Parables for Entrepreneurs

John D. Sanders

PARABLES FOR ENTREPRENEURS

Preface

This book has been written in response to the many people who have grown tired of hearing me tell these stories and examples to entrepreneurs, corporate management and investors. I heard, "Write them down so we don't have to listen to you." In putting this series of parables together, I had in mind expounding my philosophies of making companies attractive for outside capital-- why to do it, how to do it, when to do it, how to promote it and what to do with it.

Entrepreneurs should gain insight into what makes companies attractive for different types of investors at various stages in a company's growth.

I believe this book will also be useful to:

Seasoned management, to see how their policies should adapt to the changing needs of employees, suppliers, customers, bankers and investors with respect to capital needs.

Investors, to set standards for the management principles that would be attractive for their investments.

All, to understand the changing roles played by investment bankers, advisors, directors and investors with companies as the maturing process unfolds.

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I -- Introduction: Small is Beautiful

The beauty of working with small companies is that the people who are most involved with them have the same interests as outside investors. As long as the insiders are major shareholders, they have the most to gain from the company's long-term success. And if we outsiders can organize our investment so that we participate along with them, then we stand to share in their rewards. Therefore, we all think alike about the long-term future of the company.

This book will present what I consider simple but straight-forward philosophies gleaned during years of working with small companies. There have been a lot of winners and perhaps even more losers. (But, as you'll see, it doesn't take a numerical majority of small company winners to produce a jackpot for investors!)

Most of the books written about venture capital are technical in that they discuss such management mechanics as how to construct business plans, how to present specific facts, and how to write employment contracts. In this book, I'm going to discuss certain *philosophies* and how they can help organize companies, obtain financing, incentivize employees, achieve substantial growth and reap the maximum rewards from our equity investments.

I define a small company as one in which the top managers are still the major shareholders. Thus, their day-to-day and long-term management decisions are invariably compromises between making the most reward for themselves as management and maximizing the return for shareholders. As long as they as principal management are still major shareholders of the company, this conflict of interest helps to make these decisions.

As investors, we want to make sure management has this conflict of interest in deciding how to spend company money--whether it's for salaries, autos, luxurious quarters or R&D. Anything that makes life more commodious for management tends to hurt the shareholder's investment. By no means do we want management folks waiting tables at night to make ends meet. However, at no point should managers ever get the feeling their direct compensation will ever make them richer than the bundle they'd get by selling their equity.

Generally, the point at which that healthy conflict of interest begins to evaporate is at the $30 to $50 million (in annual sales) level. By that point, either the major shareholders have become wealthy enough that they've turned over much of the management to hired hands . . .

Or, they've sold out.

Over my more than 20 years in the brokerage and venture capital business, I reviewed thousands of venture capital proposals and met with the CEO's of hundreds of companies. You talk seriously with maybe one of twenty. Of those, you seriously investigate and have real feelings about putting together venture deals with perhaps only a very few.

The process followed is a lot like the sower Jesus talked about in the 13th chapter of Matthew.

And as he sowed, some seeds fell along the path, and the birds came and devoured them. Other seeds fell on rocky ground, where they had not much soil, and immediately sprang up, because they had no depth of soil, but when the sun rose they were scorched. Other seeds fell upon thorns, and the thorns grew up and choked them. Other seeds fell on good soil and brought forth good grain, some a hundred fold, some sixty, some thirty. He who has ears, let him hear.

Well, in truth the parable relates to the Kingdom of Heaven. But these ears also hear a message for capital ventures. Out of any ten investments, you'll have two or three that will fail and fold quickly. You'll have four or five that may return your seed money, but not much more. Yet, the odds are that at least one of your capital seedlings will take root in the soil of enlightened management and eventually produce a bumper crop year after year.

Why else, after all these years, do you suppose I keep shaking hands, reading proposals and raising capital for seedling companies?

My background is electrical engineering, including a bachelor's degree from the University of Louisville and both master's and Ph. D. degrees from Carnegie-Mellon University in Pittsburgh. During grad school I worked with RCA Research Labs in Princeton, NJ doing what was then pioneer work on superconducting computer memories. Other early career positions included General Electric and Southern Bell Telephone Co.

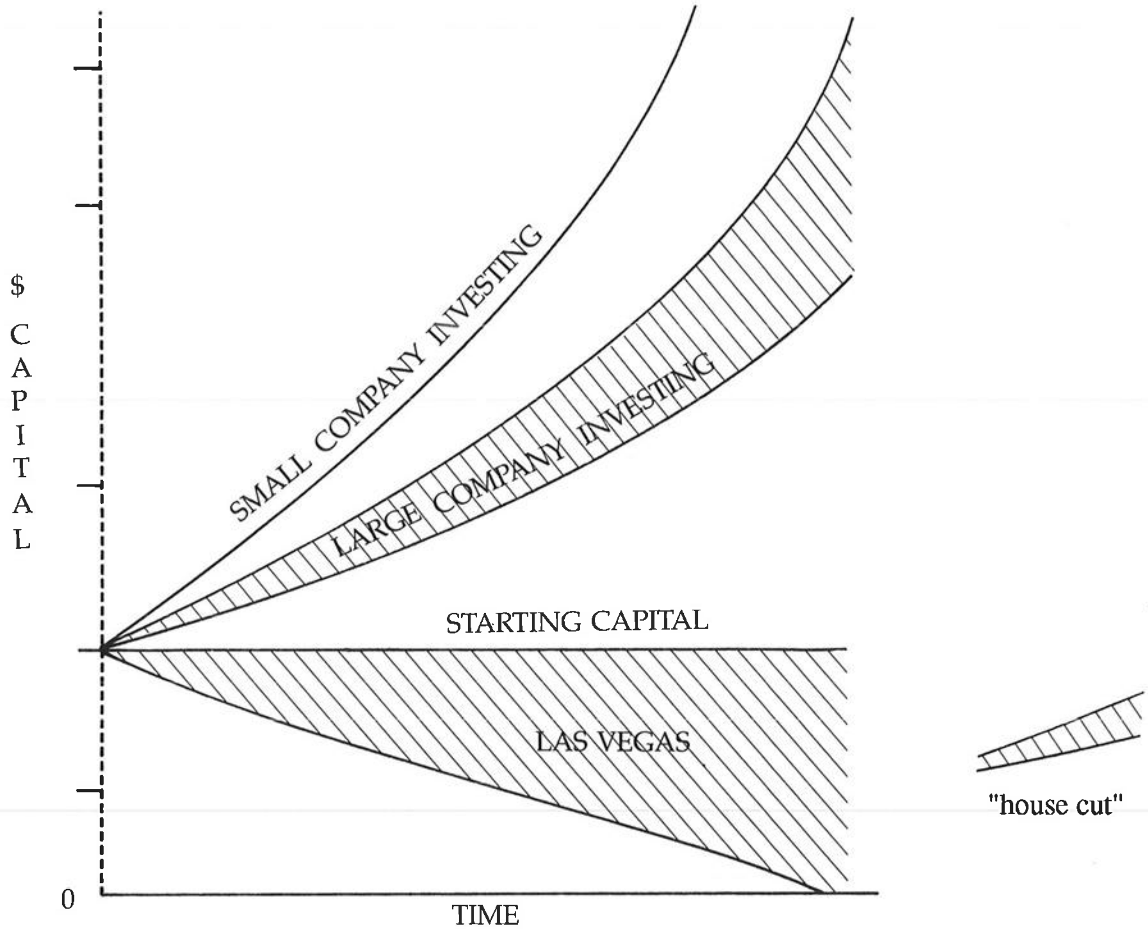
I came to Washington in 1964 and spent almost five years with the Central Intelligence Agency as a research officer-- much of that time spent fostering development of sophisticated communications equipment. During that period I learned that the most innovative work invariably was done by small companies in which key people used their best talents to get something accomplished when they felt they really wanted to do it.

In any case, in 1968 my interest in small companies converged with that of Sidney B. Wachtel. Sid owned Wachtel & Co., Inc., a stock brokerage and investment banking firm in Washington, specializing in investments in emerging growth companies. Before starting the firm in 1961, Sid had spent several years in brokerage positions with Laidlaw and Co. and A.T. Brod & Co. (both New York Stock Exchange member firms). Also, he had spent 11 distinguished years as an international financial economist for the Treasury Department, and a stint as chief statistician of the former U.S. Post Office Department.

Before plunging full-time into the investment world, Sid had been a highly active private investor with a special interest in new issues. How come? Well, I suspect he got bitten by the bug back in graduate school at New York University, where his major professor had a small mutual fund that invested in young technology stocks. That was in the late thirties.

As an investment banker with Wachtel & Co., Inc. for about 20 years, I looked for small companies with innovative managements, growth potential and capital gains prospects for investors. We generally received our compensation early in the game, with equity, and therefore put ourselves, as advisors, in the same position as the principal management, looking for major gains in equity. I'll discuss the investment banking business and methods of making money in the stock market in a later chapter.

I remain active in investment banking, and serve as a director and advisor to more than a dozen entrepreneurial corporations ranging in size from annual revenues of about $300,000 up to over $50 million. My major activities surround my position as Chairman and CEO of TechNews, Inc., publishers of *Washington Technology*, the newspaper presenting the news of technology as it affects business and jobs in the Capital region. TechNews also sponsors seminars, conferences, provides consulting for small companies, and publishes other definitive information on the business of technology.



The above chart plots the growth in absolute capital versus time. I've divided this into three basic curves. There is also a zero line, which represents the capital starting point. Then I show the growth in capital above or below this line based on various circumstances.

Let's start with what you could expect if you went to Las Vegas. Suppose you had a $500 stake and decided to plunk down $1 on each bet. One of your options would be to stand at the craps table and bet the "come" line, which pays $1 (even odds) each time you roll your desired number before tossing a seven or eleven. Another option would be to bet "hard fours" or "hard sixes," which pays around 7 to one (depending on the house).

Which is better? Actually, it almost doesn't matter, according to a theory tested with the rent money of many a gambler. Namely, since the house takes its cut on each bet, you'll wipe out your $500 *over roughly the same time span no matter what types of bets you pick.* Moreover, the faster you place bets, the faster you'll lose.

My point is that a similar theory applies to investors in large companies. It's my opinion that the growth curve, starting from our base capital, without any house cut, would show a rising slope, representing the *growth in the economy plus inflation.* Thus, a person investing in a broad range of the New York Stock Exchange issues should expect his invested capital over time to grow at the same rate as the overall economy plus inflation.

Given that the same information is available to all investors equally, it would be very difficult for someone to get ahead of someone else (except to be endowed with better judgment). But I have found that in general, you have *a lot of smart people dealing with the same information at the same time, trying to out-guess, or out-calculate, or out-analyze a lot of other equally smart people with the same information at the same time.* The result is: for every "winner," there is an equal and opposite loser. Granted, a winner or loser is defined by being above or below that growing curve, the curve with the positive slope, as opposed to the craps table flat line. But you still have to take into account that there remains a house cut: the broker's commission. And the more transactions you make, the greater your discount or differential below that base line is going to be.

Now let's relate all this to small company investing.

First, look at the maximum downside. The nice thing about losses is they never exceed 100% of your investment. Assuming you don't go on margin or use borrowed money, the most you can lose in any investment is what you put into it. Therefore, you build up the safety in this investment by making a number of these increments.

Now let's look at that terrific upside. It's virtually infinite compared to the downside! Therefore, a long-term investment in a small company is banking on the people in that company and their ability to gain market share. Rather than being limited by the growth of the economy or inflation, it's more a matter of how these people apply their talents.

Now what about comparing this analogy with New York Stock Exchange investing? *Do all small company investors have the same information at the same time? The answer is NO.* Small companies have limited exposure in the world. It's your ability to discover that company, to get in while the slope of that growth curve is still relatively low, and to be able to catch on to the growth of that momentum and the growth of the slope of that curve, that determines the success of your investment.

Furthermore, an investor in a company like this is in a position to use real judgment in the ability of management to do things better than the average growth of the economy and inflation. Once companies get extremely large, it's hard for management to buck the trend of the economy. Why? Because they *are* the economy.

Investments in small companies also tend to reduce substantially that cut taken by transaction fees. Since we're making long-term commitments, there aren't many transactions per unit of invested dollar.

In short, the economics in small company investment are such that the downside potential of 100% in any one investment, is offset by an upside that can be thousands of percents and tens of times the return on investment. The key is diversification to minimize your downside. The real upside is obtained, of course, by having the insight to get there in advance of other people, to be smarter than others in finding out what good management is and what good business is, and looking ahead as to how these things are going to grow, and then having the patience to be the long-term investor. This allows you to participate in the real, significant upward momentum of that company. It also minimizes the number of transactions, and therefore, in the long run greatly lessens the capital reduction from house cuts.

Let's outline those virtues again:

** diversification
** insight to get there early
** locating good growth business areas
** smarter in finding good management
** patience
** more patience.

Finally, it's hard to discount the real, personal pleasure in watching an investment of yours grow, to get to know the people utilizing that money, to feel you are participating in the growth of the economy and tangibly seeing the results of that investment.

III -- The Parable of the Talents (Matthew 25:14-30)

For the kingdom of heaven will be as when a man going on a journey called his servants and entrusted to them his property; to one he gave five talents, to another two, to another one, to each according to his ability. Then he went away. He who had received the five talents went at once and traded with them; and he made five talents more. So also, he who had the two talents made two talents more. But he who had received the one talent went and dug in the ground and hid his master's money.

Now after a long time the master of those servants came and settled accounts with them. And he who had received the five talents came forward, bringing five talents more, saying, 'Master, you delivered to me five talents; here I have made five talents more.' His master said to him, 'Well done, good and faithful servant; you have been faithful over a little, I will set you over much; enter into the joy of your master.' And he also who had the two talents came forward, saying, 'Master, you delivered to me two talents; here I have made two talents more.' His master said to him, 'Well done, good and faithful servant; you have been faithful over a little, I will set you over much; enter into the joy of your master.'

He also who had received the one talent came forward, saying, 'Master, I knew you to be a hard man, reaping where you did not sow, and gathering where you did not winnow; so I was afraid, and I went and hid your talent in the ground. Here you have what is yours.' But his master answered him, 'You wicked and slothful servant! You knew that I reap where I have not sowed, and gather where I have not winnowed! Then you ought to have invested my money with the bankers, and at my coming I should have received what was my own with interest.

So take the talent from him, and give it to him who has the ten talents. For to every one who has will more be given, and he will have abundance; but from him who has not, even what he has will be taken away. And cast the worthless servant into the outer darkness; there men will weep and gnash their teeth.'

This parable from the New Testament teaches me at least five lessons. The first is the master made his own choice of which three servants to test. He obviously chose these from among many servants, because at the end of the story he comes back and calls on the others to do something. I interpret this to mean: *there is no inalienable right to venture capital.* Rather, the choice is subject to the judgment and opinions of whoever provides the venture capital. There's nothing that says everyone is entitled to a grubstake.

My second point is that each of these servants was given *capital according to his abilities.* That is, the master made his own subjective decision as to how much each could manage. It was his job to give each steward an appropriate sum-- one that would be challenging but not overwhelming. Remember also, the master (venture investor) was tough and expected to reap his rewards (capital gains) from their efforts even where he hadn't sowed.

Third: Regardless of the initial capital, the profitable investment was rewarded with significant increases, that is, when the two talent man came back and returned two more, the master brought him into the "Kingdom" and made him president of his Camel Caravan Transport Co. In fact, the "twosey" and the "fivesey," as best we can determine, were each given substantial rewards. Thus: *The amount of capital you start with is not a major determinant of your reward.* It's what you do with the amount that's entrusted to you. Therefore, there is some reason to believe that you shouldn't start with too much; because if you start with too much, you can't prove you know how to take money and multiply it.

Fourth point: The New Testament seems to state that *failure is not necessarily the loss of capital, but a lack of effort to increase it.* Indeed, from my perspective as a venture capitalist, the worst situations are ones in which the management meets with a measure of success and then says, "Well, we've gone far enough. Let's not risk what we've gained." This is *really* the worst case. In fact, the entrepreneur who doesn't use his resources or his talents is thrown out of the Kingdom. He also undergoes "weeping and gnashing of teeth," which is caused, I suspect, from seeing his most ambitious managers quit and the price of his stock plummet.

Fifth: I wonder what Jesus would say about the man who tried and lost. Would he give the man another chance? If so, to what extent? It's very difficult for a person who's lost money to acquire a grubstake to start all over again. It's certainly very difficult for me to give that person money. He almost has to earn that starting money himself and prove he deserves another chance.

There's a sixth lesson from the parable of the talents, but I'm leaving it for the last chapter.

IV--Purpose of Parables - (Mark 4:10-14)

And when he was alone, they that were about him with the twelve asked of him the parable. And he said unto them, Unto you it is given to know the mystery of the kingdom of God: but unto them that are without, all these things are done in parables: That seeing they may see, and not perceive; and hearing they may hear, and not understand; lest at any time they should be converted, and their sins should be forgiven them. And he said unto them, Know ye not this parable? and how then will ye know all parables? The sower soweth the word . . .

Now please don't think that I am comparing myself with the Almighty. These verses are Jesus' preamble to the verses previously quoted from Matthew in my introduction about the sower; and, there is a point I want to get across as you read further. It's much like the use of hypotheses when we studied plain geometry in high school. Based upon knowledge and experience, a theorem is hypothesized that is subsequently proved by accepted fundamentals and previously proved theorems.

With the use of parables and stories in this book, a person who has a basic agreement with my overall philosophy of business and entrepreneurship will nod his head in agreement with the statements, and, hopefully, gain some real understanding of the business principles. However, a reader who refuses to believe the basic philosophies of the parable teller will scoff at the stories as little more than nonsense or funny conundrums.

In conclusion, I've developed some basic philosophies of business and use these parables to explain them. If you're interested and tend to agree with them, read on; I believe you'll gain some real insights into growing a strong and successful business. If you *don't* like hard work, striving to get ahead, trusting your cohorts and business partners, enjoying the fruits of your labor, etc. - - - then, don't waste your time with me.

V -- The Parking Lot Theory

My parking lot theory has its roots as follows: You are sitting and talking with a casual acquaintance. Just when that person gets up to leave, he says, "Gee, I don't seem to have any cash. Can you lend me $5 to get out of the parking lot?"

Why not? I'd be likely to do so for three reasons:

1. $5 is certainly within my impulse range of investing money and testing his honesty. It takes very little thought and very little justification.

2. It's a reasonable request for a necessary activity.

3. From his standpoint, it's a very good opportunity to endear himself to me by returning the fiver with a thank you note or even a tray of his wife's famous chocolate chip cookies.

But suppose the request is "Oh, would you lend me 20 bucks to get out of the parking lot?" Two things have occurred. First, $20 is out of my impulse range for testing a person's honesty. Five dollars is within it. Twenty dollars has gone beyond it.

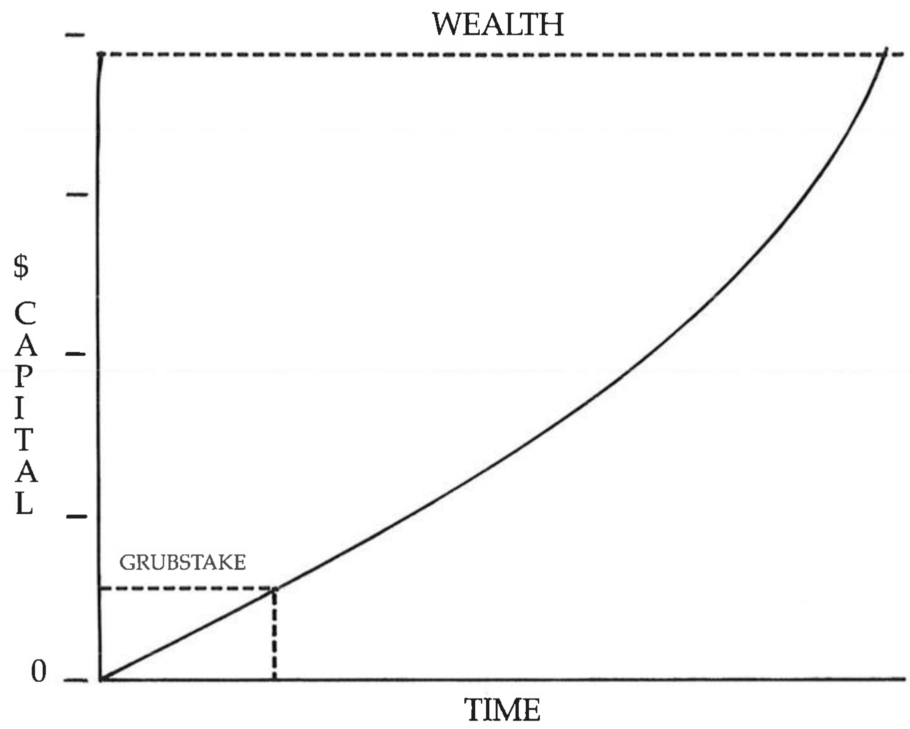
The second and possibly more important difference is that now I need a business plan. "Why does this guy need $20 to get out of the parking lot?" I need to know what he's going to do, what he'll do with the extra money, and whether his request corresponds reasonably with his needs.

The parking lot theory applies to venture capital in two ways.

First, keep the request for money within the impulse range of the potential investors. Study the market of investors from which your money will come. See what sum might fit the range of their pocketbooks and their normal investments and keep your request within that range.

Second, make sure you have a logical use of the proceeds so your investor doesn't have to waste time second-guessing your plans. Make him comfortable that what you're going to do makes sense.

VI -- The Ray Kroc Curve



This curve is a plot of dollars of "capital," or wealth, in the ordinate, versus "time" on the abscissa. It shows how the growth of capital of any particular person or organization will rise over time toward its level of wealth.

One theory of venture capital I subscribe to states that individuals or organizations destined to be wealthy will become so regardless of their initial level of capitalization. The only virtue of outside capital is to shorten the timespan in reaching success.

Many successful entrepreneurs did in fact earn their original capital, meaning that they started out broke. I call this the Ray Kroc Curve because the major domo behind the McDonald's hamburger chain started out with no capital.

Kroc, in fact, was a milkshake machine salesman. When he heard of a hamburger and shake operation that was so busy it needed a multiple shake machine, he decided to investigate these "movers and shakers" for himself. Kroc raised enough to buy into McDonald's, not by seeing a venture capitalist, but by redoubling his shake machine sales until he generated a capital surplus. As the original restaurant became a chain and became successful, raising the outside capital became easier-- *after* he had proved his performance.

Moral: Entrepreneurs like this can obtain the original capital just by working harder and earning it. An original grubstake, at best, only serves to compress the Ray Kroc Curve into a shorter time frame.

But let's face it: Some ventures *do* require large initial capital. This may apply to the entrepreneur who must buy large fixed assets-- or conduct extensive R & D prior to marketing the product-- or launch a major advertising program in order to educate and titillate buyers.

Getting that early grubstake and compressing the time curve can be a fragile process, as was already shown by the parable of the talents. That is, *the amount of capital invested should be no more than the entrepreneur can prudently use. In fact, too large a grubstake can cause the company to bypass the disciplines developed in going through that part of the curve.*

A number of years ago, I helped capitalize a small company that vowed to corner the Washington, DC market for bagels. And by golly, they did. Soon after going public at $2 a share, the price shot up to $7. Having captured 100% of a local market, the principals stroked their chins and asked themselves what they could do to increase sales. Solution: Instead of selling bagels for 15 cents each through retail groceries, why not start a chain of restaurants that could sell bagels for $1 each (when adorned with various spreads and sauces)? Awash with capital, the bagel boys soon committed themselves to four restaurant locations before the first one was even open. When it did, it was to the tune of a $15,000 "coming out" party.

"Fantastic," wrote the local reviewers, egged on by expensive PR people.

Well, it certainly was fantastic to the extent that anyone who announces he's having a party with free food and champagne can expect a marvelous turnout. But within six months, this overcapitalized, underexperienced, overambitious business had blown away like some of the seeds sown in our first parable. *Other seeds fell on rocky ground, where they had not much soil, and immediately sprang up, because they had no depth of soil, but when the sun rose they were scorched.*

I got burned, too.

One final question: Why should a venture capitalist want to grubstake a success-destined person if the latter would be better off earning his own capital at the beginning? Simply this: It's better to buy a portion of that growth curve before it becomes obviously headed in the direction of wealth. Only when the slope becomes easily predictable does Wall Street realize that your "find" is destined to be a Ray Kroc.

Since all the curves look the same at the beginning, the difficult part for the venture investor is to try to determine whether this entrepreneur is a "Kroc" -- or a crock!

VII-- The Stagecoach Race

Suppose you and I were about to place our bets on a stagecoach race. Chances are, we'd go out and examine each team of horses. We'd have an eye for the strongest-- snorting, chomping at the bit, aggressive and feisty.

Truth is, those traits don't necessarily *make* the winning team. The winning team must certainly combine speed, endurance and teamwork. However, the controlling factor is *discipline* to run the race without burning out.

Where does that discipline come from? It comes from one of two places. The first is when the driver uses the reins to control aggressiveness-- to peak the horses at their maximum, combining effective teamwork and endurance to win the race. Or, second, it comes from an experienced team which has run races and worked together over a long period. The reins aren't really needed-- maybe only a command or two from the driver.

In business, we look for the same kind of combination: ability, desire to succeed, teamwork and the discipline to control the growth so as to maximize the effect of those abilities.

But in the beginning, before the experience of the team begins to pay off, how is the business controlled? By the reins-- which are the proper applications of capital. It's the investment banker's (or Board of Directors', or commercial banker's, or advisors') job to control the reins by controlling the capital (doling out one, two or five talents) until the team is running smoothly.

Watch out for the banker (or broker) who wants to shove more money on you-- he's really just dropping the reins. It can come back to haunt you if the balance sheet gets top heavy with debt: you and your team will appear tired just when the tough uphill part of the race arrives.

As a corollary, though, it sure is better to have to hold the reins on a hard charging horse than to have to beat a dead one.

VIII -- The Spreadsheet Philosophy

VisiCalc . . . Multiplan . . . SuperCalc. Whatever the software name, the electronic spreadsheet has done for entrepreneurial planners what the invention of carbon paper did for the careers of bureaucrats. Just plug in a column of basic assumptions, push a button, and you can see your scheme tallied across a hundred or more columns extending into the next century.

The only problem is that incorrect assumptions can also be multiplied so that you run into oblivion long before you hit the next year.

Unfortunately, that's what happens all too often. Why? The spreadsheet planner calculates capital requirements based on needs rather than realities.

Typical is Harry Kerry, who wants to launch a chain of spinach pizza parlors. He figures that three would be a nice initial number of outlets to start with. He enters a column for food, labor and other expenses, then hits the "replicate" button and watches the tallies fall into place for future fiscal years.

At some point along the way the spreadsheet will show the maximum negative cash flow the business can expect to encounter at any one point. "Aha!" says Harry, "that's how much capital I'll need."

Not necessarily so. My philosophy is that the entrepreneur starts his assumptions with *the most realistic amount of capital he can expect to raise.*

What's that? There's no way you can launch your steel mill on less than $20 million? I agree-- steel mills are expensive propositions. But that's not *my* problem! Don't come to me unless you've proven that you know how to make money when given the chance to work with capital of that magnitude.

Harry Kerry, for example, may be a fellow whose experience and fund raising connections indicate a capital "comfort zone" of around $150,000. If so, I'd want Harry to return to that spreadsheet and, in effect, design the point at which his maximum negative cash flow hits $150,000. From there, he'll work *backwards* until he finds the level of magnitude on which to begin operations. And then, he'll go forward to find the level of profits he can expect to produce at the other end of the spectrum.

Leave wish lists to kids at Christmas time. Your goal is to prove that you know how to take capital and make money with it.

IX -- Know Where the Stumps Are

Then there was the time when the Sunday School teacher had finished telling his class of seven-year olds the story about Jesus walking on the water.

"Can anyone tell me how Jesus managed to do this?" the teacher asked innocently.

"Sure," said one of the charges without hesitating. "He knew where all the stumps were!"

This is no place for theological debate, but there's a message nonetheless for small startup businesses.

One of the things I did the other day was read a prospectus from a fledgling company that wants the public to kick in $2 million so that it can develop a new type of medical catheter. The idea and business plan seemed plausible enough until I got to page 24 of the prospectus. There, under the Management section, it stated that the most recent position held by the founder and CEO was that of salesman for a wholesale food distributor.

Come, let us reason together. If you would like me to raise capital from people who trust me so that you can start an electronics company, you should have a working knowledge of the technology. Or have some experience beyond owning a TV set. And if you'd like to open a Mexican restaurant, we would hope that you might have managed one. Or at least have a titillating recipe for nachos.

Obviously, investors themselves will know very little about your intended business. If you show no indication of being able to solve management problems, who will? *We investors want to be sure you know where the stumps are*. If you can walk on water without them, don't call me, I'll call you!

X -- The 3 db Effect

One of the first equations an electronics student learns is 10 x log10. One of the conclusions it leads to is that three decibels (db) creates a factor of two. Thus, if you add just three db to an audio speaker's output, you *double* its power, whether you're going from 10 to 13 db or from 60 to 63 db.

The analogy applies to many entrepreneurs. Too many have a rivetted fixation on retaining 100% of their enterprise's ownership-- even when that business is no more than a symphony of numbers on a spreadsheet.

Well, folks, 100% of nothing is still nothing. Now consider the 3 db effect. The owner who relinquishes even half of his/her ownership does so by only a factor of two. A *one-time* factor. But the gains from the one-time decision can come in *infinite multiples* and for an *indefinite period of time*. If you're shooting for 80 db of capital gain, you'll never notice that you only got 77 db. And without giving up that 3 db of ownership early in the company's history, you'd never have gotten going at all.

The major control in a company rests with whoever brings in the sales and whoever carries out good management-- not the amount of stock you own. Having outside equity investors also allows total ownership to spread and actually give you more control of management. Why? Because when you're doing a good job, you have tremendous support from those outside investors.

At the same time, however, I do believe that founders should retain majority ownership in start-up situations. To assume proper motivation and momentum, it *must be their company in the beginning*. Thus, the capital they raise from outsiders should be in an amount that lets them retain that larger share. But don't be so greedy or self-centered as to think that total ownership is more important than getting enough capital to prove that you know how to make your dreams come true.

XI - - The Zero Capital Budget

Thanks largely to my fellow engineer, former President Jimmy Carter, most of us have heard of the term *zero-based budgeting*. The concept: one doesn't necessarily use last year's budget as the foundation for next year's projections. Rather, each line item *should be evaluated and justified as if it were starting from ground zero.*

I believe the same formula should be applied to a company's capital needs. That is, *it's a vital and healthy exercise to prepare a budget as if the company will never receive another nickel of outside capital.*

Why? First, it helps us remember that no matter how lofty and worthy our goals for growth, the primary objective of any company is simply to survive.

Second, the exercise hopefully will help you prove to outside investors what they want most to hear. Namely, that *you really don't need their money to survive.* Neither I nor any investor wants to hear that you need our money in order to meet your next payroll or pay Uncle Sam back taxes. We want to build mountains, not fill in holes! By showing us that you can survive without us, we gain confidence that our money will only help you grow and improve existing profit margins.

Third, the exercise helps pinpoint just how much capital it will take to accomplish those growth goals. I usually advise clients to pick levels of new capital and then recalculate the changes from the zero-based budget. It might be starting with a hypothetical infusion of as little as $5,000, then gradually boosting the capital increments until you reach the most optimum bang for the buck.

Of the above, the most important benefit of the zero-based capital budget is in allowing the entrepreneur to measure quantitatively the value of receiving the outside capital versus operating on a no-capital survival budget. The same procedure allows the outside investor to see just how much good his capital will create. Thus, *each party better perceives his/her value to the other.*

XII -- Aunt Suzy . . . Bless Her Heart

In the initial capital phase of a company, capital generally comes from three sources. The first is people who know the entrepreneur and say, "Hey, this guy is pretty good, I'll put money in him. What he's doing seems to be within the realm of what he can accomplish."

The second source is people or organizations who really understand the product or the service and feel that the entrepreneur is sufficiently qualified and motivated to be profitable selling or producing that product or that service.

The third source, of course, is independent investors who are neither particularly familiar with the entrepreneur or the product or service.

The easiest sources are those who really don't question value. Your wealthy Aunt Suzy or your mother are the best candidates. Next are your associates. Some may simply hanker to be associated with a winner. Others may hope to be offered a job in the event the venture succeeds. Most important, they're willing to invest simply because you asked, because they like you and because they trust you.

I generally have tried to form a group of early investors in a company who will include many of these friends of the entrepreneur or close or former associates-- what I call the "Aunt Suzies." The entrepreneur can bring this money in because he's willing to put his reputation on the line. And because these people come in, it's that much easier to bring outside investors in.

Now, the people who really understand the product or the service often become interested in a deal because they feel that they can be involved in it. They might be more serious about the value, in actually what percentage of the company they get for what price than might the Aunt Suzies, but they will certainly be attracted by some formal association that might be with the company. Being on a board of directors, being on an advisory board, making some contacts for the investor, maybe even getting a small consulting contract, and other ties allow them to feel that they're not just making an investment, but are really helping to move the venture forward.

Moreover, the company can be greatly helped if it seeks out this resource. People who have $5,000 invested in a company will answer a call from the entrepreneur. They'll be delighted to respond to some request from this entrepreneur to help their five grand move forward.

Now then, if we're going to utilize both the Aunt Suzies and the talent-sharing investor in the company's initial formation, of what value is the outside investment banker or advisor?

Glad you asked. The investment banker-advisor helps the company assure the best possible relationship among the founders. It is important that the various value levels be set properly so that everybody gets the right kind of deal. The formal association of investment banker gives the credibility to the structure and to the purpose of the company and makes it more of a formal relationship. This helps the entrepreneur when he goes to Aunt Suzy in that there's an outside "stamp of approval" on the deal.

It also helps in talking with potential investors. Their natural question, whether they ask it or not, is "How do we ever get out of this deal? This might be nice to help you get the thing going, and we want to be a part of it. But even if it becomes profitable, how are we ever going to get our return?" It is important to maintain a close association with someone or an organization who keep their eyes on the goal of maximizing the capital gain for outside investors-- with the straight-forward end result that everybody is shooting to make money and to sell out at some point, either to the public or to other investors, or to another company.

Now, why would outside investors go into a deal like this? Well, they must agree on the value and the potential of the company, the overall formation of the deal, and that the whole thing makes sense. They invest because the friends and relatives invest, who invest because the outsiders invest, all of whom invest because *the founders are committed to the success of the company for the benefit of the shareholders.*

XIII -- Only the Pope Could Finance the Sistine Chapel

Can't you imagine Michelangelo lying on his back painting that fresco upon the ceiling of the Sistine Chapel in the Vatican? It took him a long time-- probably much longer than either he or the Pope imagined-- to complete the project. I bet Pope Julius finally came into the Chapel one working day and told Mike, "Either complete this project by August 30 or there are no more paydays." Probably one corner of the ceiling has less detail than the rest of the work, as Michelangelo worked to complete the contract by the absolute deadline date.

Management and investors have to be on guard for development projects that become Sistine Chapels-- where the software developer or electronics circuit designer must make it perfect, and completion always seems to be just around the corner. The costs to complete can mount totally out of proportion to estimates. There must be benchmarks to manage against so that progress can be kept within budget or measured as soon as possible in the marketplace.

My primary advice is to *not* begin development projects until there is already a strong positive cash flow in the company sufficient to carry the project to a useable completion. Don't run out of money with 95% of the project completed. We investors have seen a legion of deals where: "We're only 5% away from a marketable program." That last 5% can take forever, and there still aren't any market tests or operating statements to judge management by.

Therefore, if you want capital to carry out a development project, either

** finance it using a part of the positive cash flow from the rest of your operations,

** snuggle up to a rich sugar daddy,

** or, align yourself with the Pope.

Don't come to me!

XIV -- Valuing the Back Forty

I'm a land baron down in Buckingham County, Virginia. Well, kind of. My acreage consists pretty much of dirt and trees. And it isn't exactly located in a hub of world commerce. In fact, sometimes I wonder whatever possessed me to buy it in the first place.

Should I ever attempt to place a formal value on my dominions, I would of course summon a battery of appraisers. To each one I could present a handsome land utilization projection showing soil acidity and estimates of corn and wheat crop harvests depending on average temperature and rainfall. Then, I would produce computer printouts showing profits from the houses and apartments I intend to add. Finally, I would show the price I would charge to the developer who would own the shopping center that would be necessary to serve this growing community.

Wow! From baron to billionaire in the time it takes me to go from Column A to Column Z on my spreadsheet.

The only reason I haven't gotten an appraisal is that I'm afraid one of the darned appraisers would have the audacity to ask what similar properties in the area are selling for. When he finds they're in the $400 to $600 per acre range, he'd probably settle on about $500.

But wait a minute . . . I could be lucky! Ah yes. One of my appraisers brings his wife. She calls him aside. "George," she says, "remember that hunk of land just like this that we looked at last year just outside the city? The other day it sold for $2,500 an acre. Let's grab this one before he changes his mind!"

In fact, the latter *does* happen sometimes. An entrepreneur comes along at the right time and has investors flocking to buy into a pie-in-the-sky idea. Yes, it happens a hundred times a year in a good market when unsophisticated (and sometimes "sophisticated") investors are riding the escalator to euphoria and the entrepreneur's birth sign is positioned just between Venus and the third notch in Orion's Belt.

But here's what's wrong with it. First, the odds against it happening are too great to spend your limited time and resources looking for it. Second, such deals carry a great risk of skullduggery. Third, the expectations of the investors place a heavy burden for fast performance upon management. And, fourth, quick climbs up the roller coaster often result in hair-raising plunges.

Truth is, it makes great sense to base value on reality and build it from the ground up.

Let's look at it first from the investor's viewpoint. Why should he choose an investment carefully, watch it become successful, then still fail to realize a proper return on capital because he overpaid greatly in the first place?

Now from your standpoint: One of your greatest concerns will be to get proper additional financing as the company matures. Each successive financing should be done at a higher valuation level than the previous one. This means that time must elapse for the company to acquire a history, and that significant additions to net worth must be documented.

So let's return to that $500-per-acre property. How can I truly increase its value? By placing improvements on the land, of course. Very soon the value of the property begins to be determined primarily by the value of the corn crop I grow on it or the rent from that first house. Ere long I'll have what's called a "mature" property in which the value is determined almost exclusively by revenues and profits. If you ever go to buy an office building, for example, you'll find that the value is invariably determined by the rentals, percentage of occupancy, maintenance costs and quality of leases. The land is very secondary.

The land is your business idea. Sure, it's worth something. But you've got to build on it to achieve real value.

XV -- Marry Your Best Friend

When you hire a realtor to lease your office space, you may get along so well that you'll engage her again for other property transactions. The point, however, is that each episode has a beginning and end, just as when a lawyer handles a lawsuit or you buy tickets through a travel agent.

But not so when you engage an investment banker, board member or venture advisor, or even possibly your commercial banker. There is no clearcut beginning and end. The relationship itself is seldom circumscribed and may indeed be so broad as to range from capital raising to shareholder relations to advice on hiring key executives.

And so, getting acquainted before you link forces may be even more important than the courtship period before marriage. Shocking? Well, consider that bad marriages can be ended by divorce and even the best marriages last only for life. Entrepreneurs, investment bankers and early equity advisors can become entwined in equity sharing arrangements that can endure well beyond their respective lifetimes.

The courtship, in your case, can help answer three vital questions:

1. How good is the investment banker's reputation and track record? Recently the head of a fledgling computer software firm came to me on the rebound with a sad tale. Seems that he had needed $250,000 for the startup. He was put in touch with a venture capitalist. The latter heard his story and quickly agreed to raise the $250,000 from public investors in exchange for 30% of the business.

The venture capitalist was true to his word. But soon afterwards the entrepreneur found himself embroiled in complaints from the SEC and state regulatory agencies that the venture capitalist-- by now his co-officer-- had violated a smorgasbord of disclosure and blue sky laws.

Problem: The $250,000 had since been spent for its intended purposes and the company now faces staggering legal defense costs. He wants to know if I can help-- I can only sit and wait for the chips to fall.

2. Do you share the same business philosophy? No, you don't want a clone of yourself (more on that below), but you should agree on certain basic tenets. Equally important, you should share a common vision for the future of your company.

3. How closely and clearly do you communicate? There's no question that you and your directors and/or investment advisor will disagree often on the techniques and timing to be employed in reaching your mutual goals. That's healthy because disagreement can sharpen positions and flush out alternatives. Moreover, it's their role to keep their eyes on the forest (while you labor among the trees) and to examine your positions with the cool dispatch of a Wall Street analyst. When your advisor yawns and yeses you incessantly, it's time to *criticize his performance.*

How come I named this chapter "Marry Your Best Friend?" Well, I meant simply that all the above objectives can be achieved more handily and happily if you really like all your early associates in a business-- especially those with whom you make equity deals for long term association. Hopefully, you'll become best friends as you share the same visions and struggles together down the road of achievement. If you do, I assure you that the journey to success will be a lot more fun.

XVI -- Halitosis Is Better Than No Breath At All

Management really means weighing decisions. Good management eventually rises to the surface (sometimes the limelight) for its ability to make more right decisions than wrong decisions, or to at least make a few brilliant decisions.

Sometimes decisions have to made that turn out to be the "lesser of two evils." That's what I mean by the above title: sometimes the choices that management has to make have no immediate good result, but are certainly better than the alternative.

One of the most crucial decisions is whether or not to seek outside capital. With the acceptance of capital come responsibilities. Basically, it requires giving up something. Insurance always costs, and the availability of capital is an insurance that gives the company greater financial resources. In essence, part of the profits, their percentage ownership of the company, is always there for those investors. The management must report to investors. It certainly limits the freedom of decision; you always have someone looking over your shoulder or needing a report on what's going on. Also, management must spend time promoting their performance, not only to investors, but also to the outside world in order to make themselves attractive.

In many of my discussions with entrepreneurs, I find that they seem to think that because they have something great going, everybody is going to want to jump on their bandwagon. And when I start discussing these responsibilities of management, primarily focusing initially on that percentage of the company going to those outside investors, the so-called 'giving up a part of my company,' is probably the most distasteful. Most of the time, I find myself summing up hours of give-and-take by saying, "Well, either you need the capital, or you don't need the capital. If you need the capital, this is the best way to get it. And halitosis is better than no breath at all."

Capital with its responsibilities is better than no capital at all.

XVII -- KISS

The title KISS comes from the axiom, "Keep It Simple, Stupid!"

There are two ends to the capital spectrum. One end is straight equity-- common stock for cash. This represents the investor's total trust in the entrepreneur: "Here's two talents, go do what you need to do. Come back and report to me and give me an appropriate piece of your profits and rewards."

The other end of the spectrum is what I would consider a straight loan, in which, in effect, there is no trust. It's either total collateral or absolute security or an experience factor which indicates that there is no risk involved. And there, the cost of the loan is the lender's cost of money, plus his rental fee on the use of the money. And, he expects to get his money back with this rent factor on it.

Anything in between those two ends of the financing spectrum tends to get very complicated. Corporate financial organization, in my opinion, should be kept extremely simple. Early in a company's history, deviating from either straight equity, at one end of the spectrum, or a straight loan, at the other, can set off a chain of conflict and complication.

For example, some people think the convertible debenture combines the best of both worlds because it's a loan that can be converted to equity. To my mind, it can be the worst of both worlds early in a company's life. If the company is reasonably successful, the lender is going to get an equity participation. Yet, he'll also get interest on his equity capital early-on, when the company needs all of its money. By the same token, when you write a lending document, you begin to tie up all sorts of corporate assets. And even though it's a lending instrument at the time, with an equity consideration, it restricts a company's ability to obtain additional capital at a later time should the company run into trouble.

I would only use debt early in a company's history to finance sure things such as equipment and good accounts receivable or fast-moving inventory. Vendor credit would be considered much the same way, although it's one step lower on the pecking order when any kind of trouble arises. There's plenty of time in later financings for such gimmicks as warrants, convertible debt and multiple classes of stock.

One thing especially to stay away from is any kind of early debt which also takes away all of the company's reserve capital. I have been approached at times by entrepreneurs who received an early Small Business Administration loan, and I find that although this appeared to be inexpensive money when it was granted, it ties up every bit of the entrepreneur's reserve capacity. Then when that critical point comes early in the history of the company when the entrepreneur should be able to financially express his confidence in the future, he can't-- and also there is no room for the next person to come in and participate. All phases of the company business and the personal assets of the entrepreneur are so tied up that there is no maneuvering room to balance for the errors.

XVIII -- Members of the Bored?

In my opinion, directors in small companies have three main purposes. One is to provide a sounding board for management. This allows management to go periodically to persons close enough to the company to be informed, but not so close that their overview is blurred by the daily activities and management decisions. As I mentioned earlier, they can define the forest while management is dealing with the trees. Thus, management can draw its plans and questions together, present them to the board of directors and get opinions about what ought to be done.

The second major purpose of the board of directors is to bring credibility to the company's image. To the extent that an entrepreneurial company can get respected people on its board of directors, it can often gain immediate credibility in a market that might otherwise be difficult to penetrate. At the same time, you gain both attention and added respect from bankers, customers and employees. All this, in turn, generates momentum and propels you toward those profit goals at a faster pace than you would have traveled when relying wholly on the successful performance of the business.

Thirdly, these outside directors provide a direction for long-term goals. Listen to them. Their advice is important for gauging what people on the "outside" want to invest in.

One of the early mistakes of some small companies is to make a board position a reward for management activities. In no way should the board of directors give the appearance that membership is a special privilege for insiders. It loses its value as a sounding board if dominated from the inside. It tends to be more like an extension of the Friday afternoon get-together to discuss management problems instead of being a fixed focal point for management to draw conclusions and to pull itself together to present its image to the outside.

If membership on the board becomes a reward for management, it will also tend to create friction *within* management. I truly believe the best course is to include only the president or a second partner who is really an equal or obvious heir-apparent. Others can certainly be brought in to attend meetings and to present various management reports, but the president, his partner, or an heir-apparent should be the only insiders officially on the board. Another reason to avoid loading the board with insiders is that it is constantly creates the image that the company is being run for the benefit of management and not for the benefit of the stockholders.

Here are some other tips for maximizing your use of this valuable resource:

* The directors who serve initially really do so from a desire to help the company. Don't ignore the outside directors. They want to be a part of a winning combination, of a team that is going to grow. I've found that in most cases they're eager to help you make business contacts, help find good personnel, and help resolve internal conflicts.

* I believe that regular meetings are important. A quarterly meeting is perhaps best because enough time passes that strategic events have occurred. Monthly meetings tend to become so routine they fail to generate sufficient preparation by either management or board members.

* Don't fail to keep members informed as to ongoing problems. A board that learns everything after the fact tends to feel it's become a teacher grading a test instead of a strategic planning body. A board can't hope to contribute to a solution if it isn't kept up on what's happening.

* Don't overlook board members as investors. I've found that many will put up some money in a pinch-- *if they've been kept informed.* Should a crunch occur, directors may feel obligated to contribute cash to its solution, if they believe they helped create the problem, or let it happen.

* Take advantage of each member's professional skills. If they are part of another company, they can provide resources of their company to help out in a tight situation.

* Hold surprises, both good and bad, to a minimum at meetings. If, in fact, there are real problems coming up at a meeting, or significant pluses, let the directors know in advance. Don't bring them to a meeting and then say, "Have I got some good news for you!" (They'll start waiting for the other shoe to drop.) These meetings are not surprise meetings. These are working sessions. Thus, planning should be done both on the inside and the outside.

XIX -- Shake the Dust From Your Feet

The small company must identify itself in the marketplace-- competing either against the big boys, established products, or just to get started producing revenues. Until your reputation for quality performance begins to dominate your marketing story, breaking into new market areas or selling new products or services is difficult at best. The most under- estimated costs in any business plan almost always turns out to be marketing expenses.

In reality, the only customers that truly produce profitable business are repeat customers. Getting these people the first time is expensive.

If that is true, then how does a small company break into the market? How does the small company compete with established companies or products? First of all, go to where your reputation is already known. That is why investors placed their confidence in you. That would be why new customers would place their confidence in you. Then, of course, do what you promise, when you promise it, and at the cost you promise!

OK. So we make our first sales to our friends and former customers. Now what? We must embark into the real world. We have begun to build that customer list, and now have a story we believe in, and for which the world "should beat a path to our door." Guess what? No one is knocking at the portal.

The truly most cost effective route to capture early revenues is shoe leather and the telephone. Here's the marketing plan that Jesus put forth in Luke 9:1-6 to his new sales force in presenting the new product line:

Jesus called the twelve disciples together and gave them power and authority to drive out all demons and to cure diseases. Then he sent them out to preach the Kingdom of God and to heal the sick, after saying to them, "Take nothing with you for the trip: no walking stick, no beggar's bag, no food, no money, not even an extra shirt. Wherever you are welcomed, stay in the same house until you leave that town; wherever people don't welcome you, leave that town and shake the dust off your feet as a warning to them." The disciples left and traveled through all the villages, preaching the Good News and healing people everywhere.

Now that's a coach with confidence in what he's selling! Give your disciples the power to drive out the demons of poor quality and non-performance and cure the diseases of inefficiency and lethargy. It's a big world out there, and, if your product or service is really good, there are plenty of customers who will pay a fair price. Knock on doors, call on the phone, send your best people to talk with potential customers. Give your prospects the impression that: based on your reputation and performance, if they don't want it, there are many more probable customers and many more towns where you will be welcomed.. *Shake the dust of that prospect off your feet and move on.* That non-receptive prospect is the real loser and should heed the warning.

The above advice applies to virtually every company. Personal contact is hard to beat. However, your salespeople may want a few bucks of walkin'-around money or a least an extra shirt. You should also provide them with straight forward corporate brochures and product/service information to leave behind with the customer. In any case, get started selling and receiving feedback from the market. Some well designed ads aimed at a targeted audience should produce some good prospects to visit.

I love good advertising. It raises market awareness of your name, products and services. Organize your ad program toward your potential customer base, and geographically to where you can follow-up personally. Work out a realistic program with a targeted publication (such as *Washington Technology*) or use an experienced ad agency, so that results can be monitored and the program adjusted to meet financial and market requirements. As the company grows, the advertising budget must grow with it-- but feedback from the market through your salespeople remains important. Be careful, though; you can make a smashing success with advertising, or, you can find that the money really went into a sinkhole.

Advertising, corporate and product brochures, travel for salespeople, seminars, proposal preparation, and the diverse types of other marketing expenses-- all fine tuned with revenues related to those expenses, constitute another series of complex decisions testing the best management abilities.

XX -- Mainstream Investors

Mainstream investors are those third-party investors. They are making independent judgments as to where they invest money. They are not particularly interested in psychological goals, in wanting to be a part of something, but only in comparing one investment with another for the sheer economic gain. What you're doing is not as important as how well you're doing it. That contrasts with early investors who participate because they want to be a part of the drama.

Financial operating statements (P & L) and balance sheets are the first things mainstream investors look at. They must be current. The more current they are, the more it shows that the company is under control. If there are money problems, you know what they are. You can even anticipate them when your operating statements and your balance sheets are up-to-date. (Don't forget to really study those statements, and to know what is happening!)

I always suggest to an early-stage company that outside accounting be brought in as quickly as possible to conduct annual and semi-annual statements. Whether an audit is done is a judgment call along the way. Whether it's a compilation, a review, or an audit-- having the credibility of someone else looking over things is extremely important.

Furthermore, an outside accounting adds a discipline to the process. It helps management focus on the meaning of the numbers. It forces them to know that someone is going to ask the questions in order to make a presentable picture. The decision to audit is based primarily on the statements, though. As the company reaches a particular size, it's important that the audit be done so that everyone feels comfortable with the numbers. Some banks may require it, and so may some investors.

Ultimately, all stock is marketed to the mainstream investor. When you do market to them, maybe early in the game when you are approaching third-party people, what you actually are doing is providing information so that they can make their estimate of what your future profits are going to be-- for *their* evaluation of *their* projected return on *their* invested capital in your deal, versus other investments.

For instance, how good is the management? How robust is the general growth in the industry? What is the financial picture and your ability to take advantage of opportunities? Whatever is presented to mainstream investors must give them a feel for the business, since they will not have a predetermined knowledge of it.

Moreover, a believable story is imperative. Grandiose projections and celestial ideas are not nearly as important as giving the third-party investor a gut feel of what the principals are all about, what their goals are and how they can take advantage of a particular marketplace. I think it's also extremely important that whatever picture is presented to the mainstream investors, you get across the concept that the management has the interest of all shareholders at heart. This is why it is particularly important early in the game to get used to dealing with outside shareholders, whether mainstream investors, third-party, friends or your own employees.

Keep the shareholders informed of both the good and the bad. The impression that the management are the tools of the shareholders rather than shareholders as pawns of the management is an extremely important concept. Thus, the sooner the company gets into this discipline of publishing some form of annual report, the better for all concerned.

I think annual meetings are also crucial. This is your best chance to get everyone together, to give the shareholders the feeling that they are part of the overall team, and to meet the management and other employees. Employees, in turn, get the feeling that the shareholders are interested, that their stock options are worth something, and that this is an overall effort by insiders and outsiders alike.

The last point involves cash dividends. At what point do they come into play? This is probably the best single tool that the inside management-- major shareholders of the company-- have to give tangible results to outside investors. The sooner a trend is started of giving cash dividends to outside shareholders, the better, I believe. The size of dividends is significantly less important than the fact that you do it and that you show the outside investors that you care about them. The whole concept of building shareholder interest is one of the most important points that I have pushed in advising companies. Sadly, most entrepreneurs and managements, in my opinion, ignore it until too late in the game.

XXI -- Don't Bother Me With Cash Flow

Cash flow is the most important problem in a business, especially at the beginning. First, it is the single measure of money coming in the door, compared to how much is going out the door. It's also a primary measure of discipline and the simplest measure of success.

Secondly, it is a discipline in collecting receivables, which is always difficult for a business. Making the sale is usually fun. Collecting can be hard. Cash flow helps you understand your expenses in the sense that it shows you how important, as you write checks, these various expenses are to the success of your business. The beginning entrepreneur who is not actually involved in writing out those checks is much like the physician who fails to take his patient's pulse.

It's very important to keep reserves of cash. The rate at which your cash is decreasing is really an early warning of major problems in the business. One big problem of companies that get a lot of money early on is that the people in charge don't realize how important those expenses are as the cash goes out the door.

Running out of cash is exactly like an individual's heart stopping a beat. Everything else becomes unimportant. The most unforgivable management error is running out of cash. Many times I've heard entrepreneurs saying, "Well, we were undercapitalized." Baloney! There is no basic justification for such a claim. *If it was undercapitalized, then you were doing either the wrong things from the beginning or too much of the right thing, or just taking chances that everything would go right.*

One of the top football coaches in our area defines "luck" as "the meeting of preparation and opportunity." Having cash reserves allows flexibility to change your plans. It allows you to take advantage of opportunities. Those two traits, in the long run, set the tone for successful companies versus unsuccessful companies. And, taking advantage of opportunities is the way that companies get ahead. One of the major ways to prepare for it is to be flexible and to have the reserves to seize those opportunities.

Having just built up the importance of cash flow, let me now put it in its proper place. Cash flow is of primary importance only to the point where the assurance that you have enough cash seems credible. At that point, cash becomes just another management matter. If a company is really making a profit, positive cash flow will inevitably follow. And any cash problem that pops up is truly a short term problem.

Once cash flow becomes just another management problem, all involved parties can begin to sleep at night. The survival of the company is no longer in question. It's now easier for the investment banker or company's finance chief to raise capital because it's for expansion, new equipment or other "positive" reasons. New capital is for "building a mound, not filling a hole." Moreover, with ample reserves and a good cash flow, you're in a position to pick the time of your choosing for *"collecting" capital from the most propitious sources.*

Now let me explain the chapter title. What do I mean by "Don't Bother Me With Cash Flow"?

As an investment banker and financial advisor to entrepreneurs, I really shouldn't have to be overly concerned with your cash flow. It's a management problem, just like hiring salespersons or making travel decisions. I want to be confident that the company is making money, and that it will never get in a cash squeeze anymore than it gets into a people squeeze, or a critical need for special equipment or letting your space lease expire. Sure, you'll get into squeezes, but your role is to solve them as management problems.

The role (or goal) of a financial advisor or investment banker is to reduce the entrepreneur's problems to money. Once the equation has been reduced so that all the company needs is capital, the capital is available.

But here's the catch: You must determine when the money is the problem, or whether it's really an outward indication of a deeper problem. I consider this like an individual having a fever. Fevers occur two times. One is when you're exercising hard and the fever's really a rise in body temperature to throw off the extra heat generated by hard work. The other time individuals get fevers is when they are sick and there is a deeper problem. If the only measure of that condition is a fever, it tells you nothing about the individual's sickness.

Therefore, when I see a company needing money, the first thing I ask is "Is this company pumping, or is it sick?" It's the most difficult question I'll have to ask myself. *If sickness is causing the need, capital is a mere Band-Aid.* The money problems will reoccur unless the only thing needed in this case is money.

XXII --Don't Max Out.

As I try to point out over and over, the first real goal of a business should be to *"get on a roll."* Just like a good basketball team, when the team is on a roll, then the good things that happen reinforce the momentum. The same is true with business. When it's truly moving forward, good things seem to just happen, and what appear to be bad things just bounce off like water off a duck's back. Thus, with reserves, a company is always ready to have problems become opportunities to improve.

Jesus also had something to say about having reserves: (Matthew 25:1-13)

Then shall the kingdom of heaven be likened unto ten bridesmaids, which took their lamps, and went forth to meet the bridegroom. And five of them were wise, and five were foolish. They that were foolish took their lamps, and took no oil with them: But the wise took oil in their vessels with their lamps. While the bridegroom tarried, they all slumbered and slept. And, at midnight there was a cry made, Behold, the bridegroom cometh; go ye out to meet him. Then all those bridesmaids arose, and trimmed their lamps. And the foolish said unto the wise, Give us of your oil; for our lamps are gone out. But the wise answered, saying, Not so; lest there be not enough for us and you: but go ye rather to them that sell, and buy for yourselves. And while they went to buy, the bridegroom came; and they that were ready went in with him to the marriage; and the door was shut. Afterward came also the other bridesmaids, saying, Lord, Lord, open to us. But he answered and said, Verily I say unto you, I know you not. Watch therefore; for ye know neither the day nor the hour wherein the Son of man cometh.

Wow, can we make hay with this parable. The best deal seems to come along just when your line of credit is "maxed out." By the time, the banker has been sold on just how great the deal (or new contract) will be for the company, someone else who is better financed (or smarter, or, with reserve capital) has snapped it up.

This also applies to being ready for the downside. In a recession, the strong get stronger and the weak get weaker. Don't ever use up your last dollar, no matter how good the deal seems. If the economy (or your business industry) goes into a recession, every deal will get better for those who are prepared to react to the situation.

XXIII -- The Second Time Around

I must admit that running out of cash does happen. It can happen because the entrepreneur/manager makes a wrong decision. It can happen because of unforeseen problems such as sickness, or the loss of a contract, or because you tried to seize new opportunities without proper preparation.

It's been my experience that investors who invest in startup situations, as said before, do it partly because they care about the people involved and want to help fulfill their entrepreneurial dreams. I have found that you can go back to them at least one time-- that "second time around"-- and that they will generally put in one-third to one-half of their initial contribution. The price is of secondary importance, because they are still primarily interested in helping the entrepreneur and his company achieve success.

The major requirement on this second time around, though, is to show that this input *will be sufficient for positive cash flow*-- that you don't have to come back again for the company to survive.

One way to make that second trip to the trough easier is to make sure that your board of directors includes at least one or two investors who have sufficient capital. Keep them as interested parties, keep them informed, keep them part of the family. Then should money problems crop up, they become a lot like our previous "Aunt Suzy," because all the way along they have been part of creating the situation.

XXIV -- Adolescence

The evolution from entrepreneurship to a true operating company comes in stages that bear an uncanny resemblance to child development. For instance, children up to age eight depend almost wholly on their parents for decisions. From about age nine to 15 or 17 they begin to earn some of their own money, which gives them a degree of independence. Other symptoms soon follow: rejection of authority, an unwillingness to communicate, and a refusal to subject problems to parental authority. By the time the child has reached 18, however, he must be well-grounded in the basics of living and decision making. For the first time in years, he may even seek out parental advice.

The small company evolution begins, of course, with a single entrepreneur keeping his finger on the entire business family. At about $1 million in sales, the company enters the adolescent stage. It begins to have a certain flexibility in cash flow. It can begin to instigate perks for management. The entrepreneur begins to delegate more and more activities. In fact, if he doesn't become like the parent of an adolescent and begin to lengthen his leash on the company, he'll soon choke off all progress. At the same time, he may find employees withholding problems just as teenage kids keep their problems from their parents.

At about $10 million in sales, you'd better have all your systems in place because you now have virtually all the management problems of General Motors, perhaps with the exception of a union. You must rely on your management line officers. Hopefully, your $10 million dollar company will have ten $1 million entrepreneurs in place to run million-dollar operations. At the $10 million level outside capital becomes totally supplied by mainstream investors. Communications with your employees are important. It's the total evolution from the single entrepreneur having his finger on the whole operation, through the adolescent stage, to what one might call the "mature" company.

What about the relationship with the board of directors, investment bankers and other advisors during these growth periods? Initially, communications are rapid and regular because capital and cash flow are the entrepreneur's overriding concerns. Moreover, the entrepreneur is likely to seek advice on basic management questions simply because he's still learning the ropes and the experienced advisor has been through many of these situations before.

I must emphasize the communications with shareholders, even during this early period. The shareholders really want to know about these problems, much the way that parents want to help small children with problems.

Now, as cash flow becomes increasingly positive, the company begins to gain the flexibility to make its own mistakes. Advisors seem eager to direct, but management has to develop its own personality. Therefore, I tend to sit on the sidelines and wait for the problems to surface or become significant before getting involved. Thanks to sufficient capital reserves, the company can now afford to learn from its own mistakes.

During this adolescent period, it's as important as ever to continue regular communications with shareholders. The discipline of producing profit must continue as well.

Now for the mature stage. Here, the investment banker or financial advisor steps back in to deal with the big capital picture. He brings advice on capital markets and helps the company retain its best employees through stock option plans or other types of compensation plans.

The biggest problem I have found with companies achieving maturity is they tend to become management retirement homes. Instead of maximizing shareholder profits, they tend to pad or add to payrolls, create more perks, rely on advertising instead of personal sales calls, and a dozen other things to make the lives of managers easier.

Continually, my job as investment banker has been to see that discipline reigns. If management maintains their major shareholder positions and that healthy "conflict of interest" I described in the first chapter, the investment banker can devote his time to helping the company look for acquisitions, mergers, or additional capital sources. It's when the company reaches this adulthood, and does it through the stages of childhood and adolescence, that the early members of the board of directors or advisory team have their proudest moments *(and generally most financially rewarding).*

XXV -- Wall Out of Plumb

Management problems-- they are everywhere. Whenever I have been asked (or forced) to deal with arguments among management or just plain ol' problems of management, the question arises as to whether the situation can be fixed, or is it just better to drop the whole deal and start over.

I remember the time when I was visiting some friends who had recently purchased an old frame house they were going to restore. As I was sitting in the living room, my head began to ache as I studied the structure of the walls and door edges. The picture hanging on the wall was not parallel to any edge, and my engineering training began to force me to concentrate on how they could ever get any two edges of the walls, doors and windows to be parallel. Everything was crooked. It began to drive me bonkers, and I had to leave. You couldn't get me involved with restoring that house-- I would much prefer to start over.

The same idea occurred to Amos in the Old Testament when he surveyed the condition of his people's nation, in Amos 7:7-8:

I had another vision from the Lord. In it I saw him standing beside a wall that had been built with the use of a plumb line, and there was a plumb line in his hand. He asked me, "Amos, what do you see?"

"A plumb line," I answered.

Then he said, "I am using it to show that my people are like a wall that is out of line. I will not change my mind again about punishing them. The places where Isaac's descendants worship will be destroyed. The holy places of Israel will be left in ruins. I will bring the dynasty of King Jeroboam to an end."

The wall that is "out of plumb" cannot be fixed. It must be virtually torn down and built up again from the bottom. In most cases, it's usually the foundation that has sunk and caused the cracking or sinking of the wall.

The same types of cracks and "out of plumb" walls appear in a company that has developed internal management problems and does not have a strong management foundation. The decision must be made as to whether the situation "can be restored," or, whether it must be reduced down to a base core and then expanded from a different base. It's time to use the "management plumb line."

The ultimate management plumb line is Chapter 11 of the Federal Bankruptcy Act. Through the use of this excellent business tool (or a similar informal creditor-company standoff), the stockholders and the creditors can use their combined efforts to restore good management techniques and a sound foundation to a business situation that has really "gotten out of plumb." Then the previous management dynasty usually comes to an end, just like King Jeroboam.

XXVI -- Loosen The Reins, Let's Grow (Exodus 18)

Just as in adolescence, we must build into an organization the management structure to deal with problems on their proper level. The organization must gain strength by working together, making and overcoming lots of small mistakes. Listen to the advice given to Moses when the Israelite nation had reached a period of stabilization in their journey through the wilderness from Egypt to the Promised Land. This is a long section, but these words are as applicable today as they were thirty-five hundred years ago.

Moses' father-in-law Jethro, the priest of Midian, heard about everything that God had done for Moses and the people of Israel when he led them out of Egypt. So he came to Moses, bringing with him Moses wife Zipporah, who had been left behind, and Gershom and Eliezer, her two sons. Jethro came with Moses' wife and her two sons into the desert where Moses was camped at the holy mountain. He had sent word to Moses that they were coming so Moses went out to meet him, bowed before him, and kissed him. They asked about each other's health and then went into Moses' tent. Moses told Jethro everything that the Lord had done to the King and the people of Egypt in order to rescue the Israelites. He also told him about the hardships the people had faced on the way and how the Lord had saved them. When Jethro heard all this, he was happy and said, "Praise the Lord, who saved you from the king and the people of Egypt! Praise the Lord, who saved his people from slavery! . . .

The next day Moses was settling disputes among the people, and he was kept busy from morning till night. When Jethro saw everything that Moses had to do, he asked, "What is all this that you are doing for the people? Why are you doing this all alone, with people standing here from morning till night to consult you?"

Moses answered, "I must do this because the people come to me to learn God's will. When two people have a dispute, they come to me, and I decide which one of them is right, and I tell them God's commands and laws."

Then Jethro said, "You are not doing this right. You will wear yourself out and these people as well. This is too much for you to do alone. Now let me give you some good advice, and God will be with you. It is right for you to represent the people before God and bring their disputes to him. You should teach them God's commands and explain to them how they should live and what they should do. But in addition, you should choose some capable men and appoint them as leaders of the people: leaders of thousands, hundreds, fifties, and tens. They must be God-fearing men who can be trusted and who cannot be bribed. Let them serve as judges for the people on a permanent basis. They can bring all the difficult cases to you, but they themselves can decide all the smaller disputes. That will make it easier for you, as they share your burden. If you do this, as God commands, you will not wear yourself out, and all these people can go home with their disputes settled."

Moses took Jethro's advice and chose capable men from among all the Israelites. He appointed them as leaders of thousands, hundreds, fifties, and tens. They served as judges for the people on a permanent basis, bringing the difficult cases to Moses but deciding the smaller disputes themselves.

Then Moses said good-bye to Jethro, and Jethro went back home.

Holy Smokes! What a story from so long ago. Moses was reaching the point where he couldn't do it all himself. However, he was caught up in the enormity of it all such that he "couldn't change the tires while the car was moving." He didn't want to trust the management to others. He felt the total responsibility.

Jethro pointed out the management techniques for the first Organization Chart-- with capable managers over the various parts of the company, trusted with the size of organization representing their respective abilities. Note the basic requirements for *the world's first vice presidents*-- stockholder fearing persons (the same basic goals as the stockholders), and those who can be trusted and cannot be bribed. *Exactly the same characteristics as we constantly seek today.* This set up the organization for much more efficiency; so it could develop the life of its own for when the entrepreneur was gone from day-to-day management.

As soon as the new management team began to operate, Moses realized the need for each manager to understand the basic rules to utilize in making judgment decisions. Thus, we find Moses, in Exodus 20, up on the top of Mount Sinai receiving *the world's first Corporate Operations Manual-- the Ten Commandments.*

By the way, this process of turning over management responsibility usually must begin when the sales level gets above the $1 million annual level. It must be pretty well completed when the annual sales level is at $10 to $20 million, or the entrepreneur will find his Jethro (or Board of Directors, or other advisors, or his father-in-law) telling him to get some help or the situation will crumble. What would have been a great achievement will be destroyed by its own success. *The problems of failure are easy to define-- the problems of success are tougher.*

XXVII -- Let's Fight

No matter how much the partners originally like each other, many times there comes a major disagreement among management. These are partners who are breaking up-- not unlike a divorce in marriage.

These major disagreements don't usually occur when the times seem to be toughest. In the beginning when the company is struggling for survival, the goal is clear. However, somewhere along in the process, the goals can become intangible and everyone is not pulling in the same direction. When there is a struggle for survival, the struggle outweighs all the other problems. When survival is assured and is no longer the dominant goal, people now have the luxury of letting their fundamental disagreements surface. Sometimes, these basic disagreements come just after the company has raised a bunch of capital-- who controls it-- or when just enough success has come to put some reserve money in the bank.

Yes, the proper amount of argument makes for healthy examination of the problems of growth. When the disagreements get personal, they begin to erode the trust among the principals-- can ultimately lead to a major break-- and certainly poison the water for all those involved in the company's future.

Look what Jesus had to say about attacking these problems at the roots, as we read from Matthew 18:15-17:

If your brother sins against you, go to him and show him his fault. But do it privately, just between yourselves. If he listens to you, you have won your brother back. But if he will not listen to you, take one or two other persons with you, so that 'every accusation may be upheld by the testimony of two or more witnesses,' as the scripture says. And if he will not listen to them, then tell the whole thing to the church. Finally, if he will not listen to the church, treat him as though he were a pagan or a tax collector.

There's not much I want to add to this advice, except to substitute "Board of Directors" or "Stockholders" for "church." If the parties won't listen to good advice from those most closely concerned, then it must go to those who have ultimate responsibility. When the problem gets to the Board of Directors, one of the parties is probably going to be forced to leave the company as an outcast. Be forewarned though; don't let it get to the Board or the Stockholders unless you are ready for their decision.

XXVIII -- No Pain, No Gain!

That story of Moses back in Chapter XXV has too much relevance today for us not to visit it once again for another message.

How many times have we either heard, or participated in, conversations about the tough old times in business or maybe even some sports event? It seems that those temporary adversities produced a leaner, meaner team or organization that had a great impact on the ultimate success.

The same was true with that reunion dinner between Moses and Jethro. Now that survival of the company seemed assured, they were discussing those problem periods in the early days of the journey into the wilderness-- the success of the Red Sea opening, having food supplied to them, water being found in the most unlikely places; oh, but in addition, they also remembered the hardship and *the absence of Moses the Entrepreneur from his family*. (This conflict-of-interest may be the toughest of all to juggle.) Read that first paragraph of Exodus 18 again.

Maybe it's important-- and certainly a positive influence-- for organizations to go through those periods of travail and difficulty in order to develop discipline and the appreciation of the positive aspects of strong team effort. As my soccer playing daughter says, "No pain, no gain!" And, my baseball playing son couches the same thought in, "No guts, no glory!" It all means the same. You must push to the limit to really appreciate the rewards. If early success comes easy, then the organization may not be ready for the recession, or change in Defense Department R & D policy, or cancellation of the big program, or the difficulty of obtaining big contracts.

Also, what a wonderful feeling to recount the experiences of the early days with those who were there to participate. The character was really developed and carried through all the way from top to bottom.

Praise the Lord, who saved you from the king and the people of Egypt! Praise the Lord, who saved his people from slavery! Maybe for the purpose of this parable, this should read: Praise entrepreneurship, that saved you from the slavery of bureaucracy and the psychology of large companies.

XXIX -- From Obscure to Distinguished

Promoting the successful company into the mainstream capital markets is the biggest thrill of being involved in the capital system. It's a pleasure for management, the investment bankers, the board of directors and stockholders alike. What is done, in the purest sense, is to cultivate demand buyers of the company's securities at ever increasing prices reflecting the growing value.

How to promote your company? As I said earlier, it begins with the simple habit of keeping shareholders informed. Interesting, descriptive annual reports are something I like to see a company begin as early as possible. The annual report does more than communicate to the shareholder. You can use it as a sales background with customers. It impresses bankers. It shows employees a strong, growing company with nothing to hide from shareholders or employees.

Next, make the shareholders' meetings important occasions. I encourage attendence by customers, your bankers and other outsiders. It shows appreciation for their support. And by all means involve employees. Always have some refreshments. They don't have to be elaborate and needn't include hard liquor. What's important is that people feel comfortable and that they are part of the team.

Generally, company offices are a good place to have the meetings, especially when there are products, prototype models, and other signs of progress to show off. I also encourage selecting a convenient location-- if the company offices are not it-- and a time that will attract as many of your people as possible.

Be informal, as if this were a family. In fact, I like that even with bigger companies. Invite interested investors, bankers and brokers. Create an aura so that people want to get into the club.

There are other things you can do to distinguish your company from the average small company. Most companies ignore the outside shareholders. I have found that when the outside shareholders have an enthusiasm, it encourages all the others. It feeds back to the employees, it feeds back to your other inside people and creates a dynamic situation. This is why I urge that just as soon as cash flow ceases to be the overriding problem, that paying small cash dividends can be very important.

Most companies do not do this, which means it's out of the norm; therefore paying dividends immediately sets you apart from others. But, by all means, keep them small with respect to the earnings. No one expects to live off the dividends. Still shareholders always appreciate the thought, even if you pay a penny a share on a hundred shares. No one throws that check away!

If you keep the dividends small, you can always increase them. In fact, one of the noblest and most potentially rewarding goals you can pursue is to increase the dividend rate year after year, even when profits are down. Why? It'll stabilize your stock price and buoy the confidence of capital markets. Moreover, the outsider can never accuse you of being a "management" company and keeping it all. All they can ever do is say, "Hey, you should have done more." But they can never say, "Hey, you ignored us completely."

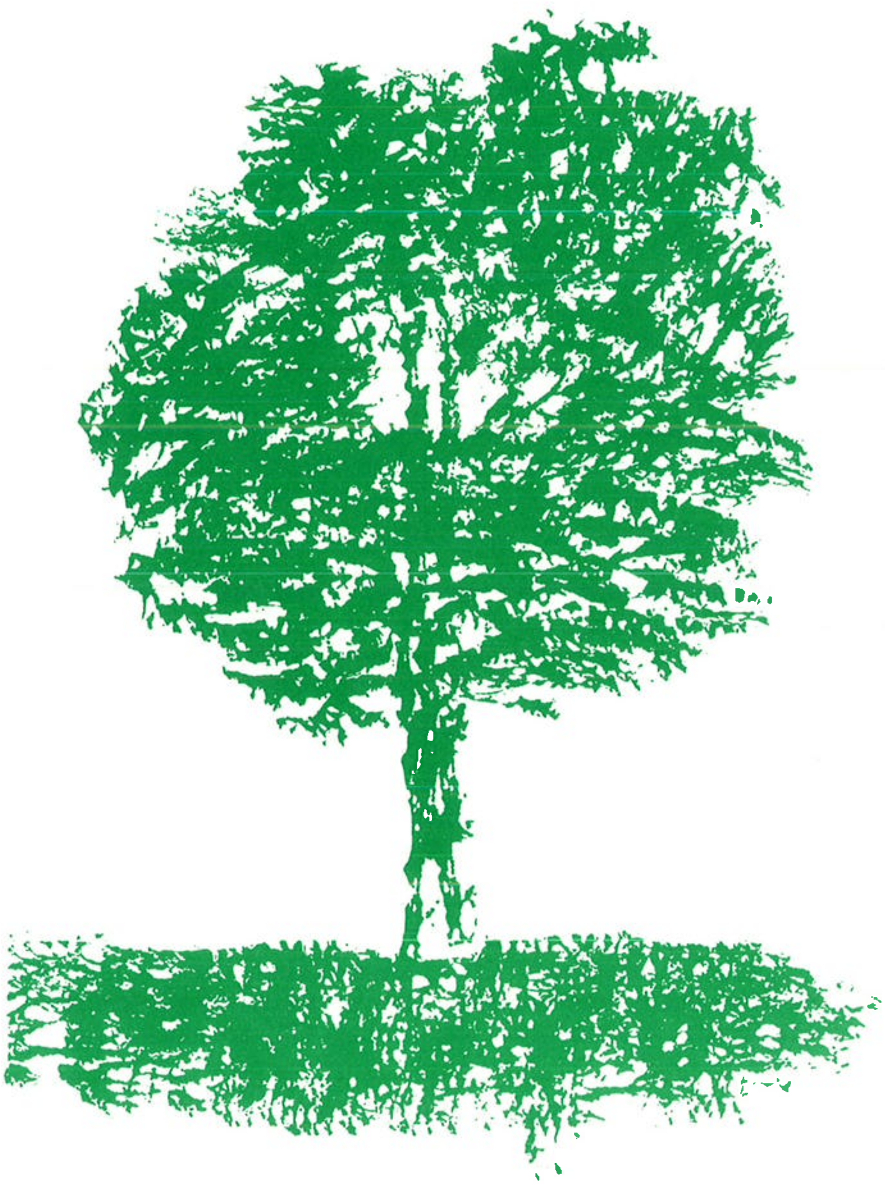
I advise management to call major shareholders periodically just to say "I have something I thought you'd be interested in." By the same token, send them written articles about the progress of the company. Keep them up on industry awards and employee achievement.

Keep the profits uppermost in your mind. When the profits are growing, opportunities open up. Again, cash flow will not be your most important problem, but just one of the situations you'll have to monitor. The key is to set your goals by the growth of sales and earnings. These are the things that begin to dominate a successful company. They are *the first things* that investors look at. They are *the most important things* that investors look at. If the company is growing in sales and earnings-- and these are truly accountable sales and earnings-- every other problem is solvable.

With profits growing steadily, institutional capital is going to take a look at you. Joint ventures with larger companies are a very viable opportunity and have been one of my more successful ways for financing small companies. The big guys want to get in bed with a small guy who shows he knows how to make money. The banks are willing to extend working capital. Also, probably most important, the company can pick its time for public offering or other capital financing. You're not dominated by the need for capital; *you become an interesting opportunity for capital to find a home.*

A company's ultimate success, of course, is measured by the value of the stock. This is the reason the management started the company. The reason they've worked so hard is to maximize the value of their shares.

As the value increases each year with higher profits, the shareholders can always cash in. It's just a matter of at what point you want to liquidate some of your holdings in order to move on to other things. You can always find a buyer for a growing company. Remember, management has the most to gain as long as they remain major shareholders and perform well.



XXX -- Going Public. Why?? When?? How??

No treatise on entrepreneurship can be complete without some discussion of that magnificent take-off point for a small company-- the Initial Public Offering (IPO) of stock. There are three major schools of thought concerning the timing and style of the IPO.

School 1: Wait until your performance allows you to use a large investment banking firm, and raise enough capital to financially make it all worthwhile, and gain broad acceptance in the stock market. Making it all worthwhile might mean big sums of capital both for the company and the selling stockholders to cash out. The major underwriters need a size of offering that allows sufficient amounts of securities for the size of their distribution systems of brokers and funds.

School 2: While still in the virgin stage, where value is only in the eyes of the beholder, go public and raise a bunch of money to do what you want or need to do. None of the normal ratios have meaning-- P/E (Price-to-Earnings) Ratios can't be applied when there are no earnings. During the hot IPO markets, there are underwriters who can really sell the speculative deals where management hasn't been tested. You may have to dress up the Board of Directors, or get into some exotic projects, or just be in exactly the right industry at the right time. This is the same situation I mentioned back in Chapter XIV where the appraiser's spouse went wild on my nearly valueless land because she *saw* possibilities none of the rest of us could see.

School 3: After a track record of a few years of growth in revenues and profits, do a relatively small underwriting through a reputable regional investment banking firm (such as Wachtel & Co., Inc.). Such a deal may not result in an enormous sum of money, but it can be sufficient for the next phase of growth, and provide just the right *number of talents* to allow management to prove its ability to take public money, yield rewards to investors, and set up the much larger second public offering when the time is right.

Remember, in the best of years, only about 500 companies have IPO's. It's not a big marketplace. It gets a lot of press when the market is hot. Schools 1 and 2 are risky goals. School 1 requires excellent performance, and good timing of your venture's growth to coincide with the warm period of reception with the investing public. The warmth must not only be for your company's track record, but the industry group within which you fall must be in favor at that time with the stock market gurus. Furthermore, you must find the underwriter whose distribution system would be interested in your type of company. School 2 requires even more precise timing for an especially hot IPO market. You also really need to market your company to as many of the IPO underwriters as possible, in order to find the one whose distribution system gets excited about your concepts. Furthermore, watch out; you could go through all the work and expense of preparation up to the point of the clearance by the S.E.C. and find that the underwriter's selling ability was also a concept.

I am generally in favor of School 3-- and there aren't many of us. Based upon the percentage of the gross proceeds, the expenses of the offering can be relatively high. However, if the deal structure is simple, and everyone in the process watches his expenses, the costs can be minimized so that *the deal is fair to everyone.*

Advantages of School 3 --

- New injection of equity capital to allow next phase of growth.
- A public market for the stock to prove management ability to multiply those *talents.*
- Early investors have liquidity.
- Company begins process of public exposure.
- Employee stock options have meaning.
- Timing of second offering isn't so dependent on IPO market.
- Founders have access to Rule 144 for sale of stock.
- Other forms of capital raising are available more easily.
- Bankers and vendors are more impressed.

Disadvantages --

- Must continue high discipline in management.
- More stringent reporting requirements than if private.
- Can't run company like a "private" deal.
- Might get a better deal later.

It doesn't look to me like any of the disadvantages are anything but sour grapes. The worst part of a small, early deal is that later you might find out you "gave up too much, too soon." If that turns out to be the case, then you're already rich-- so, who cares?

I should point out that the goal of being public-- if it dominates the thinking of management all through the corporate history-- can provide one of the best overall Corporate Operating Manuals. The principles of consistently reporting to your bosses-- the stockholders-- provides the best method of toeing the line whenever corporate strategy must be decided. Sure, the investors want growth of revenues and profits, but they know that the management must be fairly dealt with, new business must be pursued, employees must have good surroundings to work in, and other conflicts-of-interest must be weighed against current profits. As a result of these methods of operation, an IPO should be just the "next step" in the overall progress of the company.

Oh yes, one final thought. It seems that timing appears as an important virtue of business judgment. How do you guarantee that you will be able to gauge your business progress to coincide with the proper timing? Simple. Just implement the principles of management that we have discussed-- keep it simple, make a profit, have positive cash flow, have reserves-- *then you'll always be ready, and you pick your timing.* When the time arrives, you're ready. If you're always sitting outside the window, then when the window opens you can jump right through.

XXXI -- The Testing Never Ends

Back in Chapter XXIX, I said that a company's ultimate success is measured by the value of its stock. But what about measuring the success of you, the founder, entrepreneur, mover and shaker? Silas Marner, Ebineezer Scrooge, J.R. Ewing, and surely someone in your own personal experience have all taught us that money in itself is not a guarantee of happiness.

The Bible has numerous stories and statements about about the dangers of riches-- "The Rich Young Ruler" (Luke 18:18-25); *It's easier for a camel to go through the eye of a needle than for a rich man to enter the Kingdom of Heaven* (Matthew 19:24); "The Prodigal Son" (Luke 15:11-24); *Riches make themselves wings* (Proverbs 23:4-5); *The love of money is the root of all evils* (1 Timothy 6:10); *Let not the rich man glory in his riches* (Jeremiah 9:23); *He who trusts in his riches will wither* (Proverbs 11:28); *If riches increase, set not your heart on them* (Psalms 62:10); *A good name is rather to be chosen than great riches, and favor is better than silver or gold* (Proverbs 22:1); etc.

The tone can be heard clearly: Because *you've been chosen by the master*, don't let it go to your head. The more opportunities (talents) that are available to you-- the more the responsibilities to yourself and to the master. *You can't rest . . . you're always being tested.*

{By the way, as an aside-- read that story of "The Prodigal Son." Don't you think it should really be referred to as "The Repentant Father"? The father (venture investor) made the error-- he gave the son (the small company) too much money too soon. The son did just what you'd expect-- that is, without the discipline of handling reserves, he took his inheritance and blew it before establishing positive cash flow.}

I know a guy who happens to be one of the top individual sales performers of all time. Recently, at age 37, he decided to take a long hiatus after a year in which he netted (not grossed) $1.7 million selling computer systems. "You know," he said one day as we watched a Pelican glide over his seaside home, "I always set goals for myself as to what I defined as 'success.' But each time I reached that point, I'd set more goals further down the road. Then one day just after I 'retired' I was walking by a store and saw a T-shirt in the window. I stood there for a half hour looking at it because it explained in five words why I was never able to stop."

He had made it a point to wear the T-shirt during our visit. It read: "There Is No Finish Line."

What there is my friend, is the thrill of the race. The hope of this little booklet is simply that by sowing your seeds deep, keeping it simple, being nice to Aunt Suzy and walking where those stumps are, you'll have fun on your entrepreneurial journey!

Just one thing more. Back in Chapter III I discussed the Parable of the Talents and suggested five ways in which it applied to small, young companies. I promised to mention a sixth, which I'll do now.

The story says that *"For to every one who has will more be given, and he will have abundance; but from him who has not, even what he has will be taken away."*

Now all that may seem terribly cruel at first glance. But what it really says is: *Get yourself on a roll so that problems become opportunities.* Furthermore, resources are precious, be they capital or natural wonders. He who squanders resources should not be trusted with them. He who respects those resources and invests them wisely can expect to be given additional resources to care for and multiply.

Or to put it another way: How many times have we said to ourselves, "How come everything good happens to that guy? Seems like he can do no wrong!"?

Here's hoping that guy is you.

About the Author

Author John D. Sanders is Chairman and Chief Executive Officer of TechNews, Inc., the publisher of *Washington Technology* newspaper, a bi-weekly publication giving the news of technology as it affects business and jobs in the metropolitan Washington, DC area. For more than 20 years, he has been a vice president of Wachtel & Co., Inc., a Washington, DC investment banking firm specializing in the development of small corporations. Sanders serves on the boards of more than 15 companies, including Daedalus Enterprises, Inc., Enterprise Communications, Inc., Industrial Training Corp., Information Analysis, Inc., Radiation Systems, Inc., Teledial, Inc. and Tork, Inc. He has been active in the management of a dozen public underwritings and numerous private placements of equity securities. He has also conducted many formal appraisal and evaluation studies for such clients as Allen & Co., Inc., CACI International, Inc., Flow General, Inc., VSE Corporation, and Gray and Co. Communications.

One of his favorite pastimes: lecturing on venture capital to such organizations as the George Washington University Law School, the Entrepreneurship Institute, the MIT Enterprise Forum, the Baltimore-Washington Venture Club and the U.S. Patent Office Innovation Conference. He has served as an officer of a number of organizations including the Washington Society of Investment Analysts and the Washington Chapter of the National Association of Corporate Directors. Also, he is a Member of the Board of Visitors of the University of Maryland Graduate School's Center for the Study of Future Management and a Trustee of the Washington Technology Foundation.

Sanders received a degree in electrical engineering from the University of Louisville in 1961 and went on to earn both master's and Ph. D. degrees in that discipline from Carnegie-Mellon University. After positions with RCA Research Laboratories and General Electric Co., he joined the Central Intelligence Agency in 1964 in a research capacity that utilized his engineering skills. Always an active investor and "student of the dynamics of small business," Sanders remains active in the investment banking arena.

The author lives in Arlington, VA with his wife Carole, daughter Elaine and son Paul.