but ‘which house’ is a longer term commitment and will require a home inspection and arranging a mortgage, let alone the need for you and your spouse to discuss pros and cons before finally deciding to make an offer. Another reason why you may want to log different kinds of lead differently.

Customer Relations Management (CRM) Basics

The numbers for the pipeline can be kept with a simple spreadsheet/timeline. The data will be compiled by logging things like inquiries, responses to promotion, names, addresses and other details added to your network from meetings, exhibitions, referrals, or however you classify sales leads. Then as you take the sequential steps of the sales process, you will keep more and more detailed records of what takes place in the progressive sales relationship. You will also plan future actions at the same time. For instance, you may have set up a call cycle (B2B) or an email campaign (B2C).

However, by far the most effective way to do this is to devise a customer relations management system or to buy software best suited to your needs. I learned this the hard way and by developing a CRM system using paper and pencil, then a computer, even before the term CRM was in common usage. By formalizing the CRM system, you can avoid all the panicking that we had in the early days, when suddenly our order book was empty.

As well as managing the lead conversion process, you can very simply create a hierarchy of tasks that need to be done in order to progress suspects to sales. You will be able to know when a new promotional effort is called for. You can manage the whole sales team, if it’s more than just you. I am not suggesting that the founder of the business has to do all the legwork, but if she is not on top of the numbers, then she will soon be seeing dramatic changes in monthly revenue, or swings from peaks to troughs in P&L. At least she will need to keep her eyes on the CRM dashboard that summarizes the details, to know when her intervention is called for.

If you are going to use proprietary CRM software, make sure that you buy what is most suited to your needs. You need not attempt from the outset, to have all the bells and whistles. Make sure too, that the product you buy can be customized to meet your needs, especially over time. A standard product is unlikely to do the job in your special case. There are several products that are specifically designed for the small business. If you choose one of those, make sure that it can grow with you, as your volume increases, you add more staff, products, channels of distribution, buying points/deciders, or territories. Chances are high that sooner or later you will want to link the CRM to order intake, billing and other steps in bookkeeping.

I suggest that the very first step is to set down what it is you want. Use pencil and paper, a whiteboard with readjustable sticky notes and let all those involved share in building you needs and wants list—typically that will be management, marketing, sales and finance people, if you have reached the stage where you have differentiated the tasks and don't still do all of them yourself.

Another approach might be to download one of the free CRM products and start to use it from the get-go. It may not be ideal, but it will get you familiar with the process and at least show up the things that are missing, so that you can better specify needs when you want to upgrade.

The CRM system has many uses beyond simply recording sales pipeline events. Think about the way that it can also be used to schedule sales and marketing interventions, like promotions, discounts, mail-shots or advertising. It will also allow for setting dates for follow-ups or other account actions, let alone simply recording customer information—contact names, addresses, meeting reports.

The essential use of the CRM is to keep a check on the flow of sales in the pipeline. But is does not stop there. Different departments can access to customer account information. Hence sales teams can do reports on customers for many analyses or quotes. Many CRM software packages have tracking tools and calendars, so staff can know who has been in touch and when. Sales or finance managers can use the CRM system to monitor activity.

Customer Acquisition Cost (CAC): such a system will have numbers that can be translated into very valuable data about the relationships between promotion spends and sales executives' time use—and actual sales. We saw this in the last chapter in terms of revenue. Using the conclusions from CAC analyses will allow you to see what activities are the most effective in building customer relationships. It will also allow you to see such data in terms of specific customers, products, or distribution channels.

If one particular customer is always longer to close than your average time, then you may begin to question whether you want to keep the customer. In general you should expect that sales to 'old' customers will cost less than sales to new customers, on the basis that relationships of trust have been built up in both directions.

You will hear time after time, the advice that existing or repeat customers have lower sales costs than new ones. This notion of CAC is often something that founders miss, but at their peril. You will soon come to see that the Life Time Value of a Customer (LTV) is also a very important thing to track. This of course, fits with your aim to provide what customers need and want, as well as ensuring that customer support, after sales service, and customer relations in general are given a high priority so that customers do not defect.

Neglecting CAC will likely result in disappointing results and failure. CAC is difficult to calculate, unless you are using some kind of CRM to track sales and marketing time and money.

Managing the Relationship: Sometimes the 'relationship' part of CRM is overlooked, as a consequence of it having become so sophisticated and data based. Here is some excellent advice from John Porcaro:

"*Know Your Customer*. Use analytics to segment your customers into groups that are small enough to be relevantly different, but large enough to viably allow unique content creation. Understand them at a human level, why do they consume your product or service? What need does it fulfill?

Treat each customer with Respect. Fight the urge to think of customers impersonally. Each person made the decision to purchase something from you, or chose to spend time learning about your product. Your customers trust you, start to trust them back.

Build a meaningful Relationship by adding value. Sometimes telling a customer about your company, product or service is valuable. But not usually. Give your customers something to talk about, something worth sharing. Be interesting. Be unique. Be authentic.

Track the relationship over time. Whether it's Customer Life Time Value, or Net Promoter, or Engagement, track your relationship individually, and as a whole. Set goals to enhance engagement, to grow referrals, and to increase CLV."

- **Getting Paid**: There is one very big use that you can make of the CRM, which will be discussed in more detail in Chapter 6 that follows. That is to keep a handle on payments periods of invoiced sales. Your accounts people will be monitoring on-time payments, but you can automate the process for the benefit of management, without constantly making inquiries to the accounts department. Failing to get the money in can often be as bad as failing to make the sales in the first place. Make sure you pay careful attention to the next chapter without forgetting the lessons of this one.

Checklist of What to Track

1. The sales pipeline, using customer relationship management (CRM);
2. Life Time Value of each customer (LTV);
3. Average invoice collection periods and actuals by customer.

Chapter 6: What You Can Count On

Cash Flow Forecasting in Real Time (Liquidity)

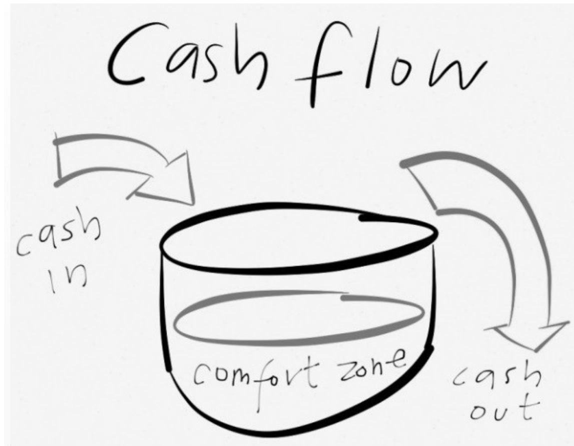


Illustration by Pete Mosley

Cash Flow *Forecasting*

Most founders struggle with the difference between cash flow *statements* and cash flow *forecasting* and how their uses differ.

The cash flow statement is used for analysis after the event to provide information about a company's gross receipts and gross payments for a specified period of time. They will be reported in the cash flow statement as either operating activities, investing activities, or financing activities. They are like a snapshot taken on a particular date, relating to the previous period.

One of the earliest tasks a business undertakes is to set up a chart of accounts—a listing of the names of the accounts that have been identified for recording transactions in a general ledger. Every startup has the flexibility to tailor its chart of accounts to best suit its needs, including adding accounts as needed. The thinking that is required here is to evaluate which groups of income and expenditure will be meaningful, when it comes to tracking money.

Accountants are likely to tell you that they are a must for a business plan. My view is that you should put them in if that is what the reader wants or requires, but giving an investor, banker, or a potential partner cash flow forecasts is ten times more important. The top three reasons for startup failure identified in most research studies are: running out of cash, having the wrong team, or misunderstanding market need.

The cash flow forecast is a vital, probably the most vital, tool that founders use in the early stages of a business. Cash flow forecasts will continue to be used later as well, but about 50% of businesses fail in their first five years. If they last that long, the failure rate tends to slow up dramatically. Manage for cash flow, not profitability. No cash, no business.

In my case, cash flow forecasting was probably the only management tool that I used in the early days. Of course we had to be good at bookkeeping, or we would not have been able to derive the forecasts.

A huge illustration of this came in our third month. Try as we might, we were failing to keep costs within bounds, even with one founder taking no salary at all. All three founders spent the biggest chunk of their time on sales activities, but we were learner pigeons, even though I'd been selling similar stuff for many years. The new company was selling something new. The ability I had developed in the past was not so effective in the new situation.

Though we had seen it coming, thanks to cash flow forecasting, we found ourselves in the situation where, if we did not pull in some cash from somewhere the following week, our goose would be cooked and the bank would call in their loan. The one unpaid founder was also my wife. Our relationship would be affected if she left, and who would not want to keep an unpaid founder, who was on the road selling? The third founder reacted to our oncoming disaster by doing and re-doing spreadsheets based on multiple scenarios.

I was the lead entrepreneur, so if I left, the other two would probably pull the plug. Therefore, my wife and I decided over the weekend that our third partner would have to go. What an awful weekend that was, as I prepared several speeches for Monday morning. In the event, Mr Three, came in bright as a button and announced that, sadly, he was going to have to quit, even before I had opened my mouth.

What Mr Three had confronted was that he did not enjoy the entrepreneurial life. He went back and worked for a multinational until his retirement several years later, living in the same house that he had lived in for the last fifty years.

That was one big cost reduction, right there, but there was still a cash shortfall looming for Friday. The only solution was to call our best customer who was sitting on a very sizable invoice, but it was not due for settlement for another 15 days. With my heart in my mouth, I called him and gingerly asked if there was any way he could pay early. Happily, he was delighted to fix that. He said he'd call his accounts payable department and request a check be pulled immediately, even though it was not the day of his company's regular monthly check runs.

Saved by two good friends, Mr Three and Super Client, we had learned our lesson and thence forward we happily did not confront the same problem in the 11 years we owned the company.

It is probably appropriate to look at cash flow forecasts on a weekly basis, at least in the earliest stages of the company's life. You should look forward at least 90 days and probably as many as 180 days. The reason for this is that it will give you enough time to take corrective action if you see a shortfall looming. You need to compare the actual cash flow results from each week to your projections to improve your assumptions each week, so it's a learning process.

Income

Next you need to schedule when you are expecting payment for each customer, providing that you don't have too many. If you have lots, then categorize them in some way.

Don't kid yourself, by thinking that an invoice is income! Only a check is income. Money in the bank, Frank! Of course a lot of income forecasting is guesswork, the more so, the longer ahead you are accounting for. Think carefully about how long it will take to get the check for different types of sale. This may be easy for some kinds of customer with whom you have an established relationship and settlement history.

My advice is not to use invoice factoring as a solution for getting cash from slow payers. There are two reasons for this. The first is that you pay a hefty price for the service. The second is even more important. You now have someone else involved with your customer and one who has no particular interest in customer service, but only to extract the money sooner rather than later. In the same vein, avoid, at all costs, putting overly overdue payments into the hands of collection agencies. That will ensure the end of a relationship with the customer.

There may be other sources of income expected, such as grants, and clearly, these need to be tracked as well.

Expenditure

Cash, obviously, is impacted by expenditure as well as income. Expenditure is frequently easier to control than income. You are more a master of what you spend, than what you earn.

It will be important here to separate fixed and variable costs. Also you will have some way of tracking those that can be influenced and those that cannot. Fixed costs will be things like rent, and variables will be those for marketing, for example. You may be able to delay payment on some bills, whereas others such as property taxes, or utilities cannot be put off. You may be able to ask the bank for help, but if you have asset leases, such as on vehicles or equipment, that will probably not be possible.

Remember that prudent bookkeeping will involve logging prepayments and accruals. If you have accrued for things like quarterly payments, then you will most likely have the cash available to pay the bills when they become due. So don't say, "Oh we can pay that later," if you know something is becoming due.

Taxes are often overlooked in a small business cash flow forecast and when they have to be paid. Each kind of tax is best dealt with by a separate line item, so that sales or other taxes are not mixed with Federal taxes.

The Cash Flow Forecast

Naturally you will be updating the forecast every period, since out-turns will be different to the previous forecast. The example below is obviously oversimplified, but it will show you how the forecast should be structured. The period forward that it covers should be as long as you can feel reasonably confident about the numbers that you will plug in. I suggest a year forward, since this will tease out seasonality or things that you have to pay up front (prepayments), or build up to be paid later (accruals)—see Chapter 10. The numbers you put in must always be real numbers when things have to actually paid.

A Simple Example of a Cash Flow *Forecast*

	Aug $	Sep $	Oct $
Opening Bank Balance	5,000	1,400	- 100
Income			
Sales	3,000	5,000	7,000
Interest	1,000	1,000	1,500
Total Cash Inflow	4,000	6,000	8,500
Expenditure			
Materials	2,000	2,400	1,900
Staff	4,000	4,000	4,000
Utilities	600	600	600
Advertising	1,000	500	250
Total Cash Outflow	7,600	7,500	5,050
Net Cash Flow	- 3,600	- 1,500	3,450
Closing Bank Balance	1,400	- 100	+ 3,350

So, how are you going to do this? The first answer is a spreadsheet. But that may not be your expertise and you may find that the accounting software you are using has a cash forecasting module. There are some commercial apps out there. One I found, but have not used is Float. Other applications integrate directly with bookkeeping software, as is the case with KashFlow with Freshbooks.

Here is some very pointed advice from Robin Fuller, to whom I refer in the Acknowledgements. He observes that,"*Firstly*, it must be understood that, unlike the annual sales budget—which might be pitched on a'most-likely'basis, the cash flow should always be on the pessimistic side. This is because you nearly always have to meet expenditure when it falls due, or shortly after, whereas the timing of the receipts of invoiced goods or services can be widely variable—especially when you have a relatively small number of valuable customers.

"*Secondly*, you should be careful about the time periods over which the forecast should be compiled. At the outset, it is probably a good idea to set it up weekly, with a break in the week in which the month ends. This allows you to touch base with the reconciled month-end balance at the bank, as per the monthly management accounts, i.e. it's one of the cornerstones in the reporting base. I have been with more than one company that has had to run cash flow forecasts on a daily basis, with the star of the show carrying out bank reconciliations twice daily! This is definitely not recommended.

"*Thirdly*, the level of detail required is nothing like the formal management accounts, but a very great deal of attention should be focused on the timing of cash transactions, and looking at all the larger transactions individually. The small stuff can be dealt with as a single item—e.g. ‘all other expenditure’, or ‘sales receipts less than $100’.

“*Fourthly*: the need to keep it simple is extremely important to allow the forecast to be updated very quickly at each period en, e.g. weekly. Fot these reasons I have always run the cash flow as a separate spreadsheet, which touched hands with the management accounts on a monthly basis. Whereas the P&L might have 20 or 30 lines, my cash flow would rarely have more than 10, and the numbers would be stated as, for example, $78.5K and not $78,541. One last caveat—watch out for sales tax: important in cash flow forecasts, but not so in the P&L!”

Checklist of What to Track

1. Income—beware the pitfall of considering a sale income before you receive cash.
2. Expenditure—actual money out of the bank account, not forward commitments.
3. (You may want to skip forward to Chapter 18 to learn about the ‘burn rate’ of cash).

Part Two
Where Is The Money Now?

Chapter 7: Forecasts Can Be Right Or Wrong

	Forecast	Actual	Variance (%)
Sales	500,000	475,000	-0.05
Production			
Sub-assemblies	12,000	13,000	8.3
Materials	25,000	25,000	0
Marketing/Sales			
Advertising	750	850	+0.1
Market Research	500	0	-100
Fixed Costs			
Staff	325,000	327,500	< 1
Rent	22,000	22,000	0

Variance Analysis and Review

Variances between forecast and actual can obviously be favorable or unfavorable. But variance analysis is not to produce numbers to praise or scold, but rather to learn. Learning, and quickly, is one of the biggest attributes an entrepreneur can have. Here we are considering the components of the business more than the Profit and Loss itself, which is why there's no bottom line on the table above—the executive team is interested in the bottom line, whereas functional managers would focus on achieving their own numbers.

Variance analysis and cash flow forecasting are probably the two tools that I most valued in the early days of my main business. Looking at variances is more about determining causes, problems and solutions, than a financial analysis *per se*.

A founder needs regular reality checks and this is one of the best ways to get one. My experience tells me that pre-startup is a time when forecasts should probably be called speculation. Budgets ought to be a little less speculative at that stage, because you logged hard numbers using quotes from suppliers, contracted costs for rent, communications equipment and other assets.

Once you are open for business that's when numbers start flowing, and even forecasts are tested for accuracy. Before launching my first business, I had no concept about what variance analysis could be. I am not even sure I had heard the terminology. By the end of the first month of the new business, however, the notion suddenly took on real meaning.

There are two aspects to the consideration of variance between what you think might happen to what actually happens. The first is the system you set up to record out-turns against prediction, whether it be paper and pencil or computer based.

The second aspect is the review process and what you decide to do in the light of the numbers. Both the collection of the numbers and the review of them must be done early each month, as soon as the sales and accounting functions can produce them. They must be reviewed on a regular basis, and you may want to set a management meeting to coincide with the availability of the numbers[1].

Which Variances: One of the critical preparatory steps you will want to take is to decide which variances you are going to track. In my case, the most significant was *sales*. This because we learned such a huge amount by considering the reason for the variances, including: sales effort, sales practices, sales prices, sales mix, competitors and many other factors. In addition to sales, you may want to include materials, staff, overheads.

Two key aspects of sales variance you will want to track are (1) volume, and (2) price. These can each be further subdivided according to the needs of the business. Here are some of the sub-categories you might want to consider, but your kind of activity will dictate the ones you decide to use.

Sales Variances

Volume	Price
• numbers of units	• total sale
• sizes of units	• type of unit
• type of units	• discounts
• location of sale	• margin

In each category of variance, you will also want to decide which variables to track. The decisions that you will take need to be carefully weighed. As an example, you can't take staffing costs out of context. They relate to the kinds of activity concerned. Lead and lag times are often tough to estimate. How quickly will a new employee become a net contributor to the business is often a tough question to answer, for example.

Obviously you are going track variances under each budget head that you have established.

Discipline: Why is this discipline so important? If you wait too long after the period (I suggest weekly in the first few months, and then monthly) has ended, too many things may have happened for any action to be taken in a timely manner. You may decide to raise the bridge or lower the water. By this I mean, you may want to rein in expenditure or hustle to close deals. The reason that you need to get the numbers and review them at about the same time each period is because if you don't, you won't get any sense of pattern.

Discipline may sound miserable, but the benefits are significant:

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1 Comment from Robin Fuller: "This is very true! Every financial director knows the reporting timetable after each month end extremely well, and will not be booking a long weekend somewhere at that time unless he has comprehensive backup from his team – which he might, after a few years! Reporting to the bank is another key date in the monthly calendar that cannot be missed."

- "A stitch in time saves nine" as needleworkers know. In other words, taking corrective action ahead of impending trouble, rather than scrambling to clear up the mess later, is always best. However, if you don't have the number on which to base decisions then you are firing in the dark.
- Both at the outset, and later, there's often a temptation to make certain business expenditures too early, when you have cash burning a hole in your pocket. Being parsimonious is a great habit in the early stages. You might be tempted to expand your offices, because things seem to be going well, only to find out that the trends don't last and then you are saddled with more expenses than the business can support.
- The numbers may lead to a bit of 'just in time worrying', and a sharpening of your focus to negotiate more diligently with suppliers.
- If on the other hand, both budgets and forecasts seem to have been pretty accurate, then this will validate your estimates and boost business confidence in future forecasts.

Who Needs to Know: The short answer is the founders. But the founders need also to decide on whether there are other key players who should be involved in the key management decisions. It is not only a matter of who needs to know, but who is the best person to explain the reasons for the variances and how best to react and make the necessary decisions in the light of the data.

Some of the explanations may not be known inside the business. Suppliers may have to be quizzed, or outside advisers may have to be consulted. If explanations are not readily obvious, then you may want to consider what other regular internal or external data sources will require monitoring.

The Review Process: Maybe the biggest benefit of doing regular variance analysis is the learning involved. When it works well, entrepreneurs, who are learners par excellence, will get better at both forecasting and knowing what levers in the business really produce the results intended.

It is very important to avoid over hasty decisions and making too many decisions at once. For instance, it might be that a product with certain safety features is consistently performing better than forecast. But it may not be those features that are producing the result, or on the other hand, maybe if those features were incorporated into all the products, then beneficial results would flow.

For instance, if you decrease input costs and hike your marketing budget at the same time, will the better margins that result, be in consequence of the one or of the other?

The interrelationships between pairs (or more) of factors of variance need to be considered. The process[2] may need as much intuition to reach conclusions, as anything else, but without the data, intuition may be just a flash in the pan.

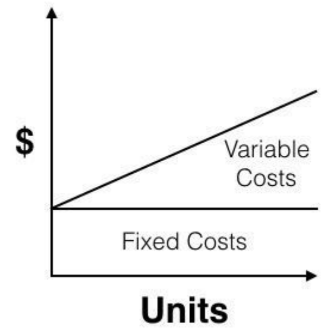
Checklist of What to Track

1. Budget—Plan—Result: measure the variances.
2. Track both dollars and time, inputs and outputs.

2 Robin says, "The point about not making too many changes at once is worth emphasizing. Ideally, you would change just one thing at a time in the same area of activity to see the effect. This is what scientists do all the time; they compare all results from new research against a constant, or 'control'.

Chapter 8: Where The Money Goes

Fixed & Variable Costs



What you will be all too aware of, is the fact that your own particular business will have its own pattern of fixed vs. variable costs. Examples of those with high fixed costs are professional services, which is why there is so much pressure on attorneys or accountants to maintain high billable hours, and why founders often do everything they can to avoid using law and CPA firms! Medical facilities are another example of a business with high fixed costs. The staff and medical equipment have to be paid for no matter how many patients there are. That's why the industry has typically billed for services, not outcomes and so many practitioners will all too freely make use of cat scans and MRIs!

On the other hand, construction firms have relative lower fixed costs. It's not always the case, but workers will be hired for the duration of the contract, say for road construction, and the equipment they need will be hired for the time it is needed. They do not keep a stock of say, cement, but only buy when it's needed.

Fixed costs: Every organization incurs both fixed and variable costs. Fixed costs are independent of the quality of goods or services produced. They include capital items that cannot be adjusted in the short term like buildings or machinery and have to be paid however much revenue is earned. Fixed costs are things like rent, and salaries which can't be chopped and changed, though in a sense all costs are variable. A building can be sold, or salaries increased/reduced.

Normally interest is considered a fixed cost. But imagine a situation where you somewhat unexpectedly land a huge contract with a big upfront payment. You might decide to pay down not only the interest on your loan, but a big chunk of the principal as well. Next month your interest is much smaller, so it will have varied from budget. On the other hand, property taxes do not take a vacation.

Also if your machinery is owned it certainly is a fixed cost. However if you are practicing financial bootstrapping and have leased the machinery with another manufacturer round the corner, then it will be more likely a variable cost, based on utilization. In a similar way, if you use a contract sales force, commission-only sales people, indirect channel people like resellers, or you use outsourced sales people of any kind, then they will constitute variable costs, not fixed ones as an in-house sales team would be. Many businesses use both of course, with contractors or agency staff being brought in during busy periods.

Variable Costs: Variable costs are those dependent on the quantity of goods or services produced and sold. They may also include sales commissions, or delivery costs. The big chunk is likely to be cost of goods sold (COGS), described in Chapter 2. Be careful, though, since you might attribute a proportion of fixed costs to an item produced, such as the person/hours attributed to one item—and thus reduce fixed costs, but increase variable costs.

If you are a production firm, materials will be a big part of variable costs[3]. You only buy the quantities required to produce a given level of output. And given that stockpiling materials will incur a finance cost, this is why just-in-time and lean manufacturing were developed, so as to minimize the amount of stock that had to financed, adding to materials (variable) costs.

Too fast growth is often cited as a reason for the failure of startups with too high rates of traction. This can occur when order intake rises steeply, but customer payments do not keep pace: accounts receivable outrun sales growth. Materials (variable costs) have to be purchased to fulfil orders and paid ahead of the cash from sales.

Overly rapid growth[4] can mean taking on more debt to finance work-in-progress, further weakening the business. Then when rapid growth tails off, the money does not come in fast enough to cover loan repayments. Another possible consequence is that during high growth the founder will assume all is well and not control costs as tightly as they should be.

Cost of Goods vs. Operating Expenses: One thing that may confuse you is the difference between cost of goods and operating expenses. Of course, it depends upon your own business type or situations, but basically operating expenses include accounting and legal fees, bank charges, sales and marketing costs, travel and

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3 Robin makes the very important point that, "As production volumes grow, cost savings can often be made through bulk discounts / better purchasing terms – all leading to economies of scale – e.g. the cost of lithium-ion batteries in the last 3 years."

4 Robin reminds us that, "growing too quickly can kill a business quicker that any other reason!" He gives the example of Independent Energy in the UK. "When the UK electricity market was re-regulated around 1999, Independent Energy was one of the first companies out of the blocks to compete with the established energy companies (there were about 8 of them, all regional specific). Everybody watched what they did. They grew extremely quickly by offering very attractive tariffs to their customers. The speed that you grow a company in this sector is mind-boggling. However, what let them down, and quite quickly, was their inability to produce accurate bills to their customers. They had decided to run with a traditional, but archaic billing system that was very inflexible and not at all suited to the needs of a rapidly growing business. Prior to the de-regulation, very few customers ever moved their electricity supplier. Independent's records were held on a system called Legacy. It could not handle large numbers of new customers in a reasonable time frame. The result was that without the ability to accurately bill their customers, they could not enforce debts. So the cash ran out and it imploded. End of story. An apocryphal tale!"

entertainment expenses, office supplies, rent and maintenance, utilities and salaries. It goes like this: Operating Cost = Cost of Goods Sold less Operating Expenses. Some of them are fixed (rent and insurance, or anything *constant*), while others are variable (salaries, especially if you employ part-timers and office supplies and vehicle expenses).

Why Be Concerned: When a startup gets off the ground, there is a tendency to think, “Ah well, as long as the bookkeeping’s done, that is all we need to bother with on the finance front!” No, as I showed in Chapter 6, cash flow forecasting and monitoring is probably the most important set of numbers to track. It’s fine to track the numbers, but we need to track them in a way that we can keep a handle on where the money is going.

And as I have also said earlier, it’s easier to control fixed costs, since you are in command of them, than it is to ‘control’ revenue, since customers are in control of that. Generally speaking, the variable costs will go up or down in line with production and sales volumes, hence they are dictated more by customers than by you.

However, there is always the possibility of ‘raising the bridge or lowering the water’. Raising sales is not something you can achieve before the moment when you are considering your month end, and raising them suddenly the following month is equally unlikely, unless you know you are entering your busy season. On the other hand lowering expenditure is something which you can effect more speedily.

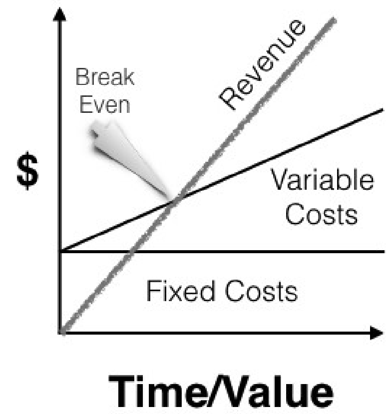
Understanding just how fixed your costs are is very important. For instance you should not assume that you must acquire a particular machine, when you could be either leasing it, or better sharing it with another firm that, like you only has need of it part time. When you have a decision to make about a new piece of equipment, sub-contract may be a way to avoid increasing fixed costs.

That kind of thinking is part of financial bootstrapping.

Checklist of What to Track

1. Keep tight control of variable costs.
2. Ensure that fixed costs are kept to the minimum and when considering capital or other asset purchases.

Chapter 9: Making Money



Break-even and Tracking Intangibles

Getting to the entrepreneurial freedom of a profitable business is clearly important to founders. However it is not always the number one objective in the early stages, when survival is the preoccupation. However break-even cannot be overlooked and progress towards it checked, even at the outset.

Break-even

Break-even analysis is key to a good business plan, because it helps the business determine the cost structures, and the number of units that need to be sold in order to cover costs or make a profit. Break-even analysis is usually done as part of a business plan to determine the practicality of the business idea, and whether or not it is worth pursuing. If the startup is not, even eventually, going to make a profit, then why take the risk at all[5].

The formula is pretty simple and looks like this: Break-even point = Fixed Costs / Contribution Margin. Contribution margin is a product's price minus all associated variable costs, resulting in the incremental profit earned for each unit sold. The total contribution margin generated by a venture represents the total earnings available to pay for fixed expenses and to generate a profit.

In my case, making a profit would be the measure by which we could determine success, but it was not the justification for starting in the first place. However,

5 Robin's experience is useful here. He comments, "In my experience, every business plan I've looked at shows both a profit and a cash positive position fairly early on in the cycle. No new business entrepreneur would think about presenting it in any other way. However, some plans do not show either a profit or a positive cash balance for (say) 5 years – and in most cases, that is just too long! That's when you should ask yourself if you really believe you are going to get there in that time. Remember, any outside investors are usually very impatient for positive results. If you do have a plan which shows good returns after a number of years, then you must 'stress test' the model to see how easily the projections can go negative, by flexing a few of the key parameters in the business plan."

break-even analysis can be helpful in the pricing and promotion process, along with cost control.

The break-even point can be determined by calculating the point at which revenue received equals the total costs associated with the production of the goods or services.

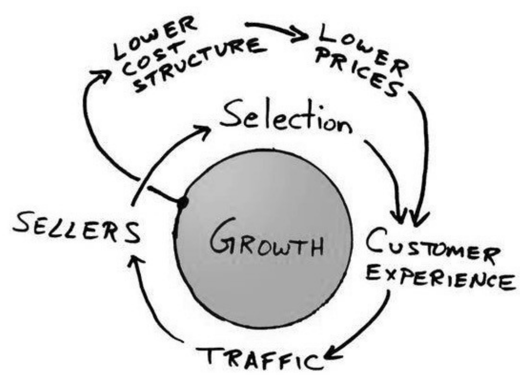
When you do your first calculations, your break-even point is higher or further out in time than you might wish, but don't panic. Many moving parts of your business can be tweaked to arrive at a break-even point that will satisfy you better.

You can look at the cost and revenue aspects of the plan to change the relative components. You can get better prices from suppliers, or alternative supplies. You can change your approach to hiring; hire fewer people, hire them later, or do more sub-contracting or outsourcing.

Nowadays, it is much easier to work from home, or use co-working spaces. On the other hand, you can look at the revenue, rather than cost aspects of the business, by increasing prices, if the market allows. These kinds of calculations, or changes in policy can be considered both before and after launch of the business.

As I have argued before, profitability (or post break-even) may not be the determinant of success in the early stages of the business. If the break-even point is three years out, that may not be unreasonable, provided the cash flow can sustain the business in the meanwhile.

This sketch is alleged to have been drawn by Jeff Bezos, the founder of Amazon:



(Source: Amazon)

Notice that there is no indication of profit in the drawing. Why would that be? He was focused on value and scale (and cash flow), so profits are an outcome, not an objective. I would certainly say that my progressive experience with Amazon is that delivering value is what determines my loyalty. If Bezos had focused on profit, I might have, as a customer, been trampled into desertion.

When break-even is critical: My experience tells me that break-even is not important when you do not have outside investment or significant loans. The funders will want to see profitability in order to feel confident about cash-outs or repayments. But intrinsically, while investors value growth and will want to see profits, profit per se, may not be the best way of valuing the startup. Delivering value to more and more customers is likely to be a better way of evaluating success. My suspicion is that is what Bezos uses as a measurement[6].

Tracking Intangibles

There are several ways to better track and understand what is leading you closer to break-even or pushing it further away. In my experience, these tools are probably too fine a grain for the harassed founder at the beginning of the journey. However I describe them briefly because they will aid in taking a holistic view of how the startup's original purpose and strategy is working out in practice.

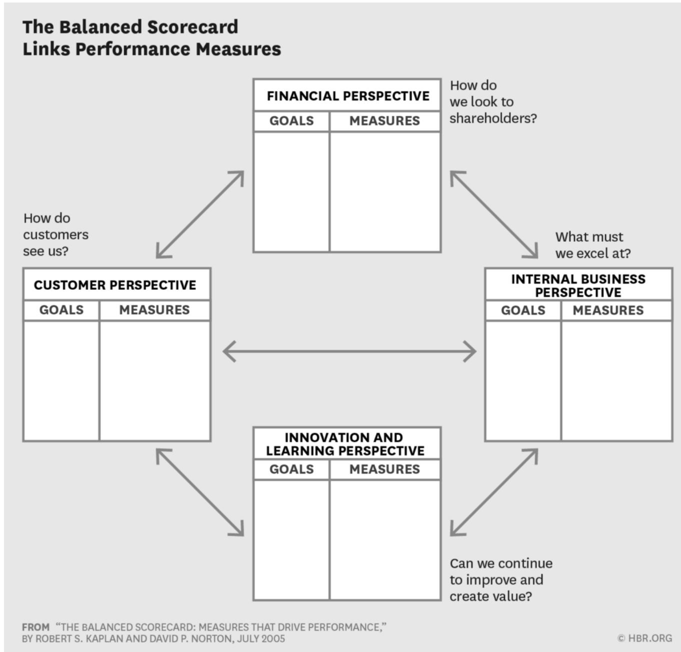
Activity Based Costing (ABC) is a means of attributing indirect costs to direct costs and thus to get a better understanding of the real cost of producing a particular product or service. It allows you to see how much of your indirect costs (overheads) are being consumed by each product or service. The process will not yield much to firms that have a low overhead (and big margins), as is the case with many startups. This is not a task for the faint hearted, and will most likely be done later in your startup's life and by accountants or IT and HR people, but it is as well to be aware of what ABC can yield to management. Robert Kaplan of Harvard Business School wrote encouraging its use 25 years ago, and he more recently suggested caution, since ABS is very labor-intensive.

The *Balanced Score Card* is a means of integrating the tangible and intangible aspects of the business. Kaplan with David Norton of HBS believe that it is necessary to integrate the measurement of intangible assets into management systems. Good entrepreneurs do this intuitively, but it will make sense to use the process more formally as the business matures.

If you think about the schematic representation of the balanced scorecard above, you will recognize that those four 'bubbles' are the subjects that should be

6 Yes, quite, says Robin. "Companies who generate a large customer base can derive value from just that asset – even though the business is not making much (or any) profit. We had this experience with Economy Calls (a telecom calls company), which never made much profit, but the customer base of some 10,000 was enough for us to get all our investment back."

concerning the founder anyway. The fuller version of that image from the original HBR article (below) may help you more.



It is important to note that the balanced scorecard was never intended as a replacement for financial tracking, but rather as a complement to it. The other aspect of it is that it can be used to good effect with a wider group of managers than just the founders, helping to ensure coherent action across all functions.

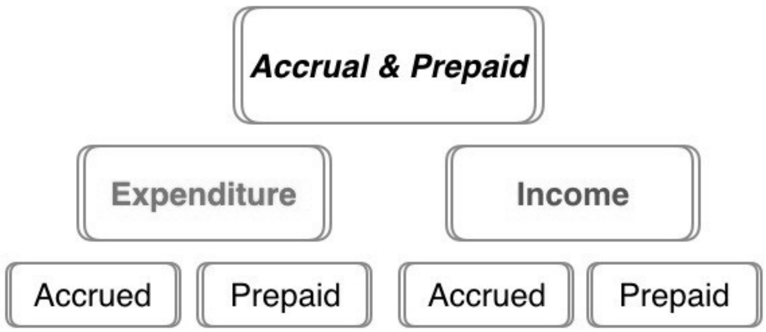
In Chapter 13, you will find more about coherent action across the company, and in particular a description of a tool that was derived from the balanced scorecard—the Strategy Map. I am personally in favor of using as many graphic and summary ways of tracking a venture's progress as possible, given the complexity of a founder's life.

Checklist of What to Track

1. Track financial progress towards break-even.
2. Track intangibles likely to contribute to break-even.

Chapter 10: Up Front and In Arrears

Accruals & Prepayments and Payments vs. Expenses



Accruals & Prepayments

It took me quite a couple of months after startup to appreciate the importance of accruals and prepayments in bookkeeping and how I read our monthly Profit and Loss. Once I understood how it worked, then I realized how important this is to understanding the company's cash position. You record revenues and expenses in the period in which they are incurred (and you become liable) regardless of when the relevant payments are actually made.

Every business is concerned with managing its expenses, since the goal is to maximize profit, at least eventually. The timing of when expenses are incurred and paid determines how they are shown on a company's financial statements. Accruals and prepayments are made to the general ledger when you use the accrual basis of accounting (see below).

Accruals are expenses incurred but not yet paid, while prepayments are payments for expenses for that are not yet incurred. Examples of accruals include the auditor's invoice which you will likely pay after the year end, but it pays for auditing the previous year. Thus you have to accrue the audit fee monthly, ahead of receiving the accountant's invoice. Often you will receive services and products, like the audit, when you have yet to receive the invoice.

By the same token, expense **prepayments** (or deferred expenses) come in a lump, but cover the whole year, for example. If you pay a year's insurance in January to cover the following 12 months, then you only put a twelfth of the invoice in each month. Otherwise, your monthly profit and loss statement is not only inaccurate, but also misleading. You want to avoid gasping when you see the report and can't figure out why you made a loss, for example.

The same principle applies to the income side. If you invoice a customer a down payment or say, three months worth of work up front, as I often used to do as a consultant, that income if shown in month one, might make it look as though you had made a walloping profit, when in reality, you had not.

When I worked in business that paid sales commissions, frequently sales people could not understand why they were not paid commissions in the month when they brought in a signed order. It was because they got paid when the client paid us.

Accrual or cash accounting—what's the difference?

Every small business must make a choice between two accounting methods. The difference between the two is how and when you record income and expenses. In the accounting debate between the two methods, most experts recommend the accrual method. There are pros and cons to both and ultimately it's up to you to decide.

The cash method, as the term implies, involves putting revenue or expenditure in the books when you disburse or bank money. This probably will be more familiar to you, since you probably do your entries in the checkbook that way. The worry about this is that it may give you a slightly distorted view of the real profitability of your business. So, with the accrual method you have a more accurate reflection of your liability at any date. Do not let this confuse you when you are doing your cash flow forecasting. Your financial accounts and your cash flow forecasts serve two different purposes. It took me a while to disentangle the two.

The accrual method requires more careful bookkeeping, but most of the bookkeeping software packages like Quick Books or Fresh Books, will make it easier than any manual system (not that there is anybody left using high stools and quill pens anymore!). Under this method, when an item is received from a vendor, it should be posted immediately in a business's books, then entered into the business's accounting database. These accruals are notations concerning funds that will be disbursed at a later date to cover an invoice.

If you have sales of under $5 million a year, you can use either the cash or accrual method. However, if your business keeps an inventory of merchandise to sell to customers, you are required by the Internal Revenue Service to use the accrual method for the inventory.

What is important is to know what the numbers represent, so that you don't lead yourself astray, either on your profit and loss account, or understanding how much money you have or will have in the bank.

Payments vs. Expenses

A *payment* is a disbursement of money. Some payments are current period expenses (e.g. current month's rent payment), but many payments are not expenses of the current period.

Under the accrual method of accounting, *expenses* are costs that have been used up or have been incurred in the process of earning revenues and/or operating a business. For example, a retailer will report its cost of the goods sold as an expense of the period in which the related sales occurred (even if the retailer has not yet paid for the goods, or had paid for the goods in an earlier period).

Here are some examples that of payments that are not expenses: paying to purchase the land; cash dividends to stockholders; payments to reduce a loan payable.

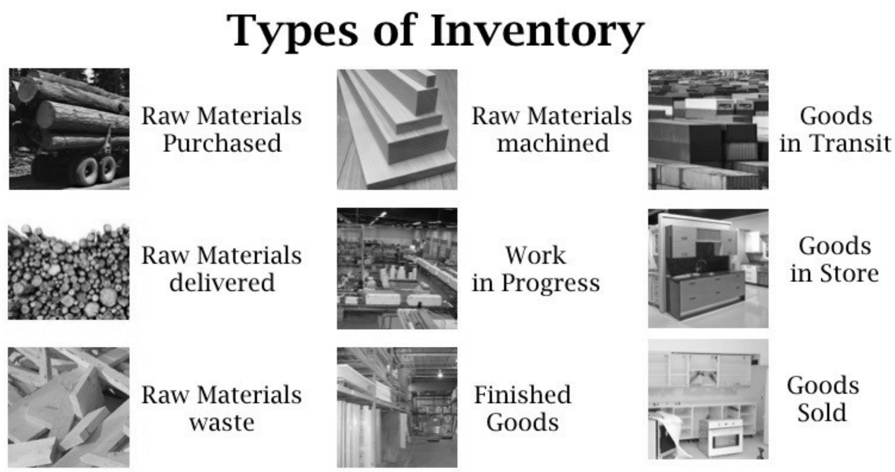
On the other hand, some payments (now) will result in expenses in a later accounting period. Examples here include paying for a booth at next year's trade show or stage payments (now) for a building that will only come into service next year. Though If this is for a freehold interest in a building, then that would be capitalised and may be depreciated over 50 years, if at all, so it's ultimate effect might be deferred over a very long period.

This is another reason why you need to pay close attention to your own terms of business and your vendors' terms, too. Sometimes you may find the two in conflict and when this happens the resolution should be paid very careful attention.

Checklist of What to Track

1. In monthly P&L accounts be sure you understand and consider the correct cash/prepayment/accrual attribution of all line items in income and expenditure.
2. If your organization uses accrual accounting, be sure to check that items (particularly large individual items) are attributed as they should be—payments/expenses.

Chapter 11: Cash Lying Idle



Inventory Management

I remember visiting a pump factory where I was hoping to make a sale. Picture a huge factory floorspace, a lot of metal—impellers, shafts, sleeves, castings, bearings, valves, bolts, gaskets, diaphragms. I think you get the picture. A pervading smell of grease and iron shavings. A place where work gets done.

The General Manager took me on a tour, lots of shaking hands with foremen, lots of pump manufacturing technology, lots of "oh, right, I understand…", even when I was not sure that I would be able to repeat what he'd told me when I returned to my own office. We got back to his office at the front of the building. It was not a plush place, with samples of pumps on the floor, plenty of paperwork and printouts, but at least a comfortable place to sit.

I complimented on his amazing plant, and then said, "Why do you have so much work in progress. It must tie up a great deal of capital!" He was astonished that a management consultant (not an engineering consultant) would have picked that up and he asked if I had worked 'in pumps'. Of course I had not, but he then went on to explain his problems with work-in-progress (WIP). It may not be just the physical parts, though. The direct labour involved to that point of production and any attributed overhead (from fixed costs) can also be considered WIP.

The illustration at the beginning of this chapter concerns kitchen cabinet manufacturing, but similar labels could be put to purchase-production-sales phases of any product company. In manufacturing, WIP is created when items are part way through the production process, like all those pump parts strewn round the plant.

A less graphic picture can be drawn for a services company or a nonprofit. If your organization is either of these, the concept of inventory or WIP is a bit intangible, but still exists. In a movie theater, you might consider the seats as inventory, especially when they are unoccupied, and could be considered inventory for which there is no demand. This means it is ‘cash lying idle’. If your marketing can get more ‘bums on seats’, you will be using your inventory in a more productive manner.

Another example of intangible inventory might be patients waiting in an emergency room. Of course, you don’t want to call them inventory, but if you are thinking about productivity, that’s what they are. In management consulting, you could think of the highly paid consultants as inventory when they are not out on a job and earning fees.

Tracking inventory: The process of tracking inventory at each stage of the production process produces vital information to match with your cash flow forecasting and checking. Quick Books, Fresh Books and other bookkeeping software will track inventory from goods inwards to the sale of finished goods, provided of course, that your data entry is efficient. However, what’s vital is that you track it carefully so that you can monitor how much cash you have lying idle.

Tracking inventory is pretty boring, and requires meticulous systems. I think that was an issue at my pump manufacturer. Production staff were good at ‘eyeballing’ the bits of pumps lying around, but few of the part-finished pumps were well labeled or controlled. Also if the company had been put into liquidation, part manufactured pumps and components would probably be given much less value than the ongoing business would attribute to them.

The issue of inventory management and WIP lies at the origin of so-called ‘just-in-time’ manufacturing or JIT developed at Toyota, or even to Henry Ford’s production lines. The old man was well aware of the burdens of inventory. Though I am not a JIT specialist, I do observe that however good the JIT system might be, it always is dependent on human as well as statistics and computer control. These and other ways that companies have been paying attention to inventory management have resulted in a reduction of 60% of inventory costs between 1982-2005.

In some sectors, such as retailing, even those us with no experience of shop keeping know that stock turn is something that keeps managers in that business up at night. A low turnover rate may point to overstocking, obsolescence, or deficiencies in the product line or marketing effort. Generally speaking, a healthy retail business will have a higher sales per square foot paired with a higher stock turn.

So too, in an entrepreneurial situation, a good inventory tracking process is dependent upon attitude of mind and human factors, plus the ability to analyze and correct what may be going wrong (or right). Clearly, you must find a way to keep enough inventory on hand to satisfy your customers' needs. At the same time, you don't want to invest all your capital in inventory so much that it drains your working capital.

When cash flow forecasts a shortfall: Inventory management is pretty boring, except when you are headed for a negative cash position and in that circumstance, most founders with significant inventory will look to cuts as a way to conserve cash, just like my pump manufacturing client.

The trouble is that you have to fully understand the consequences. In a manufacturing situation, running your stocks to the minimum may result in production delays, further exacerbating your cash situation, because incomplete production will mean delays to your invoicing and cash collection.

In service industry contexts, your first knee-jerk reaction may be to cut staff. As with manufacturing, cutting payroll may save money in the short term, but it also reduces your productive capacity, when you do achieve an upswing in order intake. Among my friends with consulting businesses, this can herald disaster. The thing about consultancy is that clients can turn it on and off like a tap, and thus nearly always expect that a consultant will be available when wanted, not three months later.

So you should use all your wisdom in decision making, but without tracking inventory you will be shooting in the dark.

Checklist of What to Track

1. Raw materials purchases.
2. Inventory at each stage of the production process.
3. Unsold finished goods (they represent idle money).

Chapter 12: You Are Not A Bank

Debtors and Settlement Periods

This chapter is going to seem really tedious and full of detail. You are a business founder and should not have to deal with such stuff. Totally misguided, as I hope you will begin to see, because cash-in-hand is much more valuable than money owed. According to the Altradius Payment Practices Barometer for 2015, 40.4% of US B2B invoices were paid late. I'd wager that the reasons are not just delinquent clients, but also suppliers who avoid biting the bullet on credit management.

First things first

When you are negotiating with the customer, check on their current financial condition. If you are dubious, probe deeper, see if there are liens, or lawsuits outstanding. Are there branch closures pending or other possible indicators that they are having a tough time. Then decide if you want to do business with them. And don't be scared to ask other vendors. At the limit, you may want to run a credit check on them. In an ideal world, all your sales would be for cash, but that's seldom the case.

The only bad debt I had in 11 years was when I did not follow this rule. It was at a very early stage of the business and I was excited to fill the order book early and took on Nigerian manufacturer of plastic sandals. I thought that would be a fun client. No way. They never paid a cent. I stupidly gave all my customers the same or similar terms, when I was starting out.

Think about whether you want some kind of up-front payment. This is particularly true if you are in a service business. We asked for this with the first government contract we got. They said that no, that was not the way the government did things. Our reply was that in that case, we would sadly have to walk away. The civil servant found that there was a way. Civil servants are good at doing that.

When delivering a service, remind yourself that you are paying costs, especially wages, from the day that you start work. It is only reasonable that you get a chunk of money to cover those bills as they come due. I once remember telling an oil major that our banking terms were more onerous that Citibank. In a jocular way, I reminded the client that we were a pipsqueak of a firm and could not afford to lend them money for nothing. If you are a manager in a multinational, the idea may not have even struck you, so far are you from where the rubber meets the road.

Make sure you know where the invoice has to be sent and to whom. Is email acceptable or does it have to sent by mail? Don't delay invoicing. Do it now! After the event, you can even check that it has arrived at the right place and is in the payments system.

Do not shy away from being direct about money

And as you know, from your own personal experience, issues to do with money are often the easiest way to fall out with someone. This is especially true where there is any confusion about who agreed what.

For the eleven years before we sold our business to the people who worked in it for one symbolic pound Sterling, we had an average settlement period of 35 days. How was this? Many companies I know even today run at something more like a 60 day average. What does this mean? Probably that a good chunk of customers are enjoying free credit for 60-90 days. There will even be some enjoying 120 days of your money—for no cost to them. How nice for them to be able to keep less tied up in working capital.

Be very clear about your terms of business. When we started, we felt shy about all the paragraphs of our terms, so we printed them in 8 point type in gray on the back of our invoices. We pretty soon learned the hard way that this was a bad decision. When chasing past-due accounts, we often had clients say they did not know about settlement periods, and when we remonstrated and told them that the terms were printed on the back of every invoice, their response was that they had not 'seen' them! We smartly reprinted our invoices with the terms in black in 12 point type.

You are clear about rules with your children. Why be any different with your customers. Just like at home, clarity makes for peace.

Whether your business sells products or services, you have already paid for raw materials, components or other supplies, you have paid employees and the related costs, and you have covered overheads like rent and utilities. Even if you have good gross margins, they are being unnecessarily undermined by the 'invisible' cost of the working capital you have tied up.

In addition you may be borrowing money from the bank at high interest rates. A double whammy. Just imagine if you could reduce your loans and save the interest. I learned very early on that there was nothing wrong with chasing payments that had gone beyond terms. It seems scary in the early days of a startup. But it's just a task, like the many other good housekeeping jobs that you do.

Of course, you prefer the creative aspects of your job, but the germs of late settlement by customers may infect your business with a deadly disease called running out of money. What I discovered is that you can have a very reasonable conversation with customers about them sticking to the terms of the contract.

Before we invoiced a penny, we had drawn up the ten or so paragraphs of our terms of business. Among other things, all invoices were payable *within* 30 days. Not even *at* 30 days and certainly not *after* 30 days. What is the implication of that? It means that if your customers are trade buyers, their own company would have a cycle for their check runs. Imagine that their check runs were on the 7th of the month and you invoiced on the 15th of the previous month. If you are unaware of how they run their accounts payable, chances are high that your invoice will be paid late and you will be thus carrying the debt for nearly an extra 30 days, imagining that their check run on the 7th gets mailed out the following day, or later if a supervisor has to approve the payment, plus maybe there is a weekend intervening, and then there is the mail delivery time. Following your receipt of the check, it has to be entered in your books and then banked.

Why has this happened, all unknown to you? Because the invoice may have sat on your customer's desk for a day or two before being processed, especially if you sent it to your contact, rather than direct to his accounts department. The clerical person processing the invoice at their end looks at the date of the invoice and seeing that your terms are 30 days (from the 15th), she knows that if she paid the bill on the next cycle, it would be *early*, from their point of view. So what does she do? She puts it into their system to be paid on the 7th of the *next* month (if you are lucky) and her boss has not said that company policy is to pay all invoices in 60 days!

Be Polite

Fresh Books, the cloud-based bookkeeping software people, looked at their data to see what insights they might be able to gain from user experience.

The first thing they noticed in the data is that being polite really matters! A simple "please pay your invoice within" or "thank you for your business" can increase the percentage of invoices that are paid by more than 5 per cent! That could easily equate to thousands of dollars per year. Not only that, but politeness clearly gets you paid faster.

Apart from anything else, making your terms of business friendly and user-oriented is good for customer relations. A horrible legalese set of terms just look off-putting. A UK survey, revealed that just 7% of people read the online terms and conditions when signing up for products and services. It may not be too different in the business world.

Since your legal adviser may want all sorts of wordy clauses, why not put a clear summary of the important things, like settlement terms, right up-front in simple English. There is no need to hide or obfuscate.

Why and how you, the founder, should get your hands dirty

Why? Because cash is the blood of your business and without it, you will die. It is as simple as that. Getting paid within terms is the cheapest money you can get, and it's not unreasonable to expect your customers to comply with those terms to which they have previously agreed.

I know that you probably hate chasing people to pay up. But it's better than the heart of your business going into cardiac arrest. You don't particularly like doing the dishes, either. But you do it.

You may also think that if you chase customers for money, they will be upset or irritated, or worse that they won't want to give you any more business. If your product or services fulfill their promises, it should not have an adverse effect. But this is why you need to take action right up-front.

Here's what I suggest: when you close the sale, find out what the settlement process is. Be very direct. Ask your buyer what happens when he receives the invoice; how he signs it off; where it goes and how it's processed and by whom. Get the name of a real person, not just the department. Tell your customer that should questions arise, you'll know whom to contact.

Before you actually send the invoice, check to see if you need a purchase order, or is the invoice number sufficient? Do you need an EIN (Employer Identification Number), do you need the invoice to be broken down in any way, or will "services rendered" be an adequate description of what the customer purchased? I did some consulting for an Institute not long ago and invoiced simply my hours and out-of-pocket expenses. When I called my client to see why I had not been paid, she said that the finance people in academia simply never had such simple invoices, so I had to re-submit with the definitions of the tasks performed.

If you contact the person concerned, say a week before the invoice is due to be paid to confirm all is well, there should be no need for any further chasing. It will also signal to the accounts payable person that you are on top of it and that there will be no latitude for late payment. It's just business-like, that's all. A tedious chore, but worth the investment every time.

Who else could do the job? The best person is probably whoever it was that made the sale in the first place. Certainly the worst person in your company to do the work is the accounts department, unless the person already has a direct relationship with the customer executive, or the opposite number in the client's accounting department.

Alternatives to risking late payment

Alternative 1: One way you may want to consider is offering discounts for quick settlement. You would have to do the math, but for instance, you might want to offer a 5% discount for settlement in 15 days rather than 30, or maybe an even higher percentage. Why would you want to give money away?

Think about it. Basically cash now is worth more than cash later. In any event, your business has lots of uses for cash and may help avoid borrowing money from the bank, and it cuts down on the hassle factor. If the sale was for $5,000, for example, your monthly rate of interest at 8% (a common commercial loan rate), you will 'save' about $30 for early settlement, but let that settlement drag out to 120 days, it will have cost you nearly $100, plus all the bother and pain of chasing for the money, probably more than once.

Alternative 2: An alternative is to set out in your terms of business that all invoices are due for payment in 10, rather than 30 days. The question is whether you will be any better at enforcing the shorter period than the longer one? I doubt it. In this situation you may get into a whole other round of edgy discussion with the customer, who may claim that since the goods arrived seven days after the invoice, there was no way he'd pay for them until he had inspected them. He may tell you that his company has a standard procedure for goods inwards and that in any event, that process takes two days and there was a weekend intervening… You see what I mean?

Alternative 3: Another route is to charge interest for late settlement. Enforcing an interest charge on past-due accounts may help discourage some customers from putting off those payments, saving you hours of making collections calls and printing late payment notices.

My feeling about this route is that you may then open yourself up to more confusion and irritation for both seller as well as buyer. What if the customer pays late, without adding your interest charge? Do you then go back and try and collect payment just for the interest charge? Probably not. Now you have both annoyed the user, and not kept the terms of the contract.

Alternative 4: Since so many people hate chasing for money as much as waiting for it, they decide to use invoice factoring, because then someone else chases for payment, not you. But what sort of effect do you think this has on the customer? They now have some aggressive third party intervening, who cares nothing for the relationship that you have so carefully built up; all the factoring company wants is to get the money, not to understand. They are called invoice factors, but basically they are debt collectors. And, in addition you have given away some of your margin, because the factoring firm will charge you a percentage for every invoice you sell to them.

Alternative 5: Be prepared to ditch clients who don't pay within terms. That may sound harsh, too. But your time is very valuable. In addition, constant late payers may say something about the customer. Perhaps they niggle over other things too. Perhaps it may show that they are having worse financial problems than you are. Perhaps their systems are shaky. If they don't pay on time, maybe there will come a time when they won't pay at all and you will have a bad debt on your hands.

Checklist of What to Track

1. Be prepared. Start the process before you even sign a sales contract. Make an assessment of the client's likely ability to pay within terms. Don't hide the number of days within which they have to pay.

2. Make clear what the terms are and stick to them, by keeping a weekly chart of accounts payable, aged by due date. Debt tracking!

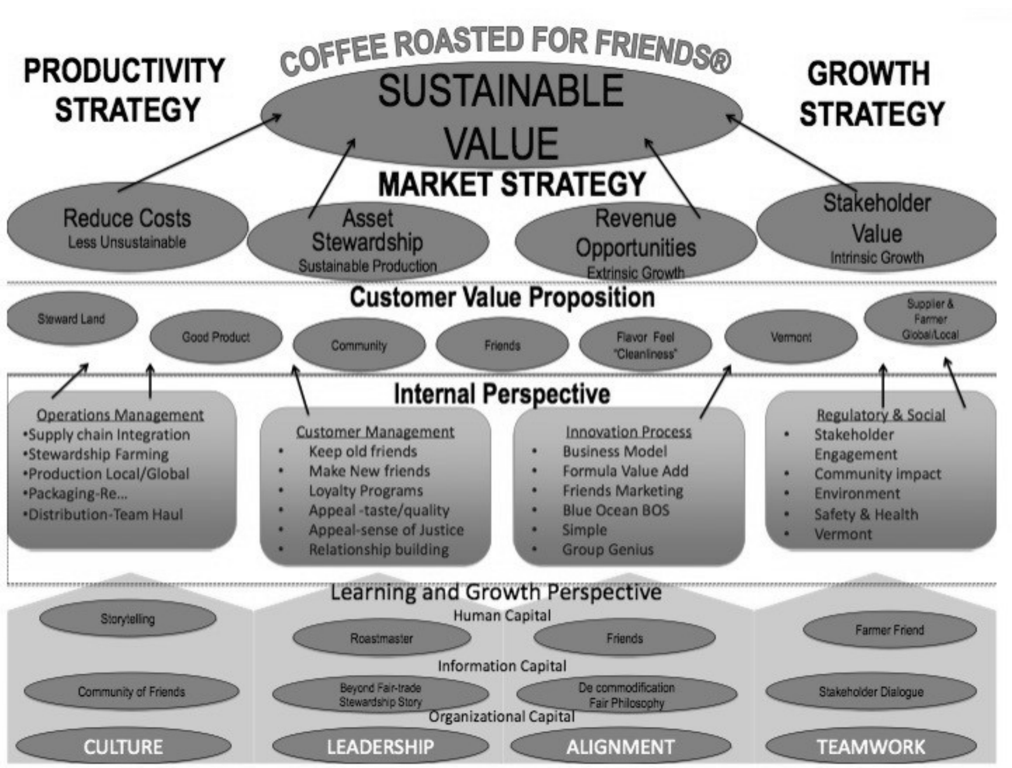
Part Three:
The Proof Is In The Pudding

Chapter 13: As Easy As Pie

Coherent Action Across the Piece

One visual tool you will want to use is the Strategy Map. Developed from the Balanced Scorecard, it was designed by Drs. Robert S. Kaplan and David P. Norton in 1966. The strategy map is a diagram that is used to document the primary strategic goals being pursued by an organization or management team. It followed the development of the balanced scorecard I talked about in Chapter 9.

The example below was produced by a team of my MBA students, working as consultants calling themselves Mountain Valley Partners, in a strategy consulting assignment for Vermont Coffee Roasters, founded and run with his 30 or so employees, by Paul Ralston in Middlebury, Vermont—"good work", he called it, four years later (notwithstanding a few layout issues).



The strategy map helps view the many components of strategy without ploughing through a long document. Visual tools can shortcut the complex process of decision making.

If you look at Vermont Coffee's strategy map, and think about it horizontally, you will quickly pick up how you can determine if the verticals are really coherent. This is very much a summary, but if you were inside the company, it would enable you to have a dialog with a co-founder, or other managers if you have them.

A huge plank of Vermont Coffee's strategy and way of life is their slogan *Coffee Roasted for Friends®* and if you knew the company and its products, you'd know that this is not just a registered tag line, it actually permeates all that the company does. As Paul says, “It’s really our mission, our reason for being in this business. Coffee is a social stimulus that brings people together to share ideas and stories, and when people come together, a community is formed and friends are made.”

Inside the business: Taking coherent action is often tough for stressed founders, who seldom have enough moments in their day. Making decisions in the light of only one aspect of business can bring the edifice down. So it helps to have a single map use to ensure that no wrong turns are taken.

Keeping track of coherent actions is critical. If some parts of the organization are out of synch with others, it may actually lead to the whole edifice falling. How often, in the ‘old days’, did you hear companies that claimed ‘customers are our first priority’, but then fell down on customer service, indulged in price gouging, immediately betraying their claims. In other words, no coherence between actions.

All this implies excellent (two-way) communication. As a founder you have a very clear idea of where the business is headed, but you need to keep yourself informed on the extent to which everyone in the business is ‘on the same page’. Make no assumptions. Check and track that this is true, because even if one wheel is imbalanced the vehicle will wobble.

Outside the business: Not only do you need to track whether your internal policies and actions are coherent, but all around you should be in alignment. If you do have outside investors, even if they are family members, you have to track that they are aligned with what the founders are trying to achieve.

It’s a common misconception that investors’ and founders’ interests are aligned and that both are in line with the company as a whole. It is unwise to ‘take the money and run’. The best money is that which comes from investors who can bring more than that. If they play a mentoring and advisory role, it multiplies the value of the money. However, it is wrong to assume that because at the time of the original investment, everyone was in thunderous agreement that this will continue without good husbandry.

More ways to track: In Chapter 16, you will find another helpful way to ensure coherence: Key Performance Indicators (KPIs) and Critical Success Factors (CSFs). Do not be daunted, and read on. It will be important for you to reach your own conclusions, particular to your own enterprise.

In Chapter 21, I invite you to check whether the business model you created in the business plan is still working. Pre-startup your design made evident sense, but ever since Day One of the business being in business, that sense may have been eroded by what market feedback has told you. When you go through the process of checking the validity of the business model, this will be another moment to take care that you are not scuppering yourself by acting too fast on one individual piece of the pie.

It is a good idea to check and recheck your original assumptions. Not by pulling up the roots to see if the plant is thriving, but by monitoring the environment.

Particularly in the 21st century when things can change so fast, keeping an eye on your competitors, and businesses that might offer a better mousetrap, will be very rewarding.

Be social. Keep track of innovations at trade shows, join your sector's organization, be in touch with researchers. Mix with people outside your sectoral or geographic area. For instance you can develop an interest in say virtual reality (which is pretty interesting), but it could one day have an impact on or offer opportunities for your business. Follow social trends or even make the acquaintance of social researchers at your local university.

In short, practice some kind of benchmarking, however unsophisticated. You might want to keep a note—handwritten, or an electronic device— of changes in the spheres you think might impact your business, categorized say by competitive, functional, cultural, technological. You are a creative person, or you would not have founded a business in the first place, and you are best to decide which fields you should track.

Though my field is entrepreneurship, I keep up with wider management trends, social change, the economy—and am curious about many areas of endeavor that are well outside my ability. I don't, but you might decide to subscribe to the Conference Board, which tracks corporate leadership, the economy and business environment and human capital. Make a point of checking on small business trend predictions from publishers you trust.

Checklist of What to Track

1. Develop a strategy map and track the extent to which the components remain coherent.
2. Track the coherence of actions of the business—internally and externally.
3. Keep up to date by external social interaction and organization membership.
4. Track trend information relevant to the business, regularly.

Chapter 14: A Stitch In Time

Is Prevention Better Than Cure?

"What if?" That sounds like a simple question, but it often implies a negative answer. But looking at the downside may sound like a gloomy way to approach business. In reality, it often leads us to be more creative in coming up with ways to prevent disaster.

The amygdala (the fight or flight mechanism) uses about ⅔ of its neurons to detect negatives, and so that is often why it's easier in a brainstorming exercise, to come up with what's wrong than what's right. It's not that we're pessimists. Our brains are just wired that way. I did a workshop some time back with Rick Hanson, a psychologist and author of *Buddha's Brain*. He says, "The brain is like Velcro for negative experiences but Teflon for positive ones."

The amygdala triggers your emotions faster than your conscious awareness. The unique 'speed dial circuits' of the two almond sized nuclei within your brain are the first to react to emotionally significant events. These organs protect you from harm by interpreting subconscious hints of danger to trigger lightning fast responses. But beware of being over hasty. This ancient part of the brain, is in us humans tempered by other more highly developed brain functions.

The interesting thing about this predisposition to the negative is that we can use the phenomenon to good effect in business. For example, when I was setting up in 1982, I worked on "What if the business goes bust?" You might not think that would yield positive results for crafting the business plan. The briefest way I can describe my answer was, "I don't mind losing the business, but I am not prepared to lose my home." In other words, I was not prepared to put my five kids on the line, and if the business went belly-up, I was confident that I could find another job.

This negative idea made sure that I did not pledge the house as collateral against any bank borrowing, nor did I give any banker a personal guarantee. It forced us to find creative ways to find the initial finance for the business. It pushed us in the direction of financial bootstrapping. So for example, we managed to persuade my former employer to pass on the office lease, and sell us office furniture and equipment on a 12-month interest-free basis.

We also used a royalty-based loan for our initial cash needs. Raising either equity or debt in 1982 was a tough proposition with the British economy in the doldrums. We found a way to make repayments on the loan that were calculated solely as a percentage of the company's revenue stream over a period of time.

It worked almost like equity in the sense that the bank was taking a risk on our being successful. Given that the rate of interest was fixed and our revenue would be variable, the bank would gain if we did better than our projections, but less well if we failed to hit our numbers. The advantage of a royalty-based loan is that the startup does not suffer any equity dilution.

On the other hand, it's likely that if you leave setting up such an arrangement, or establishing a line of credit until you are desperate for the cash, you won't get one. Banks will lend when everything looks good, but not when they look bad. A line of credit will require the founder(s) to have a good credit history, evidence of strong cash flow and probably collateral, too.

We did many other bits of bootstrapping to keep afloat, but making sure we took calculated risks, rather than risks pure and simple. This was the way we survived the early tumultuous years.

In British English, we have a saying about using 'belt and braces' for being ultra cautious (braces are what Americans call *suspenders*. It's just as well that the expression is meaningless in the United States. In other words, you can take prevention to a counter-productive level and it becomes inertia.

Many would-be startups expect attorneys can protect them from legal problems and CPAs will make finance alright. At the limit that may be true, but the lean startup movement of fail fast, fail often is probably the better way to go. On day two of my first startup, we revoked a letter enclosing a lawsuit for what in the UK is called 'passing off'. In the United States, it's generally called 'misappropriation', but in any event it means the intentional, illegal use of the property or funds of another person for one's own use or other unauthorized purpose.

In our case, we had a company name that used one word, 'dynamics' used by another company in an entirely unrelated sector. It was an attempt at extortion, but it put the fear of … into us. In the end our lawyer advised us to tell the complainant to go away, but in rather more vulgar terms. We never heard from them again. Pre-startup, we could have asked an attorney (solicitor in the UK) to do an extensive name search at a huge cost, to prevent such a thing from happening.

In this case it would have been a step too many and would have held up our venture's creation. So use the 'worst case scenario', but do not do it to death.

Measure Twice, Cut Once: Being on top of the numbers and conserving cash means checking regularly on the key variables, but not just the ones that the accountants or venture capitalists will tell you about. That's why I suggest that you look at soft and hard data.

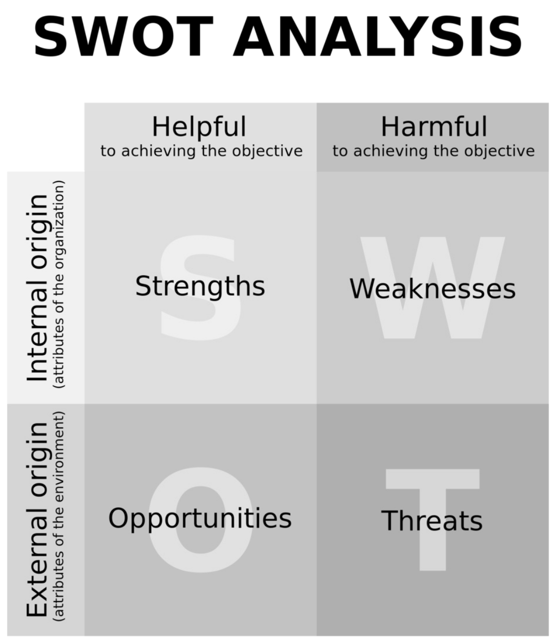
Founders should regularly make a point of discussing the 'worst case scenario', not just once, but twice. Consider the worst case that could occur at the level of the firm as a whole, and then do the same on at least one product or range of products—the macro and the micro. By doing both, the one may inform the other.

For instance, at the whole firm level, you could consider *hard* data like three months of negative cash flow, or *soft* data like the founder succumbing to depression or gets hit by a bus, or the inability of the firm to react to a new disruptive technology (think Kodak faced with digital photography). In either case, soft or hard, the overall impact on an individual product line could be disastrous.

Likewise, repeated cases of *e coli* bacteria outbreaks in one region of a national restaurant chain could be enough to bring the whole firm down. A one product or one channel startup presents a similar risk to the whole company. This latter situation frequently exists in startups created by an inventor, say, of a new miracle kitchen gadget. Such a firm cannot reduce marketing or distribution costs by cross selling complementary products, or may be exposed to high costs of customer acquisition (refer back to Chapter 5), since repeat sales are likely to be non-existent. Niche markets may allow you to focus your efforts, but may be limited by channel size or breadth.

In other words, use the word 'mitigation' as your guide—as in 'risk mitigation', which is defined at businessdictionary.com as, a systematic reduction in the extent of exposure to a risk and/or the likelihood of its occurrence.

One way you can do this is to use a SWOT analysis—intermittently, not just at the time of preparing your business plan.



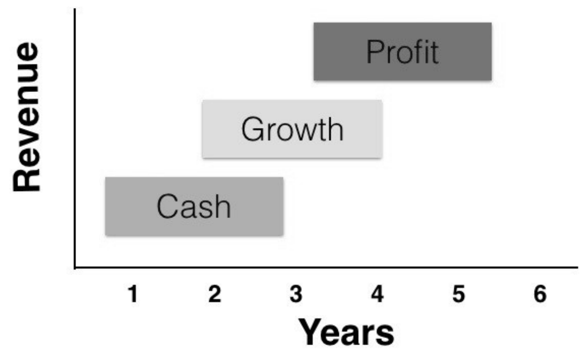
From Wikipedia

Checklist of What to Track

1. Use 'what if' tracking from time to time, examining worst case scenarios.
2. Use SWOT analysis regularly to track potential helpful and harmful circumstances.

Chapter 15: Horses For Courses

Which Numbers Count When



This over-simplified chart illustrates a key to the critical numbers to track at three main stages of the company's development—but it shows something really important. The number of years and the revenue will vary in every case. You will have your eye on each of these at succeeding stages of the business as the critical one and the length of time each variable is critical will change as the company develops.

Cash: You may consider cash is the #1 issue on day one and expect it to be so for 26 months, say, but 18 months into the business, it may transpire that it is taking longer to reach breakeven. Hence cash and cash flow measurement may stay important for more like 36 months.

Growth: Once you have passed breakeven or you see it as reliably attainable, you are probably going to change your focus towards volume growth in sales, markets, channels, regions or whatever is key to the success of the business. You could label 'growth' as 'revenue' if you prefer, since it may include interest, fees or royalties—as well as sales.

Profit: When you are clear that you see no blips in cash availability and your market position is getting to be secure, your #1 priority may well shift to profit. This will be to attract further external investment, satisfy your lenders, expand into unknown product or geographical territories. There are two main ways of considering profit—gross and net. Gross profit is revenue minus COGS (as we saw in Chapter 8), whereas net profit is gross profit minus all expenses not covered in COGS.

Traction

There is a tendency to 'go for growth' right from the start. Founders are often mesmerized by what is called *traction*, or proof that people want your product. It generally implies a high level of momentum. The term 'traction' is most often used in the tech business world and will often refer to the numbers of users and the rate of their increase in sign-up. In the 'freemium' business model, your backers may love you because you have achieved a rapidly growing number of non-paying users, because in theory at least, a growing proportion of those free users will eventually start buying the premium add-ons to the free product.

Traction may be vital in making a proof of concept, but most founders are obliged to focus on survival in the early stages of the business. It is as well not to become fixated on traction, because the parallel tendency will be to overlook keeping a balanced view of how the business is performing.

You must make sure that you focus on traction at the right time. If it's too early, and you cannot offer customer support across the board, you are likely to alienate your customers and risk running out of cash (remember the Chapter 6 strictures on maintaining a positive cash flow).

On the other hand, if you leave it too late, you may miss the bus, because your competitors have eaten your lunch. Forgive the mixed metaphor, but I aim for you to really appreciate why I consider the traction or growth stage should follow your being able to *maintain* a positive cash flow over a certain period.

If traction is all you think about, then you may miss the opportunity to create profits, by being so focused on sales growth. Unless you have outside institutional investors breathing down your neck and they are baying for traction, then there will come a point when if you do not switch to making profitability a priority, you will risk being unable to find the money to reinvest in the business.

The balancing act

What it amounts to is to keep your company's balance by focusing on tracking the right element at the right time. I have told you that I went from cash-to-growth-to-profits in my tracking habits, but I can't tell you when it will be right for you to switch your preoccupation. Only you, the founder, can do that.

There is another aspect to the balancing act: between you and your colleagues. You founded the business and thus have been the leader of the financial, as well as the product sides of the business. However, your role may need rebalancing with the other talents available to you, or the new hires you have taken on. It may be that your real talent lies in the product sphere and now that the company has a bit more breadth, it may be the time to go back to what you're good at and not abdicate your financial overview, but pass the primary responsibility to someone else.

Maybe as founder, the management stuff has been keeping you pinned to your desk, when your sales leadership was what propelled the company to have traction in the first place. "Should I replace myself?" becomes a significant question for many founders a year or two into the business. You will have seen that with Cisco, Google and many other small companies that you know.

There is an alternative. It has also been demonstrated by many founders. It's the ability to learn. Sure, it was your business idea long before the startup existed, but that does not mean that you have all the skills to pull off a success. I know I had many deficiencies that came into sharp relief on day one of the business.

Reid Hoffman, co-founder of PayPal and founder of LinkedIn, says in a blog post, "To remain successful, you have to be passionate about that kind of work as well. Ask yourself, "What am I focused on? What am I world-class at? What am I really committed to? The answers will help you determine if you should bring in a CEO." He asked himself such questions while he was still LinkedIn's CEO.

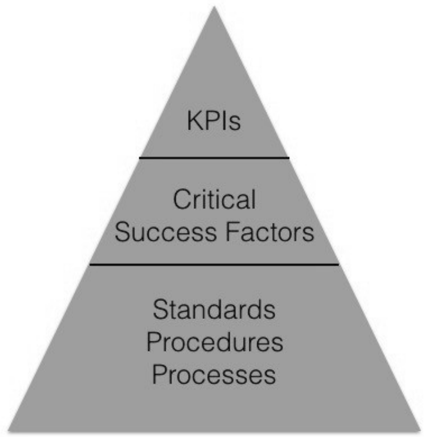
Then he goes on to say, "In my experience, CEOs need to derive satisfaction from the nuts and bolts of building a company, not just building product and articulating the vision. They need to be passionate about leadership, management, and organizational processes as the company scales."

Checklist of What to Track

1. While abdicating from none, decide what are the most important financials to track at any given stage of the company's development.
2. Track your own passion, abilities and skills, such that you are fulfilling the best role in the business.

Chapter 16: Apples To Oranges

Critical Numbers Vary by Business Type



Key Performance Indicators (KPIs) are business metrics used to evaluate factors that are crucial to the success of an organization. KPIs differ with every organization; business KPIs may be net revenue or a customer loyalty metric, while government might consider unemployment rates to be a KPI.

You have to decide what your KPIs are. An example might be the number of customer support calls handled. The problem with this is that it might suggest that if your company handled more calls, more customers would be satisfied and costs would be lower. However, chances are high that customer satisfaction would be lower and costs of new customer acquisition would rise.

You have to be very careful with the setting of KPIs. It is not as simple as it seems. For example, you might set a lower length of customer calls as a KPI. However it's my experience that a longer call may induce higher customer satisfaction. I remember a call with Apple Care where the agent observed that my area code was for Austin, TX. He observed that this was a first for him, since he was located in Austin, too. That degree of personal contact gave me a warm feeling, that in addition to my satisfaction with the resolution of my problem, increased my perception of Apple as a company that rated relationship highly.

I would tend towards KPIs that relate very closely to the survival the business, like the cost of customer acquisition (see Chapter 5), rather than internal measures that might indicate the efficiency of one single function of the business, like the length of customer calls.

In different market situations, the kind of KPIs that are important vary enormously. Imagine the different circumstances of a mining company and one in the hospitality industry. In RioTinto, the KPIs are about injury frequency rate; underlying earnings; total shareholder return; net debt; capital expenditure; operating cash flows; GHG emissions intensity. Whereas at InterContinental Hotels, they are net rooms supply; growth in fee revenues; total gross revenue; system contribution to revenue;

employee engagement survey scores; global RevPAR growth; guest heart beat. They look nothing like one another.

If you go back to your strategy's Guiding Policy (as Richard Rumelt would say), then you will be able to determine what your company's KPIs are. Rumelt describes good strategy as having, "a simple logical structure I call the Kernel. These three elements are (1) a clear-eyed diagnosis of the challenge being faced, (2) an overall guiding policy explaining how the challenge will be met, and (3) a set of coherent actions designed to focus energy and resources.

Thus it's best to tie your KPIs to your guiding policy.

Critical Success Factors (CSFs) are the critical factors or activities required for ensuring the success your business. The term was initially used in the world of data and business analysis.

Generic CSFs are, for example, good distribution or effective advertising. But you can see that using these as tracking devices are far too vague to be useful indicators for decision making. Be specific. Making them measurable and outcome focused.

The way to define CSFs is to be sure that they are: necessary to the organization's success, will benefit the organization as a whole and be synonymous with the organization's guiding policy. Unlike KPIs, CSFs are more diffuse and difficult to measure.

That does not mean that they are unimportant. They will tend to be more qualitative than quantitative. Thus they will be concerned with issues like, 'what sort of company do we want to be?' Thus to use the example of mining and hospitality—in the mining sector they might be: stock optimization to improve product delivery schedules; low cost production with minimization of work and labour; layout and flow improvements to eliminate bottlenecks and machine downtime. Whereas in hospitality they might be: employee attitude; guest satisfaction; maximize revenue/cost control; customer price-value perception.

It is just that they are tougher to track than the quantitative KPIs. As a founder you will need to be more reflective in the establishment of CSFs, since they will tend to be more about what sort of business you aim to be.

John Lockhart of MIT, the big popularizer of the CSF concept, defined CSFs as: "The limited number of areas in which results, if they are satisfactory, will ensure successful competitive performance for the organization. They are the few key areas where things must go right for the business to flourish. If results in these areas are not adequate, the organization's efforts for the period will be less than desired."

Standards, Procedures & Processes: These are often called SOPs or Standard Operating Procedures. These can be tracked easily, once they have been established. What tends to happen is that they are tracked by exception, or in other words, when things go wrong.

Developing processes, procedures and standards is particularly important if you are in the early stages of a startup, or when you are trying to rebuild or grow a business that has been underperforming. They can help to ensure that you stay on track, or get you back on track.

They will tend to save a lot of time, money and hassle. In total quality management (TQM), they are particularly important. They give you standards against which employees can measure quality. Naturally they need to be consistent and not at odds with your company's guiding policies. They must also be coherent.

In other words, they must not conflict with another. Too often in big established companies, rather than startups, espoused values are trampled underfoot because line managers ignore them.

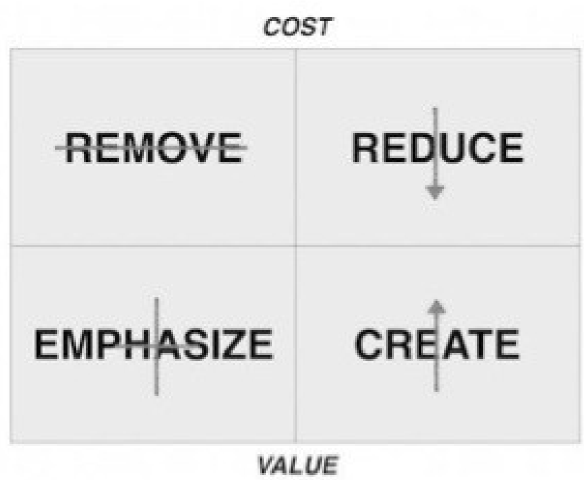
The standards, procedures and processes need to be:

- documented (best in the form of an SOP (Standard Operating Procedures manual)
- clear on both business and role;
- be the subject of training programs;
- practiced by management as a demonstration of their importance;
- be used in both management and staff meetings, hence open to improvement;
- designed to empower and inform, not constrain.

Checklist of What to Track

1. Determine, then track KPIs and CSFs, making sure periodically to revisit those that you have selected; different things now may be key or critical.
2. Document, then track SOPs and be sure that either, they are being followed, or should be changed in the light of experience.

Chapter 17: Raise The Bridge/Lower The Water



Spending Your Way Out of Trouble—or Not

Sometimes you have to take a deep breath and gulp. If revenue prospects are looking decidedly iffy and cash is tight, this is really when your entrepreneurial judgement comes into play. The trouble is whether or no you can trust your judgement. There are ways that you can help yourself.

You can use a matrix like the one above to check if spending is going to create or emphasize value, or whether you can remove or reduce cost. So it's really a bit of both/and, as well as more than either/or. The knee-jerk reaction when business is bad is to cut costs, but that may not be the best answer to the problem.

I was mentoring and monitoring an entrepreneur on behalf of a community lending institution several years ago. He had used most of his loan to pay for a very expensive website. And yet he had not really figured out where his market lay. Now the money was more or less gone and he asked, "should I redo my website, since it does not seem to be working?"

My answer was to spend money on shoe leather not the Internet. He needed to conserve his dwindling cash and sign some deals, rather than *spreading his bread upon the waters,* through the diffuse and unfocused online promotion. He had plenty of time, because he did not have enough clients. You could say time is money. That was the big dilemma for him. He was in effect throeing good money after bad, and money that he did not have.

The Internet or any indirect means of marketing has a huge wastage, and with his startup at such a tender stage, this was not the route to go. He had good references and connections. He needed to exploit them and not the dwindling money.

The difference between cost avoidance, control, cutting and containment: Cost avoidance is an effort to prevent or reduce supplier price increases. Cost control involves a formal plan to track costs and ensuring that they stay within budget. But what if the budget was wrong or ill-advised? Then you may need to revise the budget and cut costs. On the other hand you could use cost containment, which though it sounds the same, in my book, it is a different process.

Cost containment is about keeping such a close eye on costs that they are only sufficient to maintain healthy production of goods and services and satisfy financial targets. It's about preventing unnecessary expenditure and thoughtfully reducing expenditure without doing long-term damage to the company.

All four kinds of cost management can be greatly enhanced by project management skills, and under-rated skill set that you may or may not have. However, there are several software programs that you may find helpful. You can go at this cautiously. For example ZoHo offers you one free project, so you could give it a try. Or you could do a free trial at Easy Projects. You would need to research which offering suits you best. But in any event, unless you have specialists to help you, I would go for the simplest. It is not as though you are in the rocket launching business.

When Cost Containment Helps

Monthly outgoings are often a drain, when they are inessential or do not add value. In such circumstances, it really makes sense to see what areas of cost you can reduce or eliminate, without having an adverse effect on value.

Seek alternative ways of getting the job done. Perhaps no new website (cost containment), since you don't have the strategy figured out or the budget, but do more networking through meet-ups, trade association gatherings, trade shows or online forums in your customer sector. There will be some small costs, but you will be leveraging your own value, making contacts and developing a network of support as well as prospects.

Or, unlike my entrepreneur mentee, spend your 'Internet' budget on a landing page to collect signups for your newsletter and expanding your network, rather than splurging on something you have yet to be sure about. Make sure your newsletter is not only compelling reading, but also has plenty of 'asks'.

Be frugal: If you do decide that there is no avoiding laying off one or more staff members, consider how their work can be covered by independent contractors. Sublet vacant space in the plant or office. Indulge in *coopetition*[7]: share underutilized equipment with other firms that need a similar machine, but like you not on a full-time basis.

You might consider maintaining marketing spend at a particular percentage of sales. Though, watch out for getting into a downward spiral: lower sales>lower spend>lower sales.

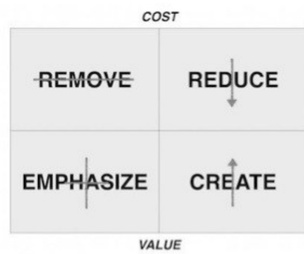
7 This new noun means collaboration between business competitors, in the hope of mutually beneficial results. It's quite different to price-fixing or dumping.

This begins to sound like financial bootstrapping. It is. Even if you did not start out that way, there is nothing wrong with going that route when you find yourself cash-strapped. Go back to the cost:value matrix at the start of the chapter and concentrate on the top two boxes, but make sure that you are constantly evaluating the bottom two at the same time.

When Cost Cutting Hinders

You should avoid 'throwing the baby out with the bath water', by which I mean that you should avoid cutting those things which are adding value, because they are the very ones that will lead to revenue and reducing your cash shortage. Indeed, you may even need to spend more on those things which are already producing value.

This is where the cost:value matrix really comes into its own. So much so that I repeat it here.



You might even want to copy it and keep it on your desktop, as a reminder for any time you are considering an expense or wondering how to offer more value. Sometimes we don't even realize how we can emphasize the best elements of the business. This may be a more powerful way to think about cost than simply wielding the axe.

Think about companies that you know who have 'exported' jobs to lower wage countries offshore to save on manufacturing costs, only to discover that it was less beneficial when differential economic changes occur. For instance, oil price hikes that make shipping into the home market suddenly more expensive; the rapid rise in Chinese wages that make cost saving evaporate; domestic market fashions face an accelerating rate of change and new products cannot be on sale quickly enough; political upheaval in the manufacturing host country that interrupts supplies.

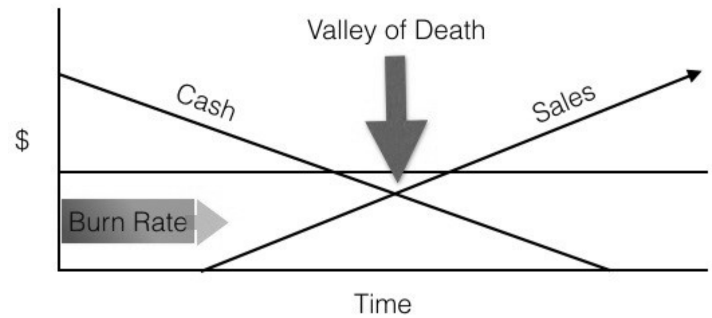
Use this example to consider the consequences of cost cutting in your own circumstances.

Checklist of What to Track

1. Use the cost:value matrix to track costs in terms of value.
2. Track the impact of prices on the market and the market on prices.

Chapter 18: Spend Money Like Water

When Burn Rate Ends in Fire Sale



When I say 'fire sale', I am not meaning it literally. Businesses might hold a fire sale when they hit insurmountable financial difficulties, or are otherwise facing bankruptcy. A fire sale in the startup world is when a company is in a desperate state like this and needs to find a buyer at short notice, or close, probably with an even greater loss.

Being concerned about the burn rate of your enterprise is not only vital, but is also one of the simplest concepts to understand. How much have you got in the bank and when will the money run out? You translate that into the monthly spend rate relative to available cash, either investment or revenue.

You can of course project this forward to estimate when you will slip into the valley of death—when the bank will foreclose, suppliers will stop shipments, and staff can't be paid. The well managed startup takes action before confronting such a misery. For if not, a fire sale will be sure to follow.

When the cash runs out and sales have not taken up the slack, it's scary. In addition, if you are cash strapped, that is not the moment that you are likely to pull in more money, either equity or loan.

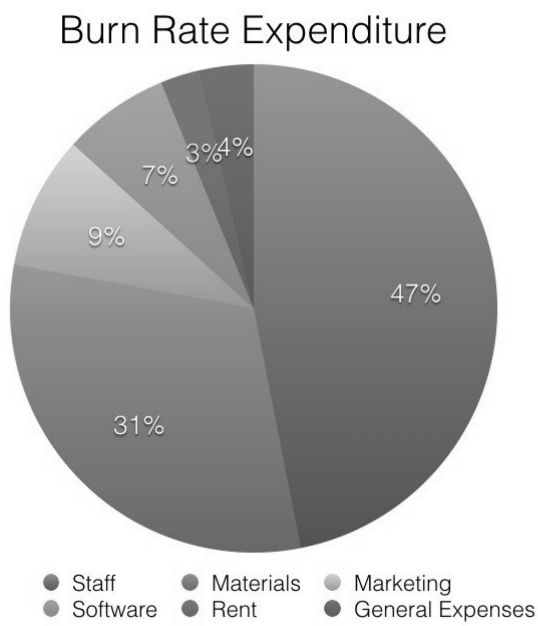
Obviously the biggest reason for startup failure (50% of startups fail before 5 years in business) is that the forecast market does not exist. But the second biggest reason is that the company runs out of cash. There should be no need for that, since it's entirely preventable.

Provided the business model is sound, how is failure preventable? By making sales the #1 job for the whole team, and being frugal with whatever amount of cash you have available. The third biggest reason for failure is having the wrong team. The wrong team may be the very cause for a cash shortage, because one or more members treats cash as a 'free' resource.

There is evidence that too much cash, especially in the wrong hands, may be more risky than too little. The big examples have been in the internet field, like web-van-dot-com and pets-dot-com. Too much cash can mask problems and create complacency.

Calculating your burn rate follows directly from your cash flow forecast (Chapter 6). Note the difference between the starting cash and ending cash numbers each month, over say a quarter. Divide the number by three (months) and you have the burn rate that you can apply to the following quarter. Take care to factor in the ups and downs of spending that you know are on the way.

You can do this live each month in your team management meetings, or you can use dashboard software from a company like Liveplan. But you can do it simply using something like a pie chart. The over simplified chart below would be more complicated in your case. You could simply update your version each month using the bookkeeping chart of accounts expenditure headings. Not rocket science, but very graphic. Like many visual dashboards you can use, the pie chart is a simple one you can create with Microsoft Office or Apple Works.



The idea here is to keep the tracking as simple and obvious as possible. Update the burn rate and input actual expenses each month, and note variances from your forecast to see if there are any big swings you need to take into account.

On its own, the tracking of the burn rate does not tell you that the startup is on track, unless you are doing the other tracking I have suggested, and above all using both your intuition and your judgement.

Milestones: There are some who don't look at the burn rate, but look to the consequences of the burn rate to test whether the startup is gaining traction. If you set milestones and then track the achievement of them, it will likely tell you something about whether the money is being spent on the right things in the right way.

If you achieve the milestones you have set for things like customer numbers/volume, getting into full production, launching new products, or opening branches, then you will likely be on track to achieving strategic ends. So low use of cash resources might be a bad thing, if you were holding back spending on the things that will help you get to the right place at the right time.

If milestones keep changing, beware. If you were originally aiming to go from A to B, then you pivot (see Chapter 24) to go from E to F, it is really difficult to know where you are. There are many examples of startups who have pivoted because the original concept was not working, and manage to raise considerable sums of money along the way for the new direction. Then they burn it fast, because their backers want to see lots of traction to up the value of the business and get their money back in spades. The projections the founders made to raise the investment are now being realized, but then it becomes really hard to determine reality from the new milestones.

Gross and net: What I have been talking about above is the gross burn rate, but it covers only the outflow of money. Chances are high that you will not just be spending money, but earning some as well. So the net burn rate is probably more critical and is much the same as the cash flow—the difference between income and expenditure.

It is important here to note that cash flow is one thing. The burn rate is about capital that you have 'burned' or spent. Your capital, whether your own or someone else's, should be expected to produce a return, unlike the revenue from sales. The burn rate is normally applied to companies that have taken outside investments from financiers, either angels of venture capitalists. So in the vast majority of startups (that do not), concern is much greater for cash flow itself, rather than burn rate.

Checklist of What to Track

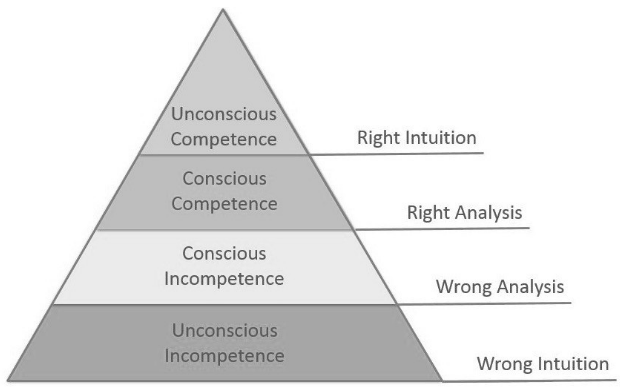
1. Consider the capital in the business and track the rate at which it is diminishing (burn rate).
2. Relate the burn rate to net cash flow tracking for the same periods.

Part Four:
Passions and Obsessions

Chapter 19: Conscious/Unconscious Competence

Entrepreneurs Are Polymaths & Multi-taskers

Entrepreneurs either are good at many things or get to be so. But as the startup matures, it is certain that functional roles will stop being blurred. Knowing when to make functional appointments and split jobs into their component parts means that you have to identify where competences lie.



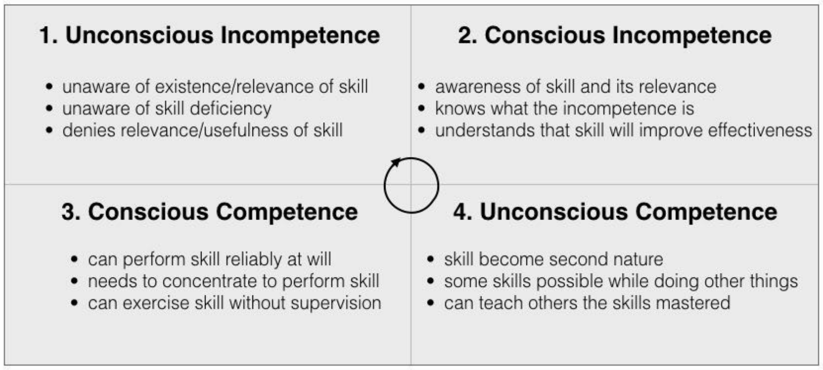
Hierarchy of Competence

When an entrepreneur sets up a business he or she has to be a polymath and multi-taker. At startup the entrepreneur will have to do many different jobs and play many different roles simultaneously. As the business grows, so will the number of specialists and many tasks will inevitably get disaggregated or delegated.

It's important for the entrepreneur to keep some kind of record of competence of himself and others as this process unfolds. In this way it becomes clear what skills or competences are becoming stronger, or which remain a weakness.

It's an irony though, because sometimes an entrepreneur does not recognize that she has a particular competence and she will mistakenly seek to fill what she believes to be a gap. I remember that about four years into our business we felt that the time had come to hire a sales manager to take over responsibility for managing and developing our sales function, little realizing that we had built the competence in ourselves. We were experiencing what, in the jargon, is called unconscious competence.

The four stages of competence are: unconscious incompetence—conscious incompetence—conscious competence—unconscious competence. There is a big literature on them in the psychology field, having been originally developed by Gordon Training International in the 1970s. Some even refer to a fifth stage called enlightened competence, where the individual does not even have to recognize his level of competence.



Unconscious Incompetence: This can be the kiss of death. It is where you don't know what you don't know, as you stumble around in the undergrowth making all kinds of mistakes and miscalculations without knowing where you have been going wrong.

This seldom happens to entrepreneurs, or if it does, it occurs even before the business opens. In the rare cases that it does happen, it will be where the founder has never learned to seek feedback, or does not listen to it when confronted. The typical next stage for entrepreneurs with this failing will be either to do more of the same silly things until the business goes belly-up, or they experience a 'conversion on the road to Damascus' and suddenly come to realize what's wrong. Hopefully this kind of realization will not come too late to save the faltering business.

The risk is that denial of the skill's value may result in the startup stumbling into oblivion early on. It may be at this point that a significant pivot (see Chapter 24) has to happen, with all the attendant risks. Apocryphal examples of pivots include YouTube that started life as a dating site, or Twitter that started life as Odeo, a podcasting site.

More recent examples include that of Haiku Deck the platform where you can make amazing presentations, which started out making celebrity-based social games under the moniker Giant Thinkwell. It never gained traction. Adam Tratt, the co-founder had to go on developing products and burning money or jump ship. Thank goodness he did the latter, for I am one of the hundreds of thousands of people who have downloaded the Haiku Deck app and use it regularly.

Haiku Deck is still in the business of building users and adding features, but they came on a pivotal road to where they are now. If you visit my Haiku Deck page you can see their story, by Adam.

Conscious Incompetence: This is where you are still stumbling, but at least you know where your lack of skill lies. This is where you make false starts as you learn the skill. That certainly happened to me when I started my first business. In the unconscious incompetence stage before we opened for business, I had assumed that things would work in a way similar to how it had been when I was running a division of a bigger company.

But almost on day one of the startup, I realized that there were other things coming into play. In my division, I always had the chief accountant to call on, for free. Now if I was having number trouble, I either had to learn the skill, or pay an outsider to solve the problem. I quickly appreciated the ability to learn things myself.

Part of conscious incompetence is the likelihood that it will induce fear—fear of failure. That's why tracking the skills we need to learn or build is so important. If it is a matter of generalized fear, we tend to fail.

I remember participating in a group activity among entrepreneurs where we played a competitive game of hoop-la, with the five posts set at intervals, with points being highest at the furthest post and lowest for the nearest one. The foolhardy risk takers went for the high points with the longest throw and failed. The timid just dropped their hoops on the nearest post and got low scores. The game demonstrated the best learners (and controlled risk-takers) were the ones who adjusted their pitches and dealt confidently with their incompetence.

Conscious Competence: Now here is another sort of risk: that you will be over confident about your skill and miss the opportunity of the beginner's mind. Knowing you know how to do something, still requires the discipline of conscious acknowledgement of your competence by following clear steps to achieve the end.

There is another element that may come into play—and that is arrogance. You block out evidence that while competent, there remain gaps in your skill set. When someone comments on your performance and you hear yourself immediately reacting by saying, "I know, I know," chances are high that you have lost your openness to learning, just because you are so competent.

As a teenager I learned a very valuable lesson that I have not followed as much as I should have. I received training in rock climbing at Outward Bound Mountain School. The most important rule our trainer instilled in us was, 'move only one limb at a time.' The reason was that if you have three points of anchorage to the rock, you are less likely to become unstuck and fall.

Unconscious Competence: You have now reached the point where you do not necessarily have to think about what you are doing while you are doing it. An example might be a farmer who is milking a cow by hand while at the same time musing about what to plant later that day, while still getting the best milk yield.

You can now demonstrate your competence to others and increase their ability to develop similar levels of competence. You are less likely to feel insecure in your decision making. However, even here there is a risk that your instinctual behaviors related to that competence may induce reckless overconfidence.

If you sense that you have reached this level of mastery, have you thought about what might come next? How about playfulness? That is to say, if you embody unconscious competence, maybe it frees you to experiment. Since you have the competence, you will be able to try things out, knowing what the limits and risks actually are.

Checklist of What to Track

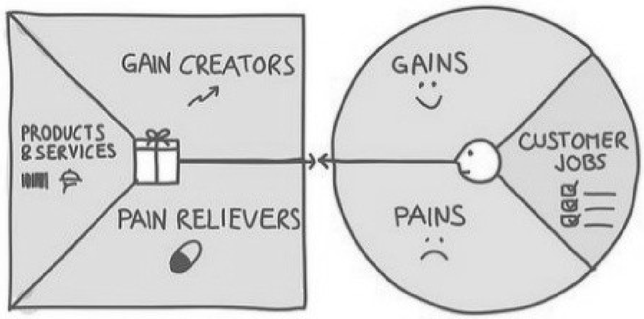
1. Use the competence grid to track where the changing skills of both yourself and your colleagues.

2. Have some simple way to track any skill shortage in the business, as the business grows.

3. Check every six months or so whether there are skills that you no longer need as fully as before, or whether there are services that you subcontracted that you could now justify in house.

Chapter 20: Monitoring The Value Proposition

Consistent Staff and Customer Perceptions



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There's a lot of material written about value propositions and you can take a look for yourself. Here, suffice it to say that a value proposition is a very shorthand way of saying what special value and benefits you are going to deliver to those getting what you offer. But then once the business is alive and kicking, you don't just leave that statement alone, assuming it's accurate. As with the numbers, you will need to keep checking their veracity. Do your customers believe that they are getting the value you think you're offering?

As the authors of the book, Value Proposition Design, suggest, you should relentlessly improve your value proposition. This at the same time as monitoring its fit with the business model (see next Chapter). You will have created value and benefits to offer to your customers when you initially designed the business, and once the business is founded, you will need to keep observing the set of customer gains you assumed you were going to create and pains that you assumed you were going to relieve. I suggest you get and use the Value Proposition Design book or use the app that you can get from Strategyzer.

Keeping your startup on track involves tracking numbers, as much of this books describes, but it is also vital to track words. As the case with the value proposition, you need to track any verbal or written statements that form the policies of the business. It is no good making a banal statement about your customers being your first priority and then not checking to see if the claim in borne out in real life.

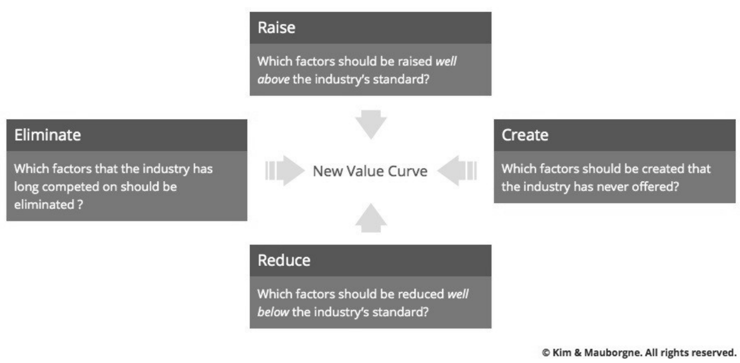
My former client, Mars Food UK, whose parent company states that the business was built on "a mutuality of benefits". That translates into their five principles of quality, responsibility, mutuality, efficiency and freedom. Having worked within the company among its associates, even over 30 years ago, I can say that they take them all very seriously in daily operations. An example from today (2015), is that they have built a wind farm at Mesquite Creek in Lamesa, Texas, that produces enough clean energy that will provide wind energy equivalent to powering their entire US operations. This is part of their plan to eliminate greenhouse gas emissions from their operations by 2040.

One significant way to track whether the startup's value proposition remains valid is to introduce new products often. Such new products should be the minimum viable (MVP[8]), so that you can establish quickly whether the assumptions behind your value proposition is truly sustainable. Such MVPs serve as real representations of the benefits you seek to offer—at the heart of the lean start-up process.

There are several key questions that will form part of both value proposition design and tracking:

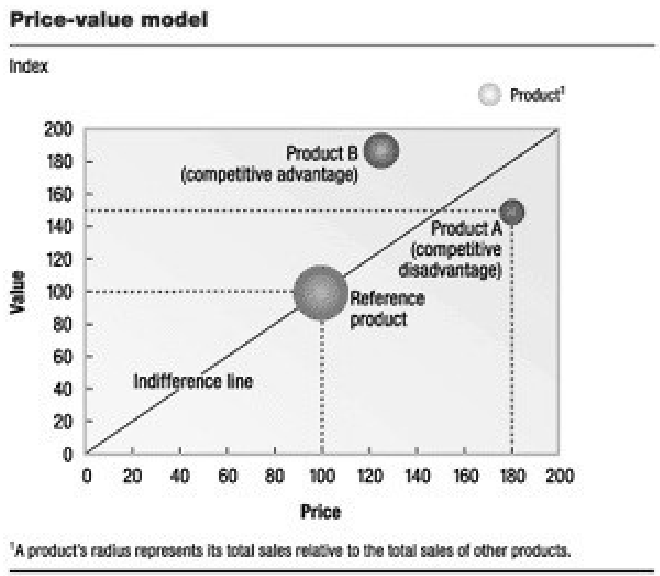
1. **Do customers really want the benefits you think they do?** This is sometimes tricky, as I learned early in my career doing market research. If you ask someone if they'd buy a product they had never heard of, or did something they had not seen in the market place already, the answers were often suspect. Rather than simply asking questions you *think* they need to answer. You have to get into their situation and look back at your proposition from their vantage point not yours, particularly if we are considering something innovative. Go back to Chapter 17 and re-visit the cost:value matrix.

2. **Have you clearly identified what is unique about your proposition?** There needs to be something that will make customer choice clear. This is pretty difficult in the Red Ocean (see *Blue Ocean Strategy: How to Create Uncontested Market Space and Make the Competition Irrelevant*, a book by W Chan Khan and Renée Mauborgne) where there is so much competition that much blood is spilled in the fight for space. Much better to swim in the Blue Ocean where there is plenty of room to attract attention. Use their Four Actions Framework and compare it with the cost:value matrix.



3. **Can you deliver on the benefits your proposition claims?** When you are sitting in your own office and dreaming up your new product or venture, it is so easy to think big. Now leave the office and consider your claims in the harsh real world. The Price-value model from McKinsey&Company (Delivering value to customers) serves as a useful tool, which you can of course adapt.

8 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.



I think from what you can see is that there are 'many ways to kill a cat', by which I mean that as long as you are continually tracking the validity of your value proposition(s), then you will be on the right track.

Just as your business is evolving since you founded it, so are the behaviors of your customers. In this situation, you have to keep up with both the changes they are making, and the ones that are impacting them—in other words the economic and social environment, which does not remain constant, either.

Using the Strategyzer value proposition canvas at the beginning of this Chapter, what you should note as you track the changes impacting your customers is that their pains will tend to be general rather than specific, whereas the gains that they desire will be much more clearly identified. Pains are often impressionistic, as in 'recruitment is so difficult', whereas gains will most likely be more quantifiable, as in 'reducing delivery times by x days'.

As with the tracking of the business model (described in the next Chapter), using the value proposition canvas in a group, you can use brainstorming, writing ideas or data on sticky notes and putting them on a value proposition canvas, so that you can gain a real overview of them all together and evaluate which ones are the most significant—and prioritize the ones that need most attention.

Be sure that however you do your value proposition canvas tracking, you first step into your customers' shoes and look 'back' at your value proposition from their perspective, or you may be kidding yourself and simply reinforcing your own assumptions. One way to do this is to gather data at user conferences (mentioned in Chapter 4), since then you are not having to use devices like surveys. Or you can gather information by attending professional conferences or trade shows in your field. The difference between a user conference and an outside event is that your own event will provide insights into existing real customers, whereas a trade show will provide an impression of a much wider group of potential users.

The beauty of using the value proposition canvas is that it is a deceptively simple visual way of comparing the fit between your proposition and the needs and wants of your customers.

Landing Pages: Another idea is that you could do some tracking and checking on either your company value proposition or the value propositions for individual products, using landing pages[9] to find out which propositions produce the best response.

Landing pages are designed to capture sales leads and thus can be a proxy for how strong the value proposition is likely to be. You only have a few seconds to convince the visitor to click the call to action. You can use the tight amount of space to really focus on pains and gains—in the language of the customer.

Checklist of What to Track

1. Track internal and external changes impacting your customers, and their use of benefits you offer.
2. Track the ongoing validity of your value proposition by checking the fit between those changes and your offer.
3. Try tracking the alternative merits of different value propositions.

9 A landing page is a standalone web page distinct from your main website that has been designed for a single focused objective, such as testing a new product or feature.

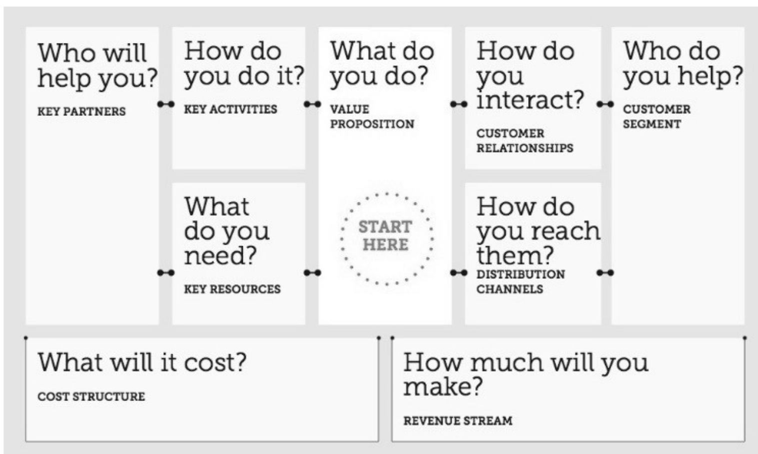
Chapter 21: Checking The Business Model

Are the Components Still Working?

You hear endless references to the two words ‘business model’. But do you know what this means?

A business model at the heart of your business plan defines how the firm will make money. Alex Osterwalder and his team first developed a deceptively simple visual way of conceiving a business model, the Business Model Canvas. “A business model describes the rationale of how an organization creates, delivers, and captures value,” says Alex. Here is a version from diytoolkit.org.

Business Model Canvas



You are best to work on your business model canvas in a group, iteratively. A simple means is to work on a white board with sticky notes, so that you can edit as you go. Then you can type what you think is the finished version. Or you can use apps from canvanizer.com. Subsequently you can see how well the canvas describes reality and make modifications in the light of experience. By working in a group you are more likely to be able to identify inconsistencies.

Inconsistencies may lead to barriers: The reason for keeping a focus on the business model on a monthly basis at the outset, is that you want to be sure that you have selected the correct ingredients for it. Will the model be scalable? Are some of the components not contributing to the whole? You will look at customer acquisition cost (see Chapter 5) that may lead to questions about you distribution channels, for instance. Some of the assumptions that you have made may create barriers to making your business model work.

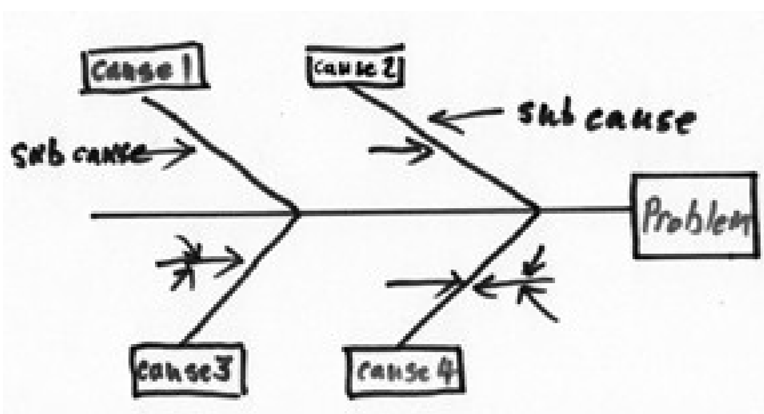
When you start using the canvas and fill words into the boxes, you will pretty soon come to realize that those in some boxes don’t fit with what you have in other boxes. For instance if one of your channels is the Web, but you have no geeks, you’ll spot the deficiency easily. Or, on the other hand, you could make use of something in one box elsewhere on the canvas. An example might be that one of your key activities might easily be turned into a revenue generator.

Clearly, you and your co-founders would start working on the canvas by developing and refining your business proposition. I would say that that has to be intimately linked with the box on customer segments. If your customer segments cannot be served by your value proposition, something is wrong. If you feel the process is risky without help, I suggest you get the book *Business Model Generation*, by Alex Osterwalder and Yves Pigneur.

When you are happy with what you have in each box, apply the 5 Whys technique. It is an iterative interrogative technique used to explore the cause-and-effect relationships underlying a particular problem. The primary goal of the technique is to determine the root cause of a defect or problem by repeating the question "Why?" Each question forms the basis of the next question. The "5" in the name derives from an empirical observation on the number of iterations typically required to resolve the problem.

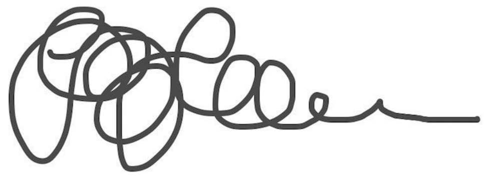
I suggest you first try it on something simple and I believe that you will quickly find that it is very revealing of root causes. Another dazzlingly simple technique you can use is the Cause and effect diagram, also called a Fishbone. They are an excellent tool from the Quality Management process. Do not allow the amazing simplicity fool you. You need pencil and paper or a whiteboard if you are working in a group. Team creativity will give you best results.

I have drawn a fishbone freehand, so as not to daunt you with pretty graphics. To start with, set down the problem to be solved, then draw the basic fishbone. You may have as many obvious causes as you like, but you will probably find that there are only a few main ones, so put them in boxes.



When you are actually in business, after careful testing of your business model, you will be implementing it daily and inducing the market to adopt it. In terms of tracking, I suggest you continuously adapt it, or rather adapt its components in response to market feedback. This is not suggesting anything near a full-scale pivot (see Chapter 24), but rather a matter of reducing uncertainty and managing risk (of failure).

The process from first design to trial to early-stage implementation will look and feel a bit like this.



I lived an example of finding a fatal flaw in a business model. Some years back, a co-founder and I were building a new business, whose value proposition was that we could detect the likelihood of a person developing a neurodegenerative disease like Alzheimer's, or Parkinson's occurring later in life by measuring any misfiled proteins in the eye, the only transparent organ of the body. Seeing them in the eye would indicate inflammation elsewhere in the body and inflammation that could lead to more serious conditions. We did not have a cure, but could only offer advice on life-style changes that might reduce the inflammation. We had a beautiful business model (and business plan) with a fatal flaw, in addition to needing ½ a million to start. Venture money was not interested in diagnosis without treatment. Every VC we approached, we were told to come back when we had a cure, because the multipliers were much more significant than we could offer, despite our ambitious growth plans.

In a similar way, many inventors think their better mousetrap will lead to a business, but while they might make a fortune from royalties, like the father of a friend of mine who invented a 'blow-off preventer' for gushing oil wells. However, with no viable business model or one that one that has ill-fitting parts, there will be no business.

If your distribution channels don't fit with the way the sector works, you may find that you have to make other changes to adapt your distribution or enable buyers to access your chosen channel in a novel way.

Opportunities as well as barriers: Sometimes opportunities make themselves available for you to switch or add channels. Amazon, the arch online retailer is now experimenting with bricks and mortar bookstores. The Olive Garden restaurant chain is edging into supermarkets with their eponymous Italian salad dressing—in bottles. I drink Starbucks coffee at home, and buy it with my groceries.

Perhaps if you make fabrics, mostly an intermediate business, you would make better **revenue** moving downstream and into the garment industry, but your **value proposition** would need to be re-examined in the light of this change. Much of your production is in large runs to supply clothing manufacturers. The smaller amounts you distribute to craft outlets, might be higher margin, but in lower volume, except for the branded stuff. You would need different **distribution channels** moving into the garment industry and, while it might produce even higher margins, you'd need different **resources** and **customer relationships**. Your **key activities** would certainly change from manufacturing quite large batches to smaller ones and your **cost structures** with them. You might also need different **resources** and **partners**.

Once you have done a significant amount of work on all nine subject boxes in the Business Model Canvas (illustrated in **bold** at the beginning of this chapter), you will find new issues impact them.

While this illustration may have flaws stemming from the fact that I have no direct experience of either the fabric or garment industries, it aims to show you the importance of keep a vigilant eye on the validity of the business model you have created.

Checklist of What to Track

1. Use a formal Business Model Canvas as the means to track the continuing validity of you business model: go back to each box and check that the contents and their interrelationships with what is in other boxes remains valid.
2. In the process of checking the components of the business model, use the 5 Whys technique.
3. If that gets you into trouble, try the Fishbone technique.

Chapter 22: Left And Right Brain Hemispheres

Decisions Are Often Emotional, Justified As Rational

You have probably heard people talking about left and right brains, but without really knowing what was implied. So here is a simple way to look at each hemisphere and what kinds of thinking can be associated with each.

Left	Right
Logic	Creativity
Analysis	Imagination
Sequence	Holistic
Reason	Intuition
Mathematics	Arts
Language	Rhythm
Facts	Feelings
Verbalization	Visualization
Words of songs	Tunes of Songs
Computation	Daydreams

First, a disclaimer: myth has it that people are predominantly 'left brained' or 'right brained'. Neurological researchers now consider this not to be so. However this complex field still indicates that each hemisphere does have different functions, though connected through the corpus callosum, (a band of nerve fibers). Without getting into the intricacies of brain science, experience (your own included) tells us that different people bring a predominance of one 'kind' of thinking or the other to their work. Think of what you see as your typical accountant or typical marketer. Of course, stereotypes can be misleading, but they are generally reliable as they stem from many people's observation.

Why does this have any significance for an entrepreneur? Chances are actually high that without being aware of it, both kinds of thinking have been used before, during and after startup.

A successful founder uses both from instinct. The trouble is that there may be times when one side is neglected. The reason for this is that you may be tempted into analysis-paralysis. In earlier chapters I have encouraged you to pay a lot of attention to numbers. I am not going back on that advice, but you need to balance numbers (left brain) with feelings (right brain) and allow intuition to live with analysis.

Richard Rumelt, the revered strategy teacher at UCLA Anderson School of Management reminds students about Honda's strategy by saying, "In 1977 my MBA final exam on the Honda Motorcycle case asked "Should Honda enter the global automotive business?" It was a "giveaway" question. Anyone who answered "yes" flunked. Markets were saturated; efficient competitors existed in Japan, the US and Europe; Honda had little or no experience in automobiles; Honda had no auto distribution system." And then he tells them, "In 1985 my wife drove a Honda."

Honda is still (in 2015) #1 motorcycle producer in the world, but it is also the world's sixth largest auto maker.

I can think of times when sales were disappointing, I would get strung up on things like volume of mail-shots, frequency of sales calls, or prospect conversion rates, when I should have been much more focused on process issues. Jacking up the names on mailing lists or pushing colleagues to get out of the office to prospective clients were often not the way to go.

We should have been looking at creating relationships *with*, rather than selling *to* our contacts. One thing we were able to observe was how sales would always go up after we had organized user conferences. Not immediately, but often within months we'd get a call from a client telling us about how he paid a visit to another user and seen how they were using our products. In the same breath he would be asking for more products from us because the company had copied the practices of the other user.

Of course, too much schmoozing might have indicated too much right brain activity, when a more hard-nosed results-oriented set of behaviors would have been better. Relationship selling is based on being authentic, trying to be yourself and be genuine. It's not a sales technique that can be used if you lack the basic characteristics. So, schmooze away, but don't get carried away. The customer has business to do. Games of golf or membership of the Rotary are fine, but not if you don't want to do those things, and only do so 'because it's a good way to make sales'. It's not.

Equally if you are paying commission to sales people, you should not be thinking that upping the rate will produce more sales. Commissions are not always the motivators you might expect them to be. They tend to be more of a reward than an incentive.

It would be folly to pay too low a base salary with seemingly attractive commissions in a situation where the sales person is not anywhere near covering their living costs with salary. This would be particularly true if times were tough and sales not easy to close—a situation in which 'commission' might be a de-motivator, rather than an encouragement. Or it would be worse—if you were asking the sales person to sell the wrong product to the wrong buyer, simply to up the volume.

The same kind of balance needs to come into play when you are dealing with seemingly numerical things like pricing or discounts. The right price is neither based on what the market will bear, nor on charging a premium, nor on undercutting the competition. Neither is setting a standard margin for all products, nor basing prices on cost plus, rather than the customer's perception of value.

So pricing has to use reason *and* intuition, rather than simply saying, "prices must go up, because costs have." You need to bring perceptions into play. So when the bean-counter with calculator (apologies to accountants; of course they are not all exclusively concerned with numbers) makes the demand for a price increase, be sure to look at prices in terms of the effect on customers as well as internal budgetary concerns. What is your gut instinct may be as important as the calculator.

The reverse is also true! Do not let your gut run away with you. I have heard people in management meetings say, “I don’t care what the numbers are…” That is an equally dangerous place for an entrepreneur to be. To avoid surprises, it is vital to check yourself to ensure that you are balancing facts and intuition.

That may sound as though I am advising the dull, controlled life. I am not, since it cuts both ways. “By using intellect only, and not your innate wisdom, you are keeping yourself from the most powerful insights," says intuitive consultant Sonia Choquette. Again, the reverse is also true.

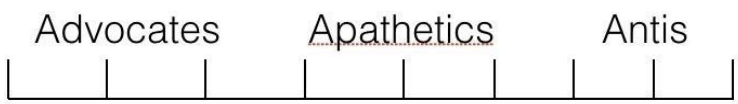
Using the table at the beginning of this chapter pick one or two of the characteristics that you think you are good at using, then track the extent to which you can feel comfortable using the matching characteristic in the other, less appealing, column.

Try to check periodically how much more comfortable you feel with the words in the less appealing column. You could even make a small checklist of the jobs you have to do as a founder and categorize them by left and right, then pick jobs that you find comfortable and make a point of tackling them first thing next Monday morning.

Checklist of What to Track

1. Try to determine whether your natural tendency is to be left or right-brained. Do not overdo the analysis, but if you are aware of your own predilection, chances are higher that you will appreciate where people unlike you are coming from.
2. Track the extent to which you are able to develop the ability to use the characteristics in your least preferred column; revisit your scoring periodically.
3. Make a point of seeing things from both right and left-brained perspectives; the corpus callosum naturally tries to integrate, but you can hasten the process.

Chapter 23: Pictures & Stories, Not Just Numbers



Indicative and Narrative Measurement

Indicative Measurement (customers): You want to achieve recognition, you seek word of mouth recommendations for your products or services. You want people to think well of what you are and what you offer. This, however, is not something you can buy, like ads.

As soon as you start to sell something, you will begin to have advocates, people who are pleased with your products and freely tell others (voluntary promoters). The trouble is that you will almost certainly have people who react apathetically (passive users) and hopefully you don't have any users who react antithetically (vociferous detractors).

Most of these users will be talking, or not, out of your earshot. You won't know how they feel unless you ask them. Even if you do ask them, their responses will be providing subjective, rather than objective feedback. But tracking word of mouth may make the difference between success and failure.

There are ways that you can survey customers on a regular basis, asking them simply if they would recommend your product or service to others. Almost certainly you will have received such surveys from your suppliers, often following an interaction, such as contacting their customer support. I always consider being asked such questions to be facile. What I tend to forget, though, is that if suppliers get enough responses and track them over time, the analysis *may* produce an indication of how customers feel about the products from the supplier.

Of course your tracking of such indicators as to whether the user will speak to others positively about you, has to be regular and consistent, so that you can plot how such a barometer is changing. It is also important to realize that such data should not be used in isolation. That is why I advocate such a range of hard and soft data collection.

Such indicative measurement is nothing and will simply be an irritant to customers, unless it is a part of a coherent set of behaviors that really do support the customer. Without naming names, both you and I and can probably name companies who do come after you wanting such data, but who do not deliver behaviors designed to reinforce the value proposition. On the other hand, I always complete the quick follow-up questionnaires that vendors like Apple and Canon send, because 'they walk their walk' of customer care.

Indicative Measurement (employees): Without the imposition of employee satisfaction questionnaires, a British company, Nixon McInnes has used a simple indicative method of tracking employee happiness, by asking staff to drop a tennis ball into a happy or unhappy bucket as they leave work.

They call it their 'happiness index': not very scientific, you might think, but they are seeking indications, not definitive measurements.

It is really important not to see such indicators as deep and penetrating studies of employee motivation or engagement (the buzz word in HR circles). This is not employing Herzberg's motivational factors (recognition, growth, autonomy and the work itself) and the hygiene factors (physical conditions, pay and bosses).

There are scoreboards/dashboards in the form of apps that you can use. An example is Happiily, (note the funny spelling) is a simple tool that helps employees track their happiness at work, and helps managers understand how their actions impact their employees. But since these indicators are rough cuts, rather than heavy-duty research, I would stick with the impressions and then as you track them, dig deeper if you notice disturbing trends or sudden shifts.

Narrative Measurement: I describe narrative measurement as calculating the cumulative impact of stories customers tell about you. This is easy to say and very hard to do, but nonetheless rewarding if you do it conscientiously.

In about the second year of my main company's life, we established user conferences. The purpose was basically two-fold. Namely, to offer users an opportunity to share experience and learn from others facing similar issues—and, for us as vendors to learn what issues and concerns our users were having, both with our products and with problems to which they had yet to find solutions. The conferences were also an opportunity for users to network.

Such conferences have spin-off values, too. They reinforce the connection with customers, in a setting that is not directly sales related. They are often fertile ground for new product ideas. But in terms of tracking, their huge benefit comes through your ability to log, annotate and analyze customer stories.

The kinds of stories it is imperative to log are those that graphically illustrate customer experience in using your products. This can be far in excess of the social benefits that such events deliver. For instance, you and your colleagues will hear how users tweak your products or apply them in contexts that you had not imagined. In addition, they will tell stories of how things have not worked so well. You need to document on-going client problems or trouble-tickets, so that problems can be converted into opportunities.

The User Ecosystem: Adobe, for example, supports more than 100 user groups around the country and hosts or helps with regional user conferences and product seminars throughout the year. They are very active in facilitating these events, but do not dictate the terms. To work well, such events need to involve a wide cross-section of people from your company. They may even include those not directly involved with products or customer relations. The reason for this is to build rapport, but more than anything else, administrative staff, for example can bring a fresh perspective to things that you thought you had nailed. They also may report the stories more objectively than colleagues who are deeply embroiled in products and customers.

Oracle is another company that has a whole range of user groups and conferences, which have almost taken on a life of their own and deliver what one might consider as professional development. The 'user ecosystem' becomes a product added value, both in terms of new business acquisition as well as customer retention.

We also invited 'warm' prospective customers to our conferences. We made sure that there were not so many as to make it look like a sales event. On the other hand such people would often ask 'innocent' questions that had existing customers search deeply for answers. All of this should be recorded, not literally, but in some organized way that you plan prior to the event.

Something we did not do, because I am talking about a pre-Internet age, was to build a virtual platform for people who participate. We did give every customer executive at the conference a list of all the others attending, and progressively we learned that a hum of chatter followed conferences. Such a hum would probably turn into things that you might record later as a positive move of customers along the scale of 'antis', to 'apathetics' to 'advocates', or even 'apostles'.

Gallup, the survey company says, "Nothing predicts organic growth like customer engagement. Aggressive advertising campaigns, mega sales promotions, promises of low prices, and reward programs may get customers through the door—but they don't create the types of emotional connections that drive long-term profits and loyalty. If your customers aren't 'true believers,' your company risks surviving based on a price relationship alone—and will never prosper."

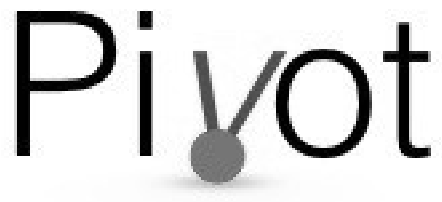
If you use the storytelling element of user conferences well, the ecosystem will help to transfer users into something much more akin to partners. This will add to your virtual and virtuous sales force. Small companies often try to change the world, as well as selling their products, but their scale makes that difficult. The more *evangelists* you can attract, the better.

Checklist of What to Track

1. Indicators of Employee and Customer satisfaction: disgruntled staff do not produce happy customers.
2. Keep careful records of your users and how their attitudes may be changing; sales numbers will not do it for you.
3. Customer storytelling: use their words in preference to your own.

Chapter 24: Recurring Catch-All

Is It Time To Pivot—People, Products, Places?



In today's entrepreneurial world and with the speed of light, startups are encouraged to pivot when things don't look good. This is true especially when the enterprise has been practicing lean startup—failing early and failing often, to enable you to put your learning into practice.

You have to have very sharp hearing. It takes tawny owls less than 0.01 of a second to assess the precise direction of a scurrying mouse, for example. Your eyes need to be peeled. Eagles can spot rabbits from several miles away while hawks and buzzards often scan the earth from a height of 10-15,000 feet looking to spot rodents below. Your nose needs to keep sniffing. Black bears have been observed to travel 18 miles in a straight line to a food source. You need to smack your lips and taste the fruits of your labor. Catfish, named for their feline-like whiskers, typically have more than 100,000 taste buds, while we have but 10,000. You need an entrepreneur's touch to sense things. Catfish are masters there too; it seems they can sense earthquakes days ahead.

We have to use all these senses to pick up on the moment to pivot—or not. Happily though, using these senses and the data that they provide is not all we have to available. We can sense pressure, itching, temperature, pain, thirst, hunger, direction, time, muscle tension, proprioception, balance, stretch, chemoreception, so use them all!

However, this book has been implying that no single factor that will cause you to make an abrupt turn away from what you are doing. There are many factors which you will be tracking—some hard and some soft. Your decision to change tack will need to take many of them into account. Actually, many startups fail through the reverse—just doing more of the same, or throwing good money after bad.

To continue the sailing analogy, if you are at the helm, and you are sailing into the wind, like most startups, you will be gauging the strength of the wind, the boat's speed, the wind's speed, what's to port and starboard, the course you're on, the state of the tide, whether you have an onshore or offshore wind, dark patches of water indicating more wind or current… The list of factors goes on and on. The good sailor acts and reacts to them intuitively, all the while factoring in the observed variables. Sometimes you start to tack and discover that you got it wrong, have to return to the course you were on and try again.

Pivot: So it is with the early stage business. The equivalent factors to those of the helmsman about to tack are many; here are some of the reasons why you might consider a pivot.

1. Lack of customers or empty pipeline.
2. Customer acquisition too expensive.
3. Inability to educate the market.
4. Trouble facing up to competitors.
5. The market 'isn't there'—got it wrong.
6. Early customers don't appreciate the beta product.
7. Better opportunities elsewhere.
8. Bits of the business don't work well together.
9. Revenues growing too slowly—not enough traction.
10. Investors remain skeptical.

No Pivot: Many of these factors intersect. Don't forget the counter arguments—why you should not pivot. Also don't forget, you can do a partial pivot, with just some part of the business—products or processes. Good entrepreneurs are always, like good skippers, trimming the sails and keeping a sensitive hand on the tiller. Here are some reasons why you might consider not pivoting.

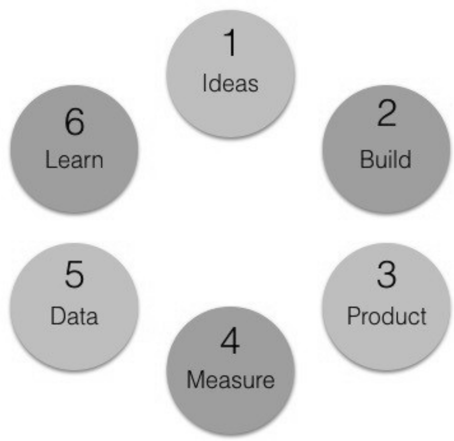
1. Customers won't believe it.
2. The wrong bit to pivot (users, product, channel).
3. The new technology will take too long to master.
4. Existing business model doesn't work, why should the new one do so?
5. Partial pivot may be better than a total pivot.
6. Wrong people for the new situation.
7. Too soon to pivot.
8. Difficulty of assessing whether to stick, pivot or *quit*.
9. Bigger benefit from calling it quits.
10. Is the need to correct course or to pivot?

People: You have been tracking how your people feel and the results of their work. What kinds of things arise? A startup or early-stage business is likely to be small and with close working relationships. Consequently, founders often find it tough to figure out whether they have the right team.

If you are bootstrapping your finances, you may be taking on part-timers, contract workers or outsourcing rather than hiring too many full time employees. Unless you are solopreneur, chances are high that the founders of the business will have hired others. Those hires will have joined the business at a stage when role clarity was missing. It's likely that they will have been multi-taskers, rather than people with very clear and limited responsibilities.

Products: If you start a business, you will probably be in love with your product. You may not see deficiencies in it, or its lack of fit with potential customers and their needs. So, you should protect yourself from your love affair. One way is to run regular product:market fit surveys. Here is one that you can use, developed by Sean Ellis.

But of course you need to keep repeating the exercise so that you can track the product:market fit over time. At its simplest this lies behind the lean startup concept.



Places: Chances are high that you will have started you business where you already are. What you need to track as time passes is whether you are in the right place. In our case we moved three times in eleven years.

Our first location was a) the office we took over from my former employer, b) near our village home and c) affordable, but since it was above a wholesale butcher's, hardly appropriate to our professional clientele or our own self-image. When we could afford to move, we wondered if we should move to the city, but in the event felt confident enough about the quality of our business that we moved to self contained offices in the nearby rural town. This move actually attracted clients. We outgrew these premises and next choice was to move to a big city with good infrastructure and support services. We took a whole floor in a newly converted former brewery. It served us well and then came a choice more to do with a sense of self-importance and our banker's desire to have more assets on our balance sheet, so we purchased a former country house in a park.

Paraphernalia: Your production processes may use all kind of equipment or other assets that are either unique but applicable elsewhere, or underutilized. Examining your hard and soft assets may reveal that you have a hidden resource that could be productive.

We had excellent parking outside the city center and training facilities that were not in daily use. We might have found that these two could have led us to running public training and other events as a new profit center.

Until the last move, our choices were rational. However none was based on hard data. In your case, unlike our own, I suggest you do use data. Here are the data to use:

- Customer and area demographics;
- Accessibility to your customers, or them to you;
- Location & foot traffic relative to competition if you are a B2C company;
- Cost of utilities and maintenance;
- Availability of human talent;
- Where customers or employees share your values;
- Local taxes or incentives;
- Availability of resources or suppliers you use;
- Expansion options and presence of potential financial support.

Realize that unless you track these factors you may be adversely affecting your opportunities. Naturally you are not going to be examining them as frequently as sales and cash, but once every six months will be good.

There are fashionable alternatives to pivoting. One is to follow an *edge* strategy. It may be that you are not taking advantage of all the strengths of your people, products and places. For example, a staff trainer might be able to introduce new skills, or people can easily access online courses through websites like Coursera and EdX and many others.

Checklist of What to Track

1. If the data and your senses suggest it's time to pivot, then track the reasons for and against.
2. Consider tracking people, product, and places, so when the crunch time comes for a pivot you have all the decision-making components to hand.
3. Be cautious and track the underlying trends is both sales and usage. Do not get freaked out by the speed of scaling; ask why a slow start could be good; keep close to the customer to see how they are using your product.

Staying Afloat in the Future

The Metamorphosis of Business Engenders Your Need to Anticipate

We had it easy in the past. Business was about maximizing shareholder value, whether our company was large or small. The financial dimension is what got measured. It is important to remember that, "not everything that counts can be counted, and not everything that can be counted counts," according to Albert Einstein

Today, three simultaneous trends progressively require that entrepreneurs track how their business performs beyond the financial dimension.

1. Internal and external pressure on organizations to meet the needs of all the stakeholders.
2. The increasing overlap between the private sector, the public sector and the social sector.
3. The tendency for new startups to aim at changing the world in which they operate.

These three trends induce a fast-growing awareness about the multiple benefits or harm that business can bring. Knowing how to track performance in the '*new*' dimensions can be challenging. I call the new dimension the Benefit Sector, where enterprises (Private, Public and Social) are tending to converge.

This pattern is brought into focus by the growing dissatisfaction with the functioning of capitalism in advanced industrial countries. The newest manifestation of this follows concern for what is now popularly known as the Triple Bottom Line (TBL) that encourages businesses to have concern not only for Profits, but also People and the Planet and the great movement known under the banner of Sustainability.

TBL and Sustainability are widely practiced in business, sometimes labeled Corporate Social Responsibility (CSR), but that movement is frequently under fire for being 'CSR Washing', like *greenwashing*, rather than a fundamental business purpose. Now the most innovative firms are more deeply into social innovation, or ways that they can move on from doing well by doing good and changing business ethics and behavior and flourishing.

Here are 10 things you need to consider as you lead your business into the future:

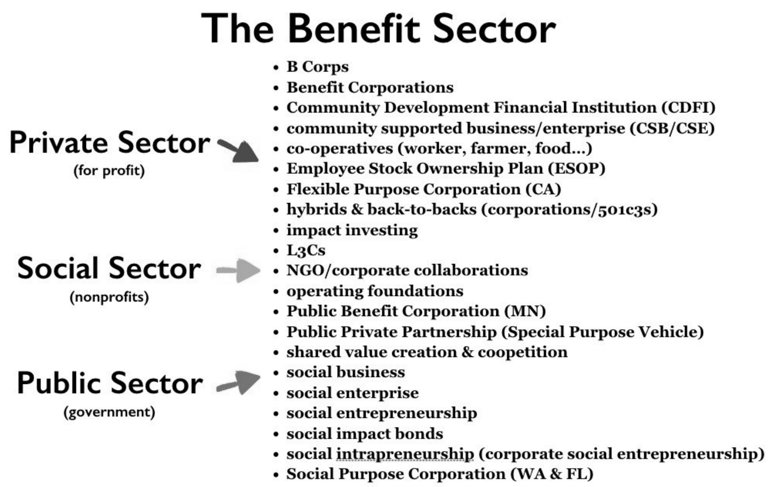
1. **Responsibility to all stakeholders**: Even the multinational sector acknowledges the importance of their responsibility to all their stakeholders. For example, Paul Polman, CEO of Unilever, say, "We are finding out quite rapidly that to be successful long term we have to ask: what do we actually give to society to make it better? We've made it clear to the organization that it's our business model, starting from the top."

2. **Startups focus on benefits:** Striking examples of business startups with a focus on benefits include Equalix (skin substitute), DayOne Response (disaster relief), Wello (clean water), Re-Nuble (liquid fertilizer from waste), Maternova (products & services for mothers and newborns), Gham Power (solar photovoltaics), Range Networks (mobile networks for rural communities). These are just a handful of a myriad of ’change the world’ startups around the world. Their seemingly tiny bases of economic power are shuffling the pack.

In your own field, make a point of searching and asking around. You will find many examples of game changers just around the corner. All it takes is to be bold—and quiver.

3. **Benefits in all sectors**: There are Benefit Sector businesses operating in all three sectors (Private, Public and Social).

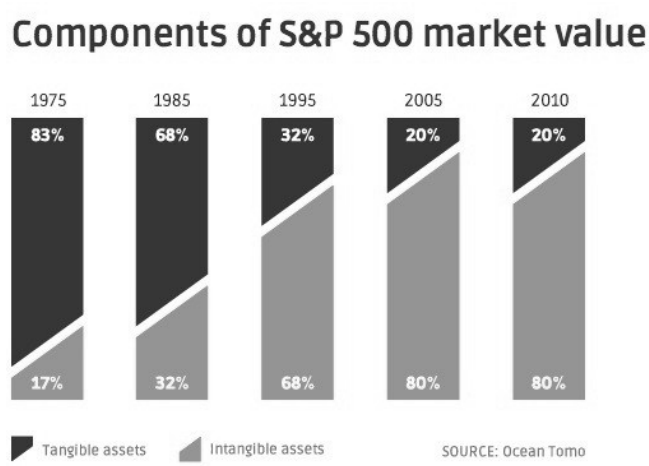
4. New governance structures: The Benefit Sector uses many different and sometimes emerging hybrid corporate governance structures.



Above you will see many kinds of institutional structures. Some will be familiar, others not. If you see one that intrigues you, do an Internet search and be intrigued.

5. **Hybrid business types**: There are a number of variants of in types of Benefit Sector businesses. For more on the Yunus concept of social business, for example, visit the Grameen Creative Lab. There are growing numbers of foundations that have for-profit subsidiaries. This is only the beginning of bottom-up changes in institutional structures. The conditions of business legislated by politicians do not always meet the real needs of changing values and purpose of entrepreneurs.

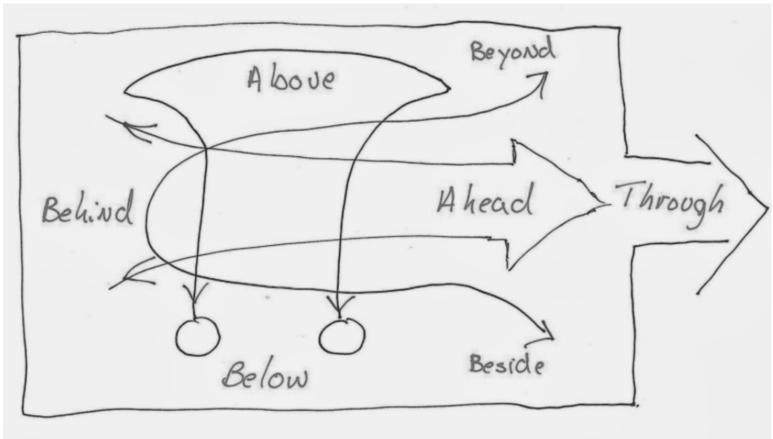
6. **Tangible and intangibles values**: Most of the value of shares quoted on the stock market concern intangible assets, rather than tangible ones, contrary to popular belief. Value is not so much related to quantifiable assets, but more to what is in the 'eye of the beholder' about how that value may change over time.



So, stop and think about your own company and how the world will value what you do. Even if you are the founder and own all the equity, you may think differently about the value of what you are doing.

7. **The new economy**: In the light of this new way of thinking about value and benefit, you might want to re-evaluate, calibrate and track how your startup is

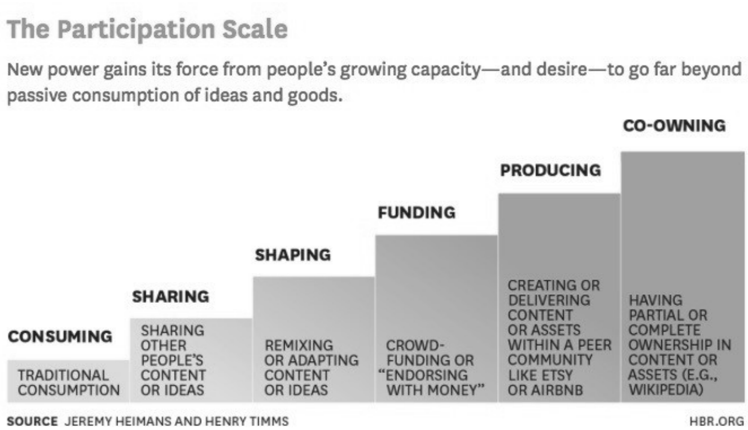
performing. It may result in your business making a contribution to a fair economy that works for people and the planet – the new economy. To realize what's going on around us, we need to be 'first class noticers' of everything that is changing in the economy. Sometimes we have tunnel vision, so tightly are we focused on the task at hand.



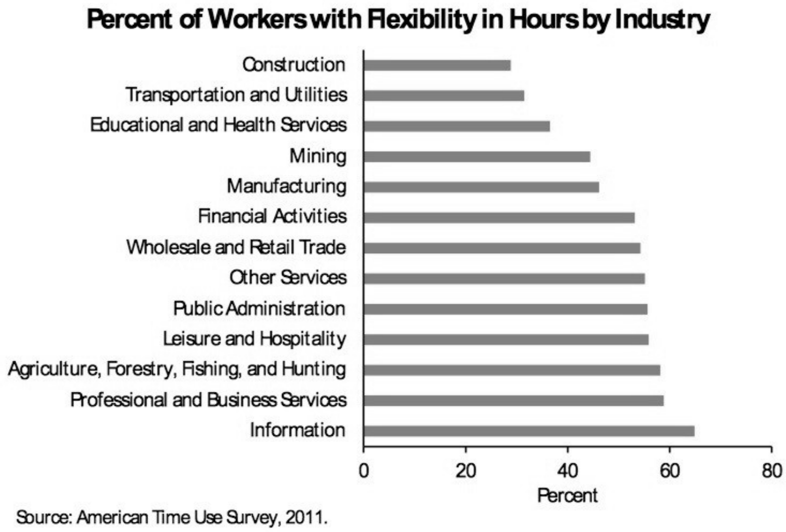
The new economy brings new freedoms to create:

- authentically;
- a life with greater purpose to embody deepest values;
- with less fear of self-recrimination or judgement.

8. **New power**: values and benefits trump money and position. The crowd is challenging the established order of things: wealthy individuals, huge corporations, mega-banks, and established politicians. In an interesting Harvard Business Review article, Jeremy Heimans and Henry Timms called old power, "a currency held and guarded by a few", and new power, "a current, which we can channel rather than hoard." They observe that, "new power taps into people's growing capacity—and desire— to participate in ways that go beyond consumption, the basic requirement of old power."



9. **New ways of working**: wherever, whenever, however. We all experience this and live much of our life in the cloud. Going to work has had a different meaning since the turn of the century. The concept of flexplace, flextime and self-employment are common and often facilitated by new technology.



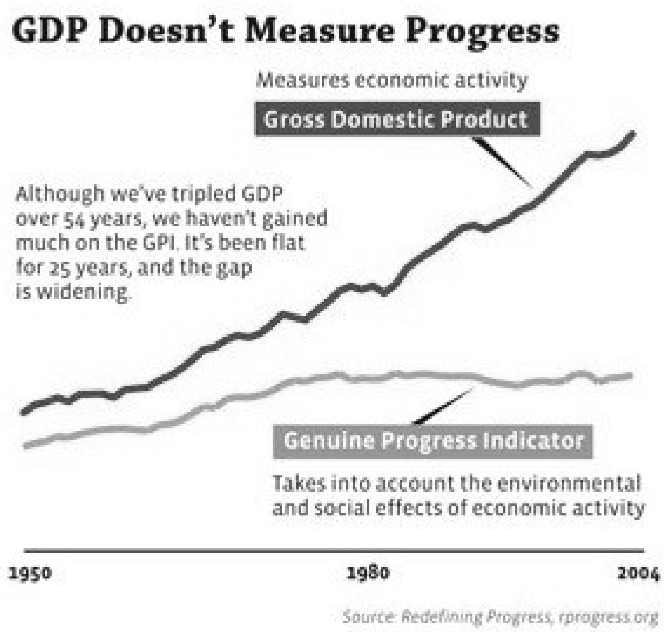
10. **Measuring wellbeing**: We still think of measuring wellbeing by considering a country's Gross Domestic Product (GDP). But there is a strong movement towards a consideration of human development as the quality to be concerned about. For instance, Measure of America that works on better alternatives to GDP, provides easy-to-use yet methodologically sound tools for understanding the distribution of well-being and opportunity in America and for stimulating fact-based dialogue about issues we all care about: health, education, and living standards.

Probably the best known alternative to measurement of output (as GDP does), is the Bhutanese measurement of Gross National Happiness (GNH). The OECD talks about subjective wellbeing:

- *Life evaluation*—a reflective assessment of a person's life, or some aspect of it.
- *Affect*—a person's feelings or emotional states, typically measured with reference to a particular point in time.

- *Edaimonia*—a sense of purpose and meaning in life, or good psychological functioning.

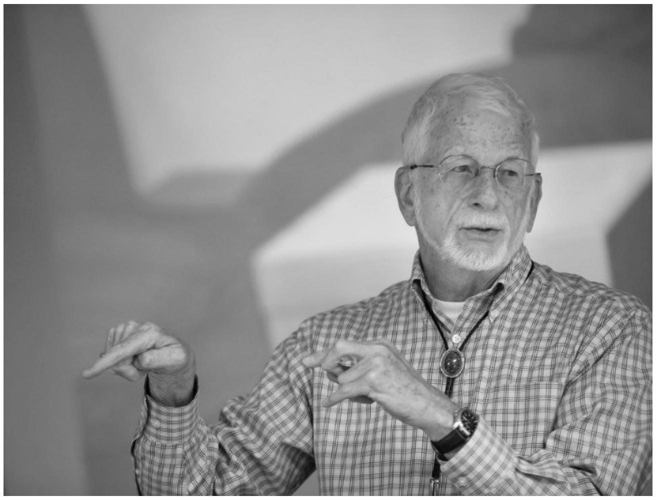
Another form of measurement used by at least 20 US States is the Genuine Progress Indicator, which results in a very telling story.



There are other attempts at better calibrating wellbeing, such as the Social Progress Index.

Entrepreneurs can be in the forefront of making changes to the way we do our evaluations of wellbeing and though these instruments are generally used by countries or states, the thinking that lies behind them can help the most progressive companies take a much more meaningful approach to the measurement of their benefits.

Will Keyser—a brief bio



A business founder devoted to other founders

Having started his first business over sixty years ago, Will has traveled many roads, and now at 77, he has just retired a second time—from seven years as an entrepreneurship and strategy teacher on an MBA program.

Will was born in the UK, grew up in the US, returned to England, left boarding school, worked on a French peasant farm, did military service in army intelligence in Germany, and dropped out of a French university. After sampling journalism and bookselling, he went to work in advertising and PR for a few years, before becoming a management consultant in the sixties.

He spent a couple of years as a British civil servant in national economic development, produced eight books on public enterprise in Europe. Returning to consulting and working with multinationals for a dozen years (in the UK, Sweden & Germany), he set up his own business with a partner in 1982, running it for 11 years before selling the business to its employees for one symbolic pound sterling.

Retiring, sort of, to the Mediterranean, Will became a new venture mentor (startups included an arboretum, a vacation rental firm), was on the board of a regional venture capital company, and he also ran a village radio station for a couple of years. He developed a business focused on the island where he made his home, built its website—to a number one, page one position on search engines—before selling it and moving back to the US.

Establishing Venture Founders ten years ago, Will has been mentoring many founders since then. They have included several startups by former students, and others including fashion retailing, green burial, fitness, hitech and clean power. He runs *Startup Owl*, the website for founders and writes extensively on entrepreneurship. *Founders Stay Afloat* was preceded by his earlier book on storytelling for startups (*Founders Are Storyetllers—Be convincing, wherever you are*).

For some idea of how he works with people, here are some comments from people with whom he has worked:

- Will has created detailed business plans on two different start up companies that are associated with my core real estate development business. Will jumps in and educates himself on all aspect of the new business and when he handed me the finished product, there were no details left out. Starting with an overview of the industry, who the competition is, the market potential, governance issues and requirements, the pros of moving forward, financial models, con's and risks, and more. He has been able to listen to me verbalize new ideas and concepts and then put them into words in a way investors and bankers understand.
- Will is brilliant and has so much to offer. He knows this material through and through, AND he wants YOU to figure out how to interact with it in your own way. Very admirable, but also challenging. He is 'a throw you in the deep end and you better learn to swim' kind of professor, but he is also always ready to help if needed.
- Will's high expectations drive students to greater levels of achievement. His no-nonsense approach, infused with humor and humility helped me start my urban farm.
- Will is very excited, very passionate about helping students start companies. He is highly-networked, always available and a great resource. I even asked him to be on my Board of Advisers for my start-up.
- You have been such a pleasure to work with and a steady voice for creativity and change and rigor. Frankly, it's hard to imagine the MBA without you. The experiential element of your course is a key component of the program, the place where the rubber hits the road in a pretty high stakes way.