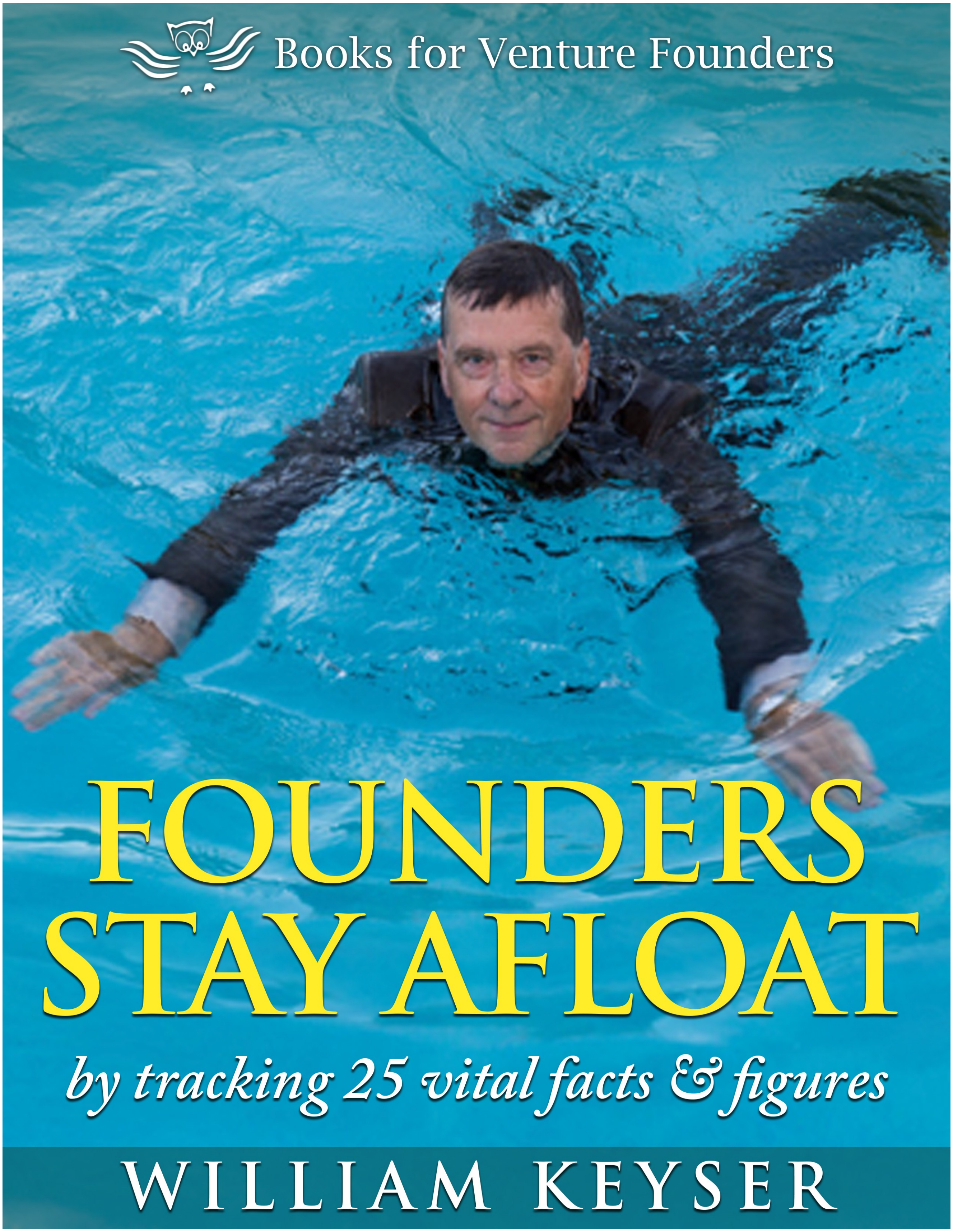
Books for Venture Founders



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.

Part One
What's To Be Expected?

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.

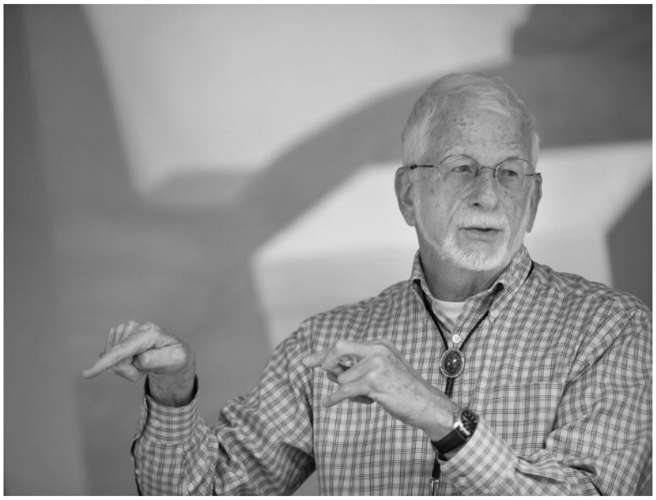
On the other hand, you can keep the annual plan as the fixed statement against which actual results can then be compared. Then, alongside that annual budget (if you have the staff to do the work!), you can re-forecast every month and enter all the actuals, to update the forecasts from that point. Each 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.

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.