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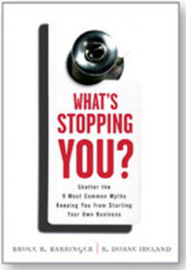

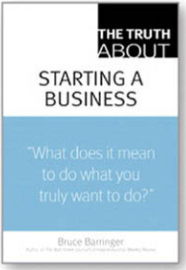

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FINANCIAL TIMES

Praise for
The Truth About Starting a Business

"When thinking about starting a business, have you ever felt discouraged because you did not know somebody or some thing? If that is the case, Barringer can be your wise uncle. In this insightful new book, he shares common-sense advice, based on research that can help to get you started and going in the right direction to launch your own venture."

James Fiet, Ph.D., Brown Forman Chair in Entrepreneurship,
University of Louisville

"Relevant and easily accessible advice on how to start your own business. Barringer's great primer covers it all, from naming your company to handling legalities, from publicity to the psychology of being an entrepreneur."

Matt Hedges, Founder and President,
Vino de Sol

"This book is a must read! Barringer has developed an easy-to-follow blueprint on how to start a new business. He takes the complexity of entrepreneurship and streamlines it, providing insight and expertise that is invaluable to those venturing out on their own."

Christopher Jones, CAGS, Licensed Educational Psychologies, NCSP,
President & CEO, Dynamic Interventions, Inc.

"I found myself smiling as I read some of the truths because I found it talking about myself and peers who have started numerous companies. This book should be on the seasoned entrepreneur's list of 'what I should have read before I started my business.'"

Joe Keeley, President & CEO,
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"This book is the ultimate handbook for starting a business: from coming up with an idea to implementing it with success and vigor. It walks a potential business owner through the steps of writing a business plan, creating an identity, financing a business, hiring personnel, marketing, and creating a work-life balance. It is a tool that no new business owner should be without."

Dr. Emily Levy, Founder & CEO,
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"Barringer cuts to the chase with his simple, relevant, and hard-hitting truths. In practical language and with significant insight about the realities of venture start-up, he speaks on very personal level to the prospective entrepreneur."

Michael H. Morris, PhD, Chris J. Witting Chair and Professor,
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"This is one of the best entrepreneurship books I've read. If you're an entrepreneur or are thinking about starting a business, this book is a must read! I wish I had this book when I first started out."

Ryan O'Donnell, Co-Founder and CEO,
BullEx Digital Safety

"Barringer reveals many realities about being an entrepreneur and starting a business. Beyond just loving what you do, it is obviously critical to understand as many of the components that go into running your business as possible."

Evan Shapiro, Co-Founder,
Blue Maze Entertainment

THE TRUTH ABOUT

STARTING A BUSINESS

Bruce R. Barringer

Publishing as FT Press
Upper Saddle River, New Jersey 07458

FT Press offers excellent discounts on this book when ordered in quantity for bulk purchases or special sales. For more information, please contact U.S. Corporate and Government Sales, 1-800-382-3419, corpsales@pearsontechgroup.com. For sales outside the U.S., please contact International Sales at international@pearsoned.com.

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TRUTH 3

Questions to ask before you quit your job

You've pretty much decided. You've picked a business idea that's a good fit for you, and you're ready to move forward. But you're nervous about quitting your job. You're just not sure when you should quit your job to start your business.

Good! Your sense of unease about quitting your job is a good thing. Making the leap from being an employee to being a business owner is a big step. You should be sure that you have identified a sound business idea and that you're fully prepared before you leave your job. There is no set formula for knowing when the timing is right to leave. But here are some questions to ask yourself as your think through your decision.

Making the leap from being an employee to being a business owner is a big step. You should be sure that you have identified a sound business idea and that you're fully prepared before you leave your job.

- **What's the real reason you want to quit your job to start a business?** If you're quitting for a positive reason, such as passion for a business idea, you'll have a better chance of succeeding than if the reason is negative, such as you're sick of your boss or you fear you might lose your job.[1] Make sure that after your job is gone and you're working on your business, it's something you really want to do.
- **Do you have a viable business idea?** It's not good enough to simply "think" you have a viable business idea. You need to write a business plan, share it with people who can give you informed feedback, and talk to prospective customers. Don't launch a venture that's hastily conceived. Know what you're doing.
- **Are your finances in order?** You need to know your start-up costs and have sufficient cash on hand or a plan for raising the cash before you launch your business. You should also have sufficient money in the bank (experts recommend up to six months) to cover living expenses while your business gets going. What if you encounter unexpected costs? Are you willing to cut

back on expenses or ask your spouse to take on an extra job to make things work?

- **Are you emotionally ready?** Owning and running a business is different from being an employee. You'll have your own money at stake and will normally work longer hours than you did before. It's also harder to simply "leave your work behind" at the end of a day. One thing that surprises many new business owners is that they miss the hectic pace and busyness of the work environment they left, where they had frequent interactions with coworkers and others. Many new business owners work alone, especially if they work out of their homes. This type of lifestyle can be lonely and hard to get used to, particularly if you enjoy frequent interactions with others. The best way to determine what your life will be like is to get to know one or more business owners in the field you'll be entering.
- **Can you start the business part time?** Many business owners start their businesses part time. While this approach isn't possible in all situations, you should give it some thought. By starting a business part time, you can gain valuable experience, tuck away the money you earn, and find out if you really like the business before you quit your job. In some businesses, it takes time to build a productive client list. You may be able to time the departure from your job with the point-in-time where your client list is large enough and profitable enough to justify your full-time attention.
- **Is your spouse supportive?** You know from your life experiences that career-related decisions don't impact just you. If you have a spouse and kids, they'll feel the impact, too. Have lengthy discussions with your spouse before you quit your job. Talk about both the hardships and the rewards that starting your business will entail. Don't make the leap without the most important people in your life on board.

Have lengthy discussions with your spouse before you quit your job. Talk about both the hardships and the rewards that starting your business will entail.

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Praise for *So, You Want to Start a Business?*

"I used *So, You Want To Start a Business?* to restructure my furniture hardware company. The book was full of applicable information that I have used and will continue to incorporate into my company. I couldn't ask for a better resource."

—Adam Prestwood, Vice President,
Pampco, Inc.

"Practical, sensible advice to anyone starting a business. A great short course in entrepreneurship."

—Billy D. Prim, Chairman and CEO,
Primo Water Corporation, Winston-Salem, NC

"This is exactly the kind of book first time entrepreneurs always needed but was never available. Everyone who is thinking about becoming an entrepreneur must read this book."

—Dr. E.W. Leonard, Associate Dean, Executive MBA Program,
Goizueta Business School, Emory University

"Here is the straight story about being a successful entrepreneur from people who have been one and taught many. Clear, practical, and concise, this book delivers the goods."

—Andy Fleming, Principal,
Core Growth Partners, Atlanta, GA

"Solid advice for building and growing a sustainable business."

—Andrew Bourne, CEO,
WayPoint Technologies, Phoenix, AZ

"Professor Hess's book has helped me improve my services and make clients feel appreciated, respected, and most of all, like they're getting a great service at a fair price."

—Sammy Starnes, Owner,
Hair Concepts, Inc.

"A treasure trove of information! I just started my company, and I have to say that this book helped me make the right decisions from the very beginning."

—Derica Justice, Owner,
Bon Bini Print & Design

"This is a great practical guide with lessons and insights for anyone who wants to start a business. You will go back to it again and again."

Ned Morgens, CEO,
SarahCare.com, Atlanta, GA

"Whether you are a striving young entrepreneur or a middle-aged person with the courage to trust your wits, this book is indispensable."

—Ben Dyer, General Partner,
Cordova Ventures, Atlanta, GA

"A must read for entrepreneurs who want to know what it really takes to launch a successful small business."

—Jay Myers, CEO,
Interactive Solutions, Inc., Memphis, TN

"A precise, pragmatic, wisdom-dripping, rich read. The authors walk the talk."

—Jim Christian, CEO,
Kandumedia.com, Denver, CO

"A powerful book full of good how-to advice."

—Philippe Sommer, Director of Entrepreneurship Programs,
Batten Institute, Darden School of Business, Charlottesville, VA

"This book is a great primer and an excellent reference book for an entrepreneur."

—Walter Negley, CEO,
TSP, Houston, TX

So, YOU WANT TO START A BUSINESS?

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So, YOU WANT TO START A BUSINESS?

8 Steps to Take Before Making the Leap

Edward D. Hess and Charles F. Goetz

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To all the entrepreneurs who have taught me that business is
much more than just making money;
it is the primary means through which most people achieve
their dreams for a better life for themselves and their families.
To that end business is a noble profession.
—Ed Hess

I dedicate this book to everyone who dreams of a better life and who is willing to accept some risk so that they can see their dreams come true.
And to my family, who has made it possible for me to achieve my dreams.
Thank you—I love you all.
—Charlie Goetz

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Acknowledgments

No one writes a book by himself. This book is the result of over 30 years of learning from teachers, entrepreneurs, colleagues, and students too numerous to mention by name—but thank you.

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And to my dear friend, colleague, and coauthor Charlie Goetz who epitomizes the American dream—thank you for your contribution and for the joy and fun of trying to help others achieve their dreams. You are a good soul.

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And a special thanks to the wonderful team at Pearson (led by our editor Jen Simon, who believed in this project as passionately as we did) who made our book better and were great partners with positive entrepreneurial attitudes.

—Ed Hess

First off, I would like to apologize for those who I might have inadvertently left out. If your name is not on this list and it should have been, unfortunately you are one of them—my sincere apology.

There have been many people who have directly and indirectly helped me in the writing of this book. In many cases, they don't even know they helped, including some of my colleagues and students at Emory and the entrepreneurs and board members that I work closely with every day.

That said, I want to thank Mike Parham, Eric Hartz, David Zalik, Adam Leaderman, Randall Bentley, Byron Kopman, and Harold Enoch.

Most importantly, though, I want to give special thanks to Ed Hess. To his credit, he recognized before anyone else that there is a large market of want-to-be entrepreneurs who have had little business training and that they deserved a tool of their very own they could use to achieve the type of business success they too have been dreaming of.

So, You Want to Start a Business? was his dream and a worthy endeavor. I very much appreciate that he allowed me to come along.
—Charlie Goetz

About the Authors

Edward D. Hess is a Professor of Business Administration and Batten Executive-in-Residence at the Darden School of Business at the University of Virginia. Prior to joining Darden, he was Adjunct Professor of Business, Founder and Executive Director of both the Center for Entrepreneurship & Corporate Growth and the Values-Based Leadership Institute at the Goizueta Business School, Emory University.

Professor Hess is the author/editor of five other books and over 40 articles on business strategy, finance, growth, and family businesses. He is a magna cum laude graduate of the University of Florida and received a J.D. degree from the University of Virginia and an LL.M degree from New York University.

He is a frequent speaker, and his work has appeared in the *Financial Times*, *Fortune* magazine, and on CNBC.

Prior to joining academia, Professor Hess spent 30 years in the business world as a lawyer, investment banker, strategy consultant, and entrepreneur with Atlantic Richfield Company, Warburg Paribas Becker, Boettcher & Company, The Robert M. Bass Group, and Andersen Corporate Finance. His primary business focus has been private entrepreneurial businesses, and he has built three successful service businesses. He has taught courses on Entrepreneurship, Entrepreneurial Leadership, Organic Growth, and Managing Small Businesses. His writings and books can be found at www.EDHLTD.com.

Charles F. Goetz is the Distinguished Lecturer in Entrepreneurship at the Goizueta Business School at Emory University. Prior to joining Emory, Mr. Goetz was a successful serial entrepreneur. He built nine businesses, which in total employed over 1,500 people. He was successful in selling a number of these businesses while also experiencing some failures. Combined, these businesses gave him a valuable insight into understanding what it truly takes to build a successful business.

Professor Goetz serves on the Boards of Directors of several entrepreneurial venture and not-for-profit organizations. He is also an Angel investor in several businesses and is a frequent speaker on Entrepreneurship and Business Development. He recently published his first book, *The Great Entrepreneurial Divide: The Winning Tactics of Successful Entrepreneurs and Why Everyone Else Fails!* In addition, he has been recognized by Emory students as an Outstanding Lecturer in the MBA and Executive MBA Programs. Prior to becoming an entrepreneur, Professor Goetz was a senior executive at Citicorp. He has a BA in Economics from Emory University and an MBA from the University of Texas at Austin.

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Introduction

Welcome to our book! In this introduction, we want to answer a few questions that many of you may have:

- Should you buy this book?
- Why is this book important?
- What topics are covered?
- Why are the authors qualified to write this book?

Who Should Buy This Book?

This book was written to help anyone starting a business—whether he or she is a business person or not. This book also should be helpful for anyone who has started a business and is not making enough money. Lastly, this book should help anyone investing in a start-up because most start-ups face the same challenges.

Why Is This Book Important?

Over 5,000,000 new businesses are started each year, but millions will fail, and most new businesses fail for the same sets of reasons. Our experience has taught us that there are 8 common reasons why start-ups fail, and with our combined 50 years building, financing, and teaching others how to build successful businesses behind us, in this book we offer ways to avoid making those 8 common mistakes.

What Topics Are Covered?

Our goal is simple and focused: to teach you how to avoid the 8 common mistakes many start-ups make.

Ask ten people why so many new business ventures fail, and many will answer, "Because the new business was undercapitalized." Undercapitalized means the business runs out of money before it makes enough profit to survive. We disagree with that conclusion. Running out of money is the result or consequence of more fundamental, underlying failures—the 8 common mistakes—which we teach you how to avoid.

People run out of money because they make one or more of the following 8 common mistakes:

1. Choosing a bad business opportunity (Chapter 3)
2. Choosing the wrong customers (Chapter 4)
3. Trying to sell the wrong product (Chapter 5)
4. Selling for the wrong price (Chapter 6)
5. Overestimating the number of and the speed of customer purchases (Chapter 7)
6. Mismanaging the business (Chapter 8)
7. Failing to hire and retain the right people (Chapter 9)
8. Being unable to grow or scale the business to accommodate growth (Chapter 10)

This book will direct your focus to the 3 Ws:

1. **W**hat will you sell?
2. **W**ho will buy?
3. **W**hy will they buy?

Why Are We Qualified to Write This Book?

Ed Hess lives in Charlottesville, Virginia, and spent most of his business life advising entrepreneurs and financing their business ventures. He went to college at the University of Florida and to law school at the University of Virginia and graduate law school at New York University. Ed's professional career was spent with firms like Atlantic Richfield Company, Warburg Paribus Becker, Boettcher and Company, The Robert M. Bass Group, and Andersen Corporate Finance, and he has built three service businesses.

In 1999, Ed began teaching business students part-time at Goizueta Business School, Emory University, during which time he created and taught the entrepreneurship course. In 2002, Ed joined the faculty at Goizueta full-time as an Adjunct Professor where he became the Founder and Executive Director of both the Center for Entrepreneurship and Corporate Growth and the Values-Based Leadership Institute.

Ed has written five other books:

- Hess, Edward D. *Make It Happen! 6 Tools for Success* (EDHLTD, 2001).
- Hess, Edward. *The Successful Family Business: Proactively Managing Both the Family and the Business* (Praeger: Westport, Connecticut, 2005).
- Hess and Kazanjian, eds. *The Search for Organic Growth* (Cambridge University Press: New York, 2006).
- Hess and Cameron, eds. *Leading with Values: Positivity, Virtue and High Performance* (Cambridge University Press: New York, 2006).
- Hess, Edward. *The Road to Organic Growth: How Great Companies Consistently Grow Marketshare from Within* (McGraw-Hill: New York, 2007).

In July 2007, Ed joined the Faculty of the Darden School of Business at the University of Virginia as a Professor of Business Administration and Batten Executive-in-Residence where he teaches courses on building small businesses and organic growth.

Charlie Goetz earned his college degree at Emory University and holds an MBA from the University of Texas. Charlie is a successful serial entrepreneur. He built several successful businesses, which in total employed over 1,500 people. He sold most of his businesses and made substantial amounts of money their sales. Charlie then began teaching entrepreneurship at Emory University in the Goizueta Business School where he was again successful. His courses are always oversubscribed, and he has earned multiple teaching awards.

Today, Charlie lives in Atlanta, Georgia, and is an investor in several new businesses and consults with people starting businesses. His specialties are marketing, customer acquisition, and product development.

How to Use This Book

There are two ways to use this book:

1. Read it from start to finish. It was written in a specific order—tracing a business idea from the idea stage through the steps of building a business.

2. If you want to focus on a specific question, issue, or problem, go to that chapter. Each chapter will stand by itself.

This book will not guarantee that you will be successful, but it should help you avoid the 8 common mistakes made by start-up businesses.

What Is a Good Business Opportunity?

CHAPTER TOPICS

This chapter uses two examples, a sandwich shop and a children's clothing store, to explore the majority of the following topics:

- ***Net profit margin and customer conversion rates***
- ***Does your business idea "pencil" (make economic sense)?***
- ***Determining pricing***
- ***Analyzing and learning from your competition***
- ***High margin business versus low margin business***
- ***Estimating your costs and nailing down the details***
- ***Burn rate and breaking even***

This is a chapter you will be able to use over and over until you find the *right* business for *you*. We are going to explore a way of thinking—a template to be used in evaluating business ideas. This method of thinking requires you to understand and keep in mind two key business concepts:

1. **Net Profit Margin**

   Net profit margin is the profit from the sale of a product divided by the sales price of the product. That percentage is a short-hand measure of profitability. Your profit from the *sale of a product* is your sales price minus all the costs to make, sell, and deliver the product.

   If your net profit margin is 20% and you sell a product for $10, then at the end of the day you should make $2.00 profit per sale. However, if your net profit margin is only 5%, then you would only make $.50 profit per sale. This being said, you would have to sell a lot more products with a 5% net profit margin than with a 20% profit margin to earn a $1000 per week profit.

   How many products would you have to sell for $10 with a 20% net profit margin to earn $1000 per week? The answer is 500. But what would be the answer if your net profit margin were 5% instead of 20%? That answer is 2,000 products—a *big* difference.

2. **Customer Conversion Ratio**

   Customer conversion ratio is the percentage of customer prospects who actually buy your product. The goal is to make sales pitches to enough prospects so that you make the required number of sales. Prospects become customers when they buy.

   Taking our example in the first point, with a product price of $10 and a net profit margin of %5, you needed to make 2000 sales per week to generate $1000 weekly profit. Well, if your customer conversion ratio is 10%, that means you would have to make 20,000 sales pitches a week—*wow.*

   So conversion ratios help you determine the number of sales pitches you need to make and thus the number of sales people you will need—and the number of customer prospects you need weekly and daily.

> The higher the conversion ratio, the lower the number of sales pitches you will need to make. As you will learn later, the best way to increase your customer conversion ratio is to focus on high probability prospects—that is, learn how to determine a prospect's likelihood of becoming a real buyer.

Number of Buying Customers ÷ Number of Attempted Sales =
Customer Conversion Ratio

Pencil It

We want to stress the importance of "penciling" your business. Do some preliminary research, and put it all down on paper to the best of your knowledge. Use the tools provided in this chapter. Understanding net profit margin, customer conversion rates, costs, and customer traffic will help you do a back-of-the-envelope mathematical analysis. Think about the following:

- Do you have the expertise or knowledge to produce the product?
- How will you make the product?
- What equipment will you need?
- How can you get customers quickly?
- How will prospects know you are in business?
- Who is your competition, and how will they respond?
- Why will your product sell, and what is your value proposition?
- Will your product be cheaper?
- Will your product be better?
- Will your product be different?
- And so on…

If your business idea pencils, it is worth seriously exploring. You can then do more research and homework, and you're on your way. If your business idea does *not* pencil, find another idea.

Ok, let's explore an example: Let's assume you want to open a sandwich shop that sells sandwiches for lunch, and let's call your new business "The Best Sandwich Shop." What questions do you need to answer to figure out whether this business idea is a good business opportunity?

1. How much money do you need to earn weekly for you and your family?
2. What will be the average sales price for your sandwiches?
3. What will be your fully loaded costs to operate your business?
4. What will be your per sandwich net profit margin?
5. How much profit will that produce per sandwich?
6. How many sandwiches do you need to sell everyday to make a living?
7. How often will customers come into your shop and buy?
8. How many total different customers will you need each week to make your livelihood?

For purposes of this example, we are assuming that

- You know how to make a good sandwich.
- You can get good sandwich meats, produce, and breads.
- You can find a good and affordable location for your shop.
- You can get the necessary state and local food establishment licenses to operate.

Example 1: The Best Sandwich Shop

The first question you have to ask is: "How much money do you need to earn before income taxes on an annual basis?"

$10,000?

$20,000?

$30,000?

$40,000?

$50,000?

$100,000?

What is your goal? What is the minimum you need? What would be *nice* to earn?

Let's assume (only as an example) that your answer is $40,000 per year before taxes or $800 per week *net profit*, assuming two weeks of vacation and holidays. Ok, how do you make $800 net profit per week?

You sell sandwiches.

How many sandwiches do you need to sell each week? The answer to that question depends on the answers to the following questions:

1. What will be the average sales price for your sandwiches?
2. What will it cost you to make a sandwich, including all your costs for rent, heat, lights, water, insurance, labor, and so on. (This is your total cost to open and run your business weekly divided by the number of sandwich sales per week.)
3. What is your average profit per sandwich: your average sales price minus your average costs per sandwich?
4. Divide $800 by that average profit number. For example, if your average net profit per sandwich is $1.00, you need to sell 800 sandwiches per week or 160 per day.

Now comes the researching and digging for information part. How do you find out what your average sales price per sandwich should be? How do you estimate your operating costs?

What Is the Average Price You Can Sell Your Sandwiches For?

First, think about the kind of sandwiches you want to sell. How many different kinds can there be? Where do people buy those sandwiches now? At what prices do those places sell their sandwiches?

Do your research. Do a survey; visit the competition. Visit sandwich places that have been in business longer than a year. Why? Because if they have lasted for a year or more, they are likely to be profitable. And that means their prices for sandwiches exceed their costs. Good information for you. See if they will give you a copy of their menu or at least their take-out menu. What prices are they asking? Do this for several good sandwich places.

Okay, this is a good start. You have learned two key pieces of information: The competition seems to be making a profit at a certain price point, and it is unlikely you can charge more than they are charging unless you are doing something very different from them.

Let's assume that after all this thinking and research, you determine that you can sell good sandwiches at an average price of $5 per sandwich. So if you need to earn $800 each week, and your sandwiches sell on average for $5 each, how many sandwiches do you need to sell each week?

160?

No!

What common mistake did you make? You forgot the difference between sales price and profit. If you guessed 160 sandwiches, that only meant you would have received $800 dollars from customers. Out of that $800, you have to pay all your operating costs. How much of the $5 sales price will be profit? What will it cost you to make a sandwich ("all-in costs")? All-in costs means your cost of food, employee costs, rent, heat, lights, wrapping paper, paper plates, salt, pepper, cleaning supplies, bathroom supplies, employee taxes, insurance, licenses, and so on.

So, what amount do you *really* need? What will be your profit margin?

Competitors

Competitors are a fact of life. You will have them.

This research should start you thinking about how you can attract customers. For example, if you visit your potential competition, why will their customers change and buy from you? Better quality? Better price? Better location? Will you give customers free potato chips or a free drink? Will your shop be more fun to visit?

Learn from competitors. Visit many, many sandwich shops. Write down what you like about each. Sam Walton built Wal-Mart by visiting competitors and copying good ideas. Take the best ideas from your competitors and make a "better sandwich shop."

But do not forget that your competition will respond. You are attacking their livelihood in building your own, and they will protect their turf either by lowering their prices or improving their product or both. This introduces the concept of sustainable advantage. What, if anything, can you do that will help you keep your customers long-term?

Wow, there are so many things to think about. At this point, there are a couple of short-cuts to finding the answers you need. The first way is public information—looking at sandwich companies that have sold stock to the public such as McDonald's, Burger King, and so on.

Comparables

In most cases, there are big companies (like McDonald's, Burger King, Subway, Quinzos, and Chick-Fil-A) who are already in the sandwich business. Some of them are *public* companies. Public companies must disclose their profit margins.

Using the Internet you can look up those companies and find their websites. Go to McDonald's website and look under Company Information. Then click Investor Relations or Investor Information. Then click on Financials or SEC filings. Under SEC filings, you will link to annual reports, which will contain the company financial statements.

Companies disclose their operating margins—gross and net. You will want to look at *net profit margins*. Look at two or three companies and use the average net profit margin. Understand this is just a guideline and that your profit margin will be different. It may be higher because you will be a smaller business (especially in the sandwich shop business), and you should have fewer costs.

Internet Research

Another research tool is to go on the Internet and search sandwich shops and sandwich shop profits. Almost every type of business has a trade association or cooperative that provides a newsletter. These are a great source of information. Today with the Internet, information is out there if you just look hard enough in enough different places. Be a good detective.

Speak with Other Entrepreneurs

Another way to do research is to go visit some sandwich shops in locations that will not be competitors of yours and speak with the owners. Tell them about your dream and ask for their help. Someone will say, "How can I help you?" Then, you should learn about their operating costs and ask them to share with you the big mistakes they made in starting their businesses. In addition, ask their advice about suppliers, how they advertised, how they were successful.

Entrepreneurs generally want to help other entrepreneurs—especially if they are not future competitors.

Back to the Math

Let's assume for our example that the net profit per sandwich is 18% (or 90¢) a sandwich. That is, you can estimate making 90¢ profit on every sandwich you sell. *How many sandwiches must you sell each day to make $800 per week?*

Profit per week = $800

Profit per sandwich = $.90

Number of sandwiches needed to sell each week = 800/$.90 = 888

Number of sandwiches needed
to sell every day on average = **178** (888/5 days per week = 178)

Is this realistic?

Is this likely?

Let's factor in some more considerations:

1. Yes, there are eight hours in a workday, but lunchtime is not eight hours long. You have a finite timeframe in which to sell 178 sandwiches.
2. Workers only have one hour max to drive, park, come in, order, eat, and go back to work. The location of your shop is critical. Parking is critical. How you design your shop to move people through quickly is critical.

This raises even more questions for you:

- What time will your lunch business begin?
- What time will your lunch business end?
- How many sandwiches can you make per hour? Or will you pre-make them?
- How many times a week will your customers buy from you?
- How many *different* customers will you need a week?

- How far will customers drive for a good sandwich?
- Do enough people work within a reasonable drive time?

Now think how different your answers would be if the business is a low margin business—say, 5% (see Table 3.1).

Table 3.1 *Number of Sandwiches Per Day*

Net Profit Margin	# Sandwiches Per Day
5%	640
10%	320
15%	213
20%	160

At a 20% profit margin, you have to sell 160 sandwiches a day. At a 5% profit margin you have to sell 640 a day—*A BIG DIFFERENCE.*

Now, if a customer comes in twice a week, every week, you will need at least the ratio shown in Table 3.2.

Table 3.2 *Number of Different Customers Per Week*

Net Profit Margin	# Different Customers Per Week
5%	1600
10%	800
15%	533
20%	400

You should now understand why net profit margins are so important. They determine your volume—*the number of customers you need* to be successful. Your conclusion: You will need 533 different customers if the average customer comes in twice a week.

Remember, you will not attract or get all the lunch business in your area. So how many potential lunch customers need to exist? 2000? 4000? 5000? Again, this raises the issue of location. Opening a shop near your apartment in a residential neighborhood is very different than opening a shop in a high employment location. Remember Willy Sutton—when asked why he robbed banks he said, "Because that is where the money is." Where are your customers? Go where your potential customers are.

The problem with that easy answer is what? You guessed it. Landlords know this. Your rent will be higher in a location near large numbers of workers. So your costs will be higher. This is the *trade-off*. Will the increased rent, though, be offset by more sales, and will the increased rent make it more likely you will succeed? Will the increased rent lower your profit margin from 15% to 12%, or will it lower it from 15% to 5%? That allows you to figure out the impact on the number of sales.

Now let's review. We have gone through a process of figuring out average sales price; figuring out our estimated net profit margin; and figuring out the estimated number of sales we need to make a day, and we have looked at how many repeat customers we may have, which helps us understand the number of potential or prospective customers we may need.

This is the *pencil process*, a method of analysis that gives us a snapshot picture of how much volume we need to do. And we have learned that net profit margin has big consequences in that it dictates the number of customers we need each day.

Let's look at another example—a children's clothing store.

Example 2:
Children's Clothing Shop

Now instead of a sandwich shop, assume you want to open a shop that sells children's clothes. (Ed's parents' first entrepreneurial venture was a children's clothing store.) Assume the average sale is $10.00 per customer with a 15% net profit margin. And let's assume you still want to take home $800 a week before taxes. So how many sales per week do you have to make?

Table 3.3 *Sales Needed Per Day*

$10 x 15%	= 1.50	Net profit per sale
$800/$1.50	= 534	Sales per week
Average sales per day/6 days	**89**	

Let's now learn about customer conversion ratio.

Customer Conversion Ratio

So you need to make 89 sales per day. Will everyone who comes into your store buy? Of course not. Lots of people will be looking, learning, planning ahead, shopping prices, exploring, or just wasting time. Some people call these non-buying people "tire kickers." So what percentage of people who come into your store will make a purchase on any given day?

Table 3.4 *Results of Different Customer Conversion Ratios*

What % of Prospects Will Buy?	# Sales Per Day	Per Day # Total People Needed	Per Week # Total People Needed
10%	89	890	5340
20%	89	445	2670
50%	89	178	1068

Wow, what a difference! Customer conversion rates have a dramatic impact on determining the likelihood you can achieve your goal of $800 net profit per week.

Customer conversion rates will help you understand the *customer traffic* you need—the number (volume) of potential prospects you need daily to sell the amount you need.

Customer traffic will depend on your location and how easy it is for you to let people know you are in business. The goal of a business location and advertising is to increase customer traffic. The more customer traffic, the more likely you will make sales, assuming your traffic consists of potential buyers. Let's review.

The lower the profit margin, the larger the number of paying customers you will need.

Business Rule #8:

Low Profit Margin =
High Volume

High Profit Margin =
Lower Volume

Customer Conversion Rates

Customer conversion rates will tell you how many total prospects you will need to make a sale.

10% conversion = 10 prospects for 1 sale

20% conversion = 5 prospects for 1 sale

How often your customers need to buy your product will give you an estimate of how big your customer base needs to be. Will your customers buy from you weekly, monthly, or only on special occasions?

So in a low profit margin business, you need a lot of customers buying from you. Low customer conversion rates indicate you need numerous customer prospects to come into your business—customer traffic. If customers will need your product or service infrequently, this requires even more customer traffic.

Business Rule #9:
Profits are your goal—sooner rather than later.

Business Rule #10:
Cash flow is your business's lifeblood—it is how you pay your bills.

Two Different Types of Businesses

1. Low Profit Margin

   Or

   Infrequent Buys ⟶ You need lots of customers.

   Or

   Low Customer Conversion Rate

2. High Profit Margin

   Or

   Frequent Customer Purchases ⟶ You need a smaller number of customers.

   Or

   High Customer Conversion Rate

The tools you learned in this chapter allow you to discover the number of potential customers and the number of sales you need every day, which gives you a basis from which to make a judgment as to whether an idea is a good opportunity.

Generally, your net profit margin or allowable profit margin range is limited or determined by the type of business you are in. Most businesses selling similar products will make similar or close to the same margins. What does this mean? Your choice of business— the type of business it is—will greatly influence how much money you can or will make.

Because public companies (companies whose stock is sold publicly) have to disclose their numbers, it is possible to compute average net profit margins by type of business (see Table 3.5).

Table 3.5 *Margins by Sector*

Industry Name	After-tax Operating Margin
Apparel	8.49%
Auto Parts	5.47%
Building Materials	9.45%
Computers/Peripherals	7.66%
E-Commerce	7.95%
Educational Services	10.67%
Electronics	5.05%
Environmental	13.15%
Food Processing	7.64%
Food Wholesalers	3.03%
Furniture/Home Furnishings	7.34%

Table 3.5 *Continued*

Industry Name	After-tax Operating Margin
Grocery	3.38%
Healthcare	12.14%
Heavy Construction	2.91%
Home Appliance	6.98%
Homebuilding	5.01%
Household Products	15.12%
Human Resources	3.33%
Information Services	15.49%
Machinery	9.62%
Medical Services	7.79%
Medical Supplies	8.98%
Metal Fabricating	10.41%
Office Equip/Supplies	7.06%
Packaging & Container	9.46%
Paper/Forest	11.12%
Pharmacy Services	1.64%
Restaurant	12.05%
Retail (Special Lines)	6.10%
Retail Automotive	4.69%
Retail Building	7.66%
Retail Store	4.71%
Shoe	8.70%
Toiletries/Cosmetics	8.76%
Wireless Networking	10.67%

Data Used: Value Line database, of 7364 firms
Date of Analysis: Data used is as of January 2008
Source: http://pages.Stern.nyu.edu/~adamodar/New_Home_Page/datafile/margin.html

So what good are these numbers? They may help you choose a business. For over 7000 big businesses in 2005, the average after-tax operating margin was 11.98%. Assuming a 30% average tax rate, the average pre-tax profit margin was around 17%.

Now, your immediate reaction might be that this is simple—choose a higher margin business…

NO! NO! NO!

You should choose the best margin business in which you would have the highest probability of succeeding at. That means:

A business you can do because of expertise, experience, knowledge, and which you would enjoy doing
and
A business for which you have or can get customers.

You have to be able to produce and deliver high-quality products or services on time, defect-free, and for a profit. And because this business will consume most of your waking hours, you should enjoy doing it.

Estimating Your Costs

Business Rule #11:
Control your costs—spend wisely on the right stuff.

The next step in thinking in more detail about your business idea is drilling down to estimate your total costs to make, sell, and deliver your product or service.

What happens if you overestimate cash coming in and underestimate your costs?

YOU CAN LOSE MONEY!

And you will have to make up that difference (loss) from your savings, a home equity loan, family loans, or selling property.

THIS IS SERIOUS!

That is why we stress: Please, please, do your homework. There is a wealth of information out there, and there's so much available right at your fingertips on the Internet.

What Does Net Profit Margin Tell You About Costs?

100% – Net profit margin = Your projected costs percentage

It gives you the answer! For example, if you are in a 10% net profit margin business, your projected costs are 90% of your *sales price* (assuming you sell enough stuff). So your total cost estimates should add up to 90% of your average sales price.

Example:

1. Sales Price = $10 per transaction

   Net Profit Margin = 10%

   Your Profit = $1

   Your Costs = $9

   All of your costs added up should approximate $9 per sale, assuming you sell enough to cover all of your costs.
2. Sales Price = $15 per transaction

   Net Profit Margin = 20%

   Your Profit = $3

   Your Costs = $12

   All of your costs added up should approximate $12, assuming you sell enough to cover all of your costs.

You need to do research and talk to other business people and accountants and create an estimated weekly cost chart (see Table 3.6).

Table 3.6 *Sample Cost Chart*

Expense	Per Monthly Cost	Expense	Per Monthly Cost
Accounting		Inventory	
Advertising		Legal	
Business Supplies		Licenses	
Cost of Supplies		Lights	
Cost to Deliver		Marketing	
Employee Costs		Phone	
Equipment		Rent	
Furniture		Repairs & Maintenance	
Heat		Taxes	
Insurance		Water	

Why Do You Need to Know Your Costs?

There are two main reasons:

1. You will not usually make sales the first day you are in business because there is a *start-up time*—a time in which you are paying expenses without receiving cash from customers.
2. It will take you time to reach *break-even*—that month when your cash in from customers equals your costs for the month.

> **Business Rule #12:**
> Know your burn rate—how soon will you run out of money?

Knowing your costs allows you to plan for your *burn rate*—how fast will you burn through the money you have available from yourself and family and friends to start your business.

To emphasize the importance of choosing a good business opportunity before you start your business, remember these basic business rules:

Business Rule #8:
Low Profit Margin = High Volume
High Profit Margin = Lower Volume

Business Rule #9:
Profits are your goal—sooner rather than later.

Business Rule #10:
Cash flow is your business's lifeblood—it is how you pay your bills.

Business Rule #11:
Control your costs—spend wisely on the right stuff.

Business Rule #12:
Know your burn rate—how soon will you run out of money?

7 Ws

The 7 Ws are a good shortcut way to think about business opportunities. Use them as a tool to evaluate whether a business idea is worth exploring seriously:

- **W**hat can I sell?
- To **W**hom can I sell?
- **W**hy will customers buy from me?
- At **W**hat price?
- **W**hat are my costs?
- **W**hen will customers buy?
- **W**hat will the competition do?

Chapter Three: Lessons Learned

1. Business ideas are like sand at the beach—plentiful, but there are few new or unique business ideas.
2. Not every business *idea* will make a good business *opportunity*.
3. Your idea needs to "pencil"—that is, make economic sense.

4. The key "pencil" drivers are:
   - The amount of money you need to make
   - Net profit margin
   - Customer conversion rate
   - Customer traffic volume
   - Speed of sales
   - Customer buying frequency
   - Burn rate and staying power—how much time (money) can you invest until you make a profit?
5. Remember the 7 Ws:
   - **W**hat can I sell?
   - To **W**hom can I sell?
   - **W**hy will customers buy from me?
   - At **W**hat price?
   - **W**hat are my costs?
   - **W**hen will customers buy?
   - **W**hat will the competition do?
6. Common mistakes business starters make:
   - Overestimating the number of customer sales
   - Overestimating how fast people will buy
   - Underestimating their costs
   - Underestimating the competition
7. Owning a low margin business means:
   - You need a lot of customers.
   - Customers need to buy frequently.
   - You will have to operate very efficiently.
   - Your room for financial mistakes or errors will be small.
   - Volume of customer traffic, customer conversion rates, and knowing the competition is very important.

8. Owning a higher margin business generally means:
   - You need fewer customers.
   - Your customers probably will not be frequent buyers.
   - You will need to consistently generate new customer prospects.
   - Customer conversion rates could be low.
   - You need a constant flow of good customer prospects.
9. Your estimated weekly costs help you predict your *burn rate*: the speed at which you will burn through your money. Burn rate tells you how long you can stay in business until you hit break-even.
10. *Break-even* is the point at which your weekly incoming cash equals your costs going out.

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Praise for *What's Stopping You?*

"Bruce Barringer and Duane Ireland's new book, *What's Stopping You?* is an insightful and thought-provoking examination of nine common myths that discourage individuals from starting new businesses. … This book is much-needed and long overdue…. The value of *What's Stopping You?* is that it effectively debunks the false premises that too often preclude acts of business start up. *What's Stopping You?* is an encouraging, instructive, and eloquently written book that would be a valuable addition to any aspiring entrepreneur's bookshelf."

Jeffrey G. Covin, Samuel and Pauline Glaubinger Professor of Entrepreneurship, Kelley School of Business, Indiana University, Bloomington, Indiana

"Over the years I have observed many seemingly great business opportunities never get off the ground. Quite often, what holds these aspiring entrepreneurs back are common misconceptions about the difficulties and risks of starting a new business. In *What's Stopping You?*, Professors Barringer and Ireland systematically break down the myths that hold many entrepreneurs back from pursuing their dreams."

Jeffrey R. Cornwall, The Jack C. Massey Chair in Entrepreneurship, Belmont University, Nashville, Tennessee

"Barringer and Ireland simultaneously demystify start-up misconceptions and empower readers to explore their own opportunity with renewed passion. Many prospective entrepreneurs feel trapped by myths, the authors carefully detail the myth's fallacies and encourage the reader to see beyond start-up stereotypes. Future and experienced entrepreneurs have much to learn from *What's Stopping You?*"

Sarah Schupp, Founder/CEO, University Parent Media, Boulder, Colorado

"Creating your own business from scratch can be a mental, emotional, and financial roller coaster ride. Bruce Barringer and Duane Ireland's book provides a 'voice of reason' and helps give you the confidence to realize you can do it. They recognize that starting a business is hard work, but that it is attainable—and that you should celebrate your accomplishments every step of the way."

Jan Stephenson Kelly, Cofounder/CEO, Spark Craft Studios, Cambridge, MA

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WHAT'S STOPPING YOU?

Shatter the 9 Most Common Myths Keeping You from Starting Your Own Business

Bruce R. Barringer, PhD
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To Janet, John, Jennifer, and Emily:
The love and support of a family is a wonderful thing.
—Bruce Barringer

To Mary Ann: Thank you for your never-ending support,
love, and nurturing for all of these years. I love you.
—R. Duane Ireland

CONTENTS

ABOUT THE AUTHORS

Bruce R. Barringer, PhD is an Associate Professor at the University of Central Florida. The author of two small business/entrepreneurship textbooks, Barringer's work is read worldwide. He is also the author of the *Wall Street Journal's Entrepreneurship Weekly Review*, which is distributed to small business and entrepreneurship teachers and students across the United States.

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PREFACE

Have you ever caught yourself daydreaming while at work and wondering if what you're doing is all you'll achieve in your career? Or has your heart ever ached to meet a certain desire, like completing work that you truly enjoy, being your own boss, making more money, or being home when your kids get out of school?

These types of thoughts and desires confront people every day—even those with seemingly perfect jobs. In response, most people just sigh or shrug and accept life as it is. But not always. A growing number of people from all walks of life are starting their own businesses as a way of improving their lives. In fact, there are roughly 15 million self-employed people in the United States today. But there is a problem. The problem is that because some business owners have hit it rich and made a large impact on society, there is a growing tendency to view business owners as bigger-than-life and place them in the same category as professional athletics and rock stars. This tendency has led to the prevailing wisdom that starting a business is an extremely difficult task and that a person must have "loads of money" and "tons of talent" to get a new business off the ground.

While it's true that some businesses are difficult to start and that talent and money are needed to get a business off the ground, many of the tales and perceptions about the enormous difficulties associated with starting a business are just myths. The truth is that the ability to start a successful business is much more within the average person's reach than the myths allow us to believe. If you have the interest it took to pick up this book, chances are you have the talent, the money, and the character needed to start and run a business of your own.

Who Is This Book Written For?

This book is for anyone who has thought about starting his own business but has been reluctant to try. This group covers a wide spectrum, from people who have an idea for a new business but are uneasy about leaving their current jobs to people who are dissatisfied with their jobs or careers but feel trapped. It also includes people who have a goal or want to live a particular lifestyle and see starting a business as the most reasonable way to make it happen.

Although some people do start businesses, most of the people in these categories think about it occasionally but set their thoughts aside because of the anxiety and worry caused by the nine myths that we discuss in the book. It's hard to blame them. Listen to the first three myths and ask yourself if they would discourage you from starting a business: Myth 1: It takes an extraordinary person to start a business; Myth 2: Starting a business involves lots of risk; Myth 3: It takes a lot of money to start a business. Pretty daunting list, isn't it? And there are six myths to go!

A potentially rewarding part of reading this book are the many people you meet that objectively aren't any smarter, richer, or more gifted than you. What they do have that you probably don't is a successful business startup. As we progress together through the chapters of the book, we knock off the myths one by one by showing how ordinary people prove that they simply aren't true. But there are exceptions. In most cases, it does take an extraordinary person and lots of money to launch a biotechnology, a medical products, or a semiconductor firm. But these cases, by far, are the exception rather than the rule. You'll be amazed what people are able to accomplish with very little money and the simple common sense that is the foundation on which many of the business startups described in this book were built.

What Will You Learn by Reading This Book?

Next time you go to a bookstore or are in an airport gift shop, try this little experiment: Spend a few minutes watching people browse through the business magazines or books. Watch their faces and try to guess what their circumstances are. If you're like us, in the majority of instances, you'll get the feeling that they're looking for answers. There is some problem or unmet need in their personal or professional lives that they'd like to resolve but can't figure out how to on their own. So they're scanning the books for potential answers. If you conduct this experiment long enough, we can almost guarantee you that you'll see the ultimate example of this scenario play out. Someone will be scanning the shelves of business books and will come across a book that immediately catches her attention. The person will then intently page through the book for a few minutes, in a state of total concentration, and a slight sign of hope or relief will gradually start to cross his or her face. As the person proceeds to the checkout counter, he or she will be clutching the book as if it were a $1,000 bill. You can't help but hope, for that person's sake, that his or her question has just been answered.

This experiment is a reminder of how desperate people are for answers to the problems or challenges in their lives and how much hope, information, and potential help books can offer. If you're reading this preface, you're probably tired of your job, want to make more money, desire to pursue the career you have always wanted, or are thinking about starting your own business for a reason equally important to you. What's stopping you, if you're similar to most of the people we talk to, is a lack of knowledge about the business startup process and nervousness about one or more of the topics covered by our nine myths. This set of circumstances leads to a lack of self-confidence, which researchers believe is the number one reason that people hesitate to start their own firms.

What you will learn by reading this book is the truth about many of the most important aspects of starting a business. Our goals are to educate you and stir your emotions. We hope that as you read the book, you'll pause from time to time and think to yourself, "That's interesting—perhaps I have been too quick to dismiss the idea of starting my own business." We also pledge that the stories will be compelling enough that you'll stop occasionally to excitedly tell a coworker or friend things like, "Do you know it's not true that nine out of ten new businesses fail?" (In truth, 66% of new businesses are still operating after two years, and 50% survive four years or more.) Or you'll want to share stories such as, "You won't believe how this woman I just read about quit her job as a general partner in an investment firm to buy an adventure travel company. She didn't do it because she could make more money—she did it to lead a more satisfying and enjoyable life."

How Is This Book Organized?

The book is organized into nine chapters—one chapter for each of the nine myths. Each chapter starts by stating the myth and the corresponding truth and is followed by a complete discussion of the chapter's topic. Each chapter contains two to three special features that add to the material in the chapter. Although the book is admittedly upbeat, we paint a realistic job preview for those who are thinking about becoming a business owner. We want people to be realistic about their prospects, but we also want them to be confident and to think, "I can do this. It's not beyond my reach."

We now invite you to enjoy learning about the myths associated with starting your own business and to learn from the lessons in this book. If you are inspired by a particular story in the book, if you would like to tell us your start-up story, or if you are impacted by this book in any way, please feel free to e-mail us your story at story@mythsbook.com. We would love to hear from you. Much of what we know we learn from people just like you. We'd love to consider including your story in future books as we work together to dispel the myths and reveal the truth about the business start-up process.

CHAPTER 3

Myth No. 3: It Takes a Lot of Money to Start a Business

Truth No. 3: It Might Not Cost as Much as You Think

How much do you think it costs to start a business? If you're thinking about a biotechnology, semiconductor, or medical product firm, you'd probably say a lot, and you'd be right. But how much do you think it costs to start an average business, like the privately owned businesses you deal with every day? And where do you think the majority of the start-up capital for these businesses comes from? According to the *Wells Fargo/Gallup Small Business Index*, the average small business is started for about $10,000, with the majority of the money coming from the owners' personal savings.[1]

If this figure strikes you as low, you're in good company; it strikes most people as low. That's because when most people think of businesses, they think of the types of businesses that they interact with the most frequently, like grocery stores, restaurants, gas stations, and large retail stores. These types of business do take a lot of money to start and run. But chances are if you start a business, it won't be like these businesses—at least initially. It will be more like the businesses highlighted so far in this book. Most of these businesses didn't take a tremendous amount of money to start. Even aggressive growth firms, in most cases, don't take an arm and a leg to get started. Each year *Inc.* magazine compiles a list of the 5,000 fastest-growing privately owned firms in the United States. In 2006, the medium amount it took to start one of the businesses on the list was $75,000.[2] That means that half of them were started for less than $75,000. And these firms cover a wide swath of businesses, from building contractors to advertising agencies to retail stores.

There is somewhat of a catch, however, involved with starting a business with limited funds. The catch is that most people simply don't have any experience or insight when it comes to determining how much it will cost to start a business, how to economize on start-up expenses, or how to raise money if needed. These are topics that there is no reason to think about until you start seriously thinking about starting a business. To provide insight regarding these issues and to further dispel the myth that it takes a lot of money to start a business, this chapter is divided into three sections. The first section provides insights into how to think about money as it relates to starting a business. The second section focuses on the techniques that enable business owners to minimize the costs associated with starting a business. The third section focuses on the choices that small business owners have for raising start-up funds if needed.

Insights Into How to Think About Money as It Relates to Starting a Business

For most people, the topic that consumes the majority of their thinking as it relates to money and starting a specific business is "How much money will it take to get the business off the ground?" While this question makes perfect sense, there is no concrete answer. The same exact business might cost one person $10,000 to start and another person $25,000—trust us, this isn't an exaggeration. The amount needed typically depends on how a person thinks about money as it relates to starting a business, how frugal a person is, and how resourceful a person is in gaining access to money and other resources.

While money is obviously needed to start even the most basic business, many of the observations that successful business owners make about money are surprising. While you'd think money would be held in high esteem, many business owners discount the importance of having plentiful funds as a key to new business success. Instead, they tend to see the absence of money as a motivator for developing qualities such as resourcefulness, creativity, focus, frugality, and drive.

The following are three insights about the role of money in the start-up process. As you read through each insight, think carefully about how each topic relates to your own attitudes about money. One of the reasons that many businesses are started for as little money as they are is that people adjust their attitudes about money as they become more acquainted with the start-up process.

Now let's look at three insights regarding the role of money in the start-up process.

Skimpy Finances Can Be a Blessing Rather Than a Curse

The first insight regarding money and the start-up process is that there is a silver lining to having limited start-up funds. Many successful business owners, when they reflect back on their start-up years, feel that having limited funds forced them to focus, become self-reliant, and develop a mindset of frugality—qualities that have served them well as they've grown their firms.

The importance of focus is affirmed by Caterina Fake, cofounder of Flickr, the popular photo-sharing Web site, which was started in 2002. In reflecting back on the role of money in the early days of her firm, Fake said:

> *"The money was scarce, but I'm a big believer that constraints inspire creativity. The less money you have, the fewer people and resources you have, the more creative you have to become. I think that had a lot to do with why we were able to iterate and innovate so fast."*[3]

Flickr's first product was a multiplayer online game called Game Neverending. At one point mid-way through the development of the game, the programmers, on a lark, added an instant messenger application to the game's environment, which allowed users to form communities to share photos. Surprisingly, the photo-sharing feature quickly passed the game itself in terms of popularity. As the photo-sharing feature continued to gain momentum, the game itself was dropped because the company couldn't afford to work on both projects simultaneously. Flickr (www.flickr.com), as a photo-sharing Web site, became extremely popular and was acquired by Yahoo! in 2005 for somewhere between 20 and 30 million dollars. Ironically, it was the lack of money, rather than the abundance of it, that caused the founders of Flickr to drop the game and focus on the photo-sharing site, a decision that turned out to be very profitable for the company.

In regard to developing a culture of self-reliance, having limited start-up funds often instills discipline in a firm and forces the founders to substitute ingenuity and hard work for financial resources. An example of how this played out in one firm is provided by Doris Christopher, the founder of The Pampered Chef. Christopher started The Pampered Chef in 1980 and ran the company out of her home well beyond its start-up years. Explaining how having limited start-up funds helped set her on a lifelong track of financial discipline, Christopher wrote:

> *"With a bankroll of only $3,000 to start my business, I didn't have any choice; I had to watch my overhead. It taught me discipline, which I have been mindful of throughout my business career."*[4]

The Pampered Chef, which was started in 1980, has been an enormously successful company. It sells kitchen utensils through home parties, utilizing a direct sales approach (like Tupperware). At last count, the company had nearly 70,000 Pampered Chef consultants and 12 million people attending its home parties each year. To this day, the main theme of Christopher's speaking and writing is to caution business owners to avoid debt, minimize overhead, and remain self-reliant.

Finally, limited funds at the outset often help a firm develop a mindset of frugality—a quality that is often very helpful as a firm grows and expands. For example, many businesses that are started on a shoestring learn to function very inexpensively and continue to watch their money very carefully, even after they become successful.

How Not Having Much Money Helped One Founding Team Learn to Be Self-Reliant and Receive a Nice Payoff When Its Business Was Acquired

In the early 1990s, Ron Gruner, a serial entrepreneur, launched Shareholder.com, a company that helped large firms better communicate with their shareholders. The company started with no investment capital and funded its growth entirely through earnings. There were times, Gruner readily admits, when having more money would have been nice and would have enabled the firm to grow much faster. But the benefit of having limited funds was that the company became self-reliant, and its employees learned how to substitute ingenuity and hard work for money. In an interview Gruner gave to Jessica Livingston, the author of *Founders at Work*, he recalled a specific example that makes this point:

"Here's an example: Back when the whole Internet thing was getting started, I hired a computer consultant to come in and advise us about what our Internet infrastructure should be. He was a well-credentialed, Microsoft-accredited engineer, etc. He came in and said, 'You need to buy x number of servers and this kind of software and all that, and it's a quarter of million dollars to do it right.' We said we couldn't even come close to doing that. So I went down to Barnes & Noble, bought several books, including some of the Dummy series. And we built our first Internet servers, which lasted us several years, on Gateway desktop computers, using Microsoft Access as our database system and using basically off-the-shelf server software. We did that for $3 [thousand] or 4,000, and it worked great."[5]

This type of behavior—doing things yourself rather than spending a lot of money—is referred to as bootstrapping, a practice we'll talk about later in the chapter. In Shareholder.com's case, an added benefit of learning to be self-reliant was that it motivated the company to remain independent during the heady dot-com era of the late 1990s and early 2000s, when money from investors was readily available. By not taking money, the company was able to remain nimble and react quickly to competitive challenges because it didn't have to consult with bankers or investors before it made a decision.

Shareholder.com grew steadily through the years, and the payoff came in 2006 when the firm was acquired by NASDAQ. Because Gruner and his team learned to be self-reliant and live with limited funds, they didn't have anyone to split the proceeds with when the firm was sold.

Raising or Borrowing Money Is Trading One Boss for Another

The second insight regarding the role of money and the start-up process has to do with raising equity capital or borrowing to fund a business. One of the first things that many people do when they decide to start a business is to try to raise money through a bank or an investor. There are several choices that business owners have for raising money, including commercial banks, SBA guaranteed loans, investors, grants, supplier financing, and several others. Of these choices, many people automatically assume that the only way they'll raise the amount of money they need is via a commercial bank or an equity investor. While the other choices might hold promise, most people's initial reactions are that the alternatives pale in comparison to the amount of money that can be raised from a bank or through an investor.

While in some cases it is necessary to go the bank or investor route, the problem with obtaining money from these sources is that there are consequences that business owners often don't fully anticipate. Bankers and investors typically assert considerable control over the businesses they provide money to as a means of protecting their investments. While the majority of bankers and investors have good intentions, the level of scrutiny and control their investments allow them often has an impact on the firms they fund. For example, banks are inherently conservative and often caution their clients to grow slowly, while investors are the opposite and regularly pressure the companies they invest in to grow quickly to increase their valuations. What's missing here is what the business owner wants. So for people leaving traditional jobs to start their own businesses, obtaining money from bankers or investors is often like trading one boss for another. You might be freeing yourself from working for a boss in a traditional sense but could have an equally influential boss in the form of a banker or an investor.

An additional consideration when taking money from an investor is that you exchange partial ownership in your business for funding. This aspect of the small business owner–investor relationship can also be problematic. Unlike the business owners introduced in this book, who started their businesses to fulfill personal aspirations or follow their passions, the majority of investors are not in it for the long term—they want their money back in three to five years along with a sizeable return. This means that a business owner like Daryn Kagan, the former CNN reporter who started a "good news" Web cast, will probably have to sell her business in three to five years from the time it was started if she accepted investment capital. Although this scenario will undoubtedly net Ms. Kagan a handsome financial return, assuming her business is gaining traction and is profitable, she'll lose direct control of the business she was so excited to create.

The solution to avoid these potential problems is steering clear of bank financing or equity funding or, at the minimum, having a clear understanding of the nature of the relationship you'll have with your banker or investors. It's possible for a small business owner to have a healthy relationship with a banker or an investor. The overarching point, however, is that small business owners should go into these relationships with their eyes wide open, fully understanding the parameters of the relationships they're developing.

Excess Funds Can Enable a start-up to Operate Unprofitably for Too Long

The third insight regarding money and the start-up process is that having excess funds often masks problems and enables a firm to operate unprofitably for too long. Many businesses lose money their first several months while they ramp up and gain customers. That's normal. But at some point, a business has to operate profitably to prove that it is a viable, ongoing pursuit. People who start businesses with limited funds typically find out quickly if their businesses are capable of turning a profit. Because they don't have excess funds to rely on, they must make adjustments quickly, like cutting expenses or increasing sales, to turn a profit. Ultimately, if the business doesn't work, it is shut down. In contrast, if a person starts a business with abundant funds, the business can operate for months at a loss and stay open if the owner relies on excess funds to keep the business afloat. The owner may never feel pressured to cut costs or generate additional sales, thinking that the business simply needs more time to prove itself. If the business ultimately fails, it will normally lose more money and more of its owner's time and prestige than the less well funded startup.

A related complication associated with having abundant funds is that a business's cost structure and clientele is often determined by the amount of money it has initially. For example, if you decided to open a clothing store and were offered $200,000 by an investor to start the business, you might rent space in an upscale mall, hire experienced salespeople, buy the latest computer equipment, and launch an expensive advertising campaign. While this sounds good, once the business is started and the $200,000 is gone, you might be locked into a high overhead business that has to sell high margin products to an affluent clientele to make the business work. Conversely, if you had started with less money, you might have signed a shorter tem lease in a more modest facility, hired your initial salespeople part-time to see which ones worked out the best, bought used computer equipment, and found inexpensive ways to spread the word about your store. Utilizing this approach, you'd actually have more flexibility and room to maneuver than the better funded scenario.

Collectively, the purpose of these three insights is to put the importance of money in starting a business in its proper perspective. While many people think, "If I only had the money, I'd start my own business," the insights provided here show that having money isn't a panacea. In fact, the discipline imposed by having limited funds is often an advantage and creates a healthier business in the long run.

The next section of this chapter focuses on techniques that enable business owners to minimize the costs associated with starting up. While many businesses ultimately do need to raise some money to get started, the amount needed can be greatly reduced through creative and novel cost-cutting techniques.

Techniques That Enable Business Owners to Minimize the Costs Associated with Starting a Business

As mentioned earlier in the chapter, the numbers reported for the average cost of starting a business strike most people as low. When you think about the cost of buying a car or even a major household appliance, it's easy to question whether the average business is really started for around $10,000. The answer is that while it might cost $10,000 to start the average business, that figure doesn't tell the whole story. Many business owners put a tremendous amount of free labor into starting their firms and become experts at scraping and scrounging to gain access to resources at reduced cost. In fact, many observers believe that a business owner's ability to "bootstrap" all or part of its resource needs is a key to business success. The term *bootstrap* comes from the German legend of Baron Munchausen pulling himself out of the sea by pulling on his own bootstraps. In start-up circles, bootstrapping means finding ways to avoid the need for bank financing or investor funding through creativity, ingenuity, thriftiness, cost-cutting, or any means necessary.[6]

This section of the chapter focuses on three techniques that enable business owners to minimize the costs associated with starting a business. The techniques include selecting an appropriate business to start, seeking help, and cutting costs and saving money at every available opportunity.

Selecting an Appropriate Business to Start

The first step involved in minimizing the costs associated with starting a business is to select an appropriate business. If you have limited funds, you should start a business that requires a small up-front investment, has a short sales cycle (meaning the customer decides quickly whether to buy), has short repayment terms (30 days or less), and has a high degree of recurring revenue. Businesses with the opposite characteristics generally take too much money for a business owner with limited resources to start and run.

Fortunately, there are many businesses that meet the criteria described. Home-based businesses, which now represent more than half of the 26.8 million U.S. small businesses, are popular largely because they take very little capital to start and have low overhead. The cost savings that are realized by operating a home-based business often help these businesses earn profits from the start, which helps them accumulate the funds necessary to move into larger quarters when needed. This is exactly what happened in the case of Emily Levy, the founder of EBL Coaching, the tutoring service for children introduced in Chapter 2. Commenting on her start-up experience, Levy wrote:

> *"My start-up costs were minimal since I was working out of my apartment. Now that the business has grown, however, I have to pay for office space, insurance, advertising and tutors, but EBL Coaching has been profitable from the start. There are many businesses that you can start with minimal capital, especially if you start small and grow organically as demand increases."*[7]

Service businesses are also fairly inexpensive to start depending on the nature of the business. Though not exhaustive, a list of service businesses that typically meet the criteria discussed above are shown in Table 3.1. An example from the table is a home inspector. Nearly every real estate transaction requires a home inspection, making it a fairly lucrative business. The up-front costs of becoming a home inspector are fairly modest, which include training and certification and a basic set of home inspection tools. The sales cycle is short, considering that once an inspection is ordered, it is normally completed within a few days. The repayment term is also short because the inspector usually requires payment the day of the inspection. And there is normally a high degree of recurring revenue. Even though the same people don't normally require repeat inspections, the vast majority of a home inspector's business comes from referrals from builders and real estate agents.

Table 3.1 Examples of Service Businesses That Are Attractive Alternatives for Prospective Business Owners with Limited Funds

Automotive Detailing	Massage Therapist
Bookkeeper	Messenger Service
Bridal Consultant	Nanny Service
Career Counselor	Online Retailer
Counselor/Psychologist	Photographer
Daycare Service	Property Management Service
eBay Store	Public Relations Consultant
Executive Search Firm	Tax Preparation Service
Financial Planner	Transcription Service
Home Inspector	Travel Agent
Interior Designer	Tutoring Service

The types of businesses that aren't good choices for prospective business owners with limited funds are businesses that bring new products to market, businesses that are capital-intensive like manufacturing firms, and businesses that require a lot of employees like a call center. While these businesses might have more potential profitability than home-based businesses and service firms, they simply take too much money to start for someone with limited start-up funds.

Seek Out Help

The second technique that helps business owners minimize the costs associated with starting a business is to seek out coaching and assistance. There are many ways for new businesses to get this type of help. The Small Business Development Center (SBDC), for example, is a government agency that provides free management assistance and coaching to small business owners. Your local SBDC can be identified at www.sba.gov/sbdc. Another good choice is the Service Corps of Retired Executives (SCORE), which is a nonprofit organization that provides free consulting services to small businesses. SCORE's 10,000+ volunteers are retired business owners who counsel in areas as diverse as finance, operations, ecommerce, and sales. You can find your local SCORE chapter at www.score.org. Both of these organizations can provide business owners concrete advice and suggestions for how to minimize the costs of starting a specific business.

Prospective business owners should also identify local small business and entrepreneurship organizations to plug into. These organizations offer seminars, sponsor networking events, hold business plan competitions, and introduce their members to service providers and potential sources of financing or funding. An example is the Oregon Entrepreneurs Network (www.oen.org), an organization that services prospective business owners in Oregon and southwest Washington. The organization, which charges a nominal membership fee, provides its members a full slate of programs and services. A similar example is the Venture Lab at the University of Central Florida in Orlando, Florida (www.venturelab.ucf.edu). The Venture Lab provides coaching and advice to anyone in Central Florida who has a business idea and needs help assessing the merits of the idea and shaping it into a viable business. There are similar organizations in almost every city in the United States.

Finally, there are organizations that provide coaching, advice, and support to specific groups of business owners and tailor their offerings to fit the groups. An example is Ladies Who Launch (www.ladieswholaunch.com), an organization that sponsors workshops and provides materials that encourage and support female business owners. The workshops include discussions, case studies, stories, and anecdotes that help women leverage their unique abilities to launch businesses efficiently and effectively. Similar organizations and support groups are available for veterans, members of minority groups, college students, senior adults, and other demographic groups.

Cut Costs and Save Money at Every Opportunity

The most obvious way to minimize the costs associated with launching a business is to cut costs and save money at every opportunity. The most effective way to do this is to develop a mindset of frugality and resourcefulness. While these attributes might seem obvious, in many cases, frugality and resourcefulness are learned skills. Many people aren't naturally frugal or resourceful, but as a result of an intensive desire to make their businesses work, they foster these qualities to help get their businesses off the ground and to minimize the costs of their ongoing operations.

A list of common cost-cutting and cost-saving techniques is provided below. While the techniques are well known, the trick is to put them into action. An example of a business owner who put the third item on the list, "Look for opportunities to barter," is provided by Clara Rankin Williams, the founder of Clara Belle Collections, a jewelry design business. When asked for words of advice regarding how to start and run a business, Williams said:

> *"Take advantage of random situations. I was at a truck show and I heard a friend talking with a marketing consultant. I asked the consultant whether there was any chance she might be interested in helping me with my marketing and swapping jewelry for services. She was. As an entrepreneur, you have to think out of the box, especially if you want to survive in an increasingly crowded marketplace."*[8]

This type of behavior exemplifies a mindset of frugality and resourcefulness. There are other cost-cutting and cost-saving techniques that aren't as well known as those shown in the following bulleted list. A sample of these techniques includes employing open source software instead of more expensive proprietary software packages, writing or participating in blogs as an alternative to buying advertising, utilizing online tools such as Skype instead of paying for long distance, and eliminating the cost of buying a fax machine by utilizing an online fax forwarding service such as eFax.

- Buy used instead of new equipment.
- Coordinate purchases with other businesses.
- Barter.
- Lease equipment rather than buying.
- Obtain payments in advance from customers.
- Minimize personal expenses.
- Avoid unnecessary expenses, such as lavish office space or furniture.
- Buy items cheaply but prudently through discount outlets or online auctions such as eBay, rather than at full-price stores.

There are many examples of business owners who dramatically reduced the cost of launching their businesses by utilizing combinations of the techniques described here. One example is provided by Michelle Madhok, the founder of SheFinds (www.shefinds.com), a company that helps people find bargains on the Internet:

> *"I financed SheFinds myself and have spent about $5,000 of my own money to get the business off the ground. The most expensive items were forming the LLC [which is a form of business ownership], legal costs, and public relations. My [Web] site was built for about $250 by a guy in the Ukraine who I found on Craig's List (www.craigslist.com). My photos were done for barter, and I got a good deal on the illustrations on my site because the artist had downtime. I worked with many independents—my lawyer was an independent, because I [didn't] see the value in paying for a big, fancy firm. And I looked for discount resources on the Internet—if you search around, you can find companies that will make quality color copies for about 20 cents a copy."*[9]

Madhok's experience is a clear example of a firm that cost $5,000 to start but could easily have cost $25,000 absent her frugal mindset and deliberate attempts to cut costs.

Choices That Small Business Owners Have for Raising Start-Up Funds if Needed

Some startups do need to raise money to get their businesses off the ground. In these instances, it's been our experience that the most knowledgeable and well-informed business owners have the most success. The most common mistake that prospective business owners make is not having a business plan. Although some books and magazine articles suggest that a business plan isn't necessary, our experience has taught us that this advice is dead wrong. It's almost inconceivable that a business would be successful obtaining money from a bank, an investor, a granting agency, a supplier, or future customer without a business plan that describes the business and validates its financial potential. Help for writing a business plan can be obtained from the SBDC, SCORE, or other small business support groups. There are also books detailing how to write a business plan available at Borders, Barnes & Noble, and Amazon.com. The first author of this book has a business plan book titled *Preparing Effective Business Plans: An Entrepreneurial Approach*, which can be obtained via Amazon.com or a similar online bookstore.

A second mistake people often make when looking for financing or funding is that they don't cast their nets wide enough. There are many sources of financing and funding available for small businesses. As a result, it is poor strategy to place too much reliance on some sources of funding and not enough on others.

This section of the chapter outlines the choices that small business owners have for raising start-up funds if needed. The alternatives include bank financing, equity funding, grants, and a few others.

Bank Financing

Historically, commercial banks have not been a practical source of financing for start-up firms. Most banks are relatively conservative and won't loan money to a business that doesn't have a proven track record and some type of collateral. That's not to say that you can't get a home equity loan to fund part or all of the money you need. It's just that most banks won't assume the risk of loaning money directly to a business with an unproven track record. They would rather loan money to an individual who has equity in a home to pledge as collateral.

The Small Business Administration (SBA) Guaranteed Loan Program is a realistic alternative for many business startups. The SBA does not have money to lend but makes it easier for business owners to obtain loans from banks by guaranteeing the loans. Approximately 50% of the 9,000 commercial banks in the United States participate in the Guaranteed Loan Program. The most notable SBA program available to small businesses is the 7(A) Loan Guaranty Program. The loans are for small businesses that are not able to obtain loans on reasonable terms through normal lending channels. Almost all small businesses are eligible to apply for an SBA guaranteed loan. The SBA can guarantee as much as 85% (debt to equity) on loans up to $150,000 and 75% on loans over $150,000. In most cases, the maximum guarantee is $1.5 million. A guaranteed loan can be used for working capital to start a new business or expand an existing one. It can also be used for real estate purchases, renovation, construction, or equipment purchases. The best way to learn more about the SBA Guaranteed Loan Program and determine if you are eligible is to meet with a participating lender.

There are a variety of other avenues that business owners can pursue to borrow money. Credit cards should be used with extreme caution. One channel for borrowing funds that is getting quite a bit of attention is Prosper (www.prosper.com), a peer-to-peer lending network. Prosper is an online auction Web site that matches people who want to borrow money with people who are willing to make loans. Most of the loans made via Prosper are fairly small ($25,000 or less) but might be sufficient to meet a new business's needs. There are also organizations that lend money to specific demographic groups. For example, Count Me In (www.countmein.org), an advocacy group for female business owners, provides loans of $500 to $10,000 to women starting or growing a business. An organization that is aligned with Count Me In and American Express, named Make Mine a Million $ Business (www.makemineamillion.org), lends up to $45,000 strictly to female-owned startups.

There are also lenders who specialize in "microfinancing" which are very small loans. For example, Accion USA (www.accionusa.org) gives $500 credit-builder loans to people with no credit history. While $500 might not sound like much, it could be enough to start a home-based business such as an eBay store.

John and Caprial Pence: How the SBA Guaranteed Loan Program Helped Two Business Owners Get the Financing They Needed

John and Caprial Pence are two of Portland, Oregon's finest cooks and busiest business owners. The two run a growing number of businesses in the Portland area, all focused around fine food. A distinctive aspect of their story is the role that the SBA Guaranteed Loan Program played in their success. The Pences have utilized the SBA loan program twice, and it has been instrumental in helping them build their businesses.

John and Caprial met at the Culinary Institute of America in Hyde Park, New York, where they were both attending school to become chefs. In the mid-1980s, following graduation, they moved to Seattle where they launched their careers. In 1990, Caprial won the James Beard Award for the best chef in the Pacific Northwest. At the same time, she was working on her first cookbook, teaching classes, and appearing on local TV.

In 1992, the Pences decided to move to Portland and bought the old Westmoreland Bistro with private financing. In 1998, they decided to remodel and expand the Bistro when space became available next door. The Pences considered several options for financing. The most realistic alternative, based on the advice of their banker, was an SBA guaranteed loan. The Pences agreed, and the bank facilitated a $260,000 seven-year SBA guaranteed loan. The loan enabled the couple to expand the seating capacity of their restaurant from 26 to 70 tables.

Following the expansion of the restaurant, the Pences decided to diversify and leverage their cooking expertise by opening a cooking school and a cookware shop. A second SBA guaranteed loan, for an identical amount as the first one, made these objectives a reality. The addition of the cooking school and the cookware shop has tripled the Pence's annual revenue.

The future for the Pences and their businesses looks bright. The restaurant initially brought in around $1,000 a day but now brings in $4,000 to $5,000 on an average weekday. The cooking school offers classes and demonstrations nearly every evening, where participants pay from $35 to $135 for hands-on classes or to view special cooking demonstrations. Just recently, the Pences started to bootstrap a television show from the cooking school, and Caprial celebrated the publication of her eighth cookbook.[10]

Equity Funding

Equity funding is obtaining money from an investor. Investors are typically interested in businesses that plan to grow rapidly and can capture fairly large markets. These businesses normally have a unique business idea, a proven management team, and are shooting to capture large markets.

There are two types of equity investors. The first are referred to as *business angels*. Business angels are individuals who invest their personal funds directly into startups. They generally invest between $10,000 and $500,000 in a single company and are looking for companies that have the potential to grow 30–40% per year before they are acquired or go public.[11] Jeffrey Sohl, the director of the University of New Hampshire's Center for Venture Research, estimates that only 10–15% of private companies meet that criterion.[12] The one exception that might help you get your foot in the door with an angel investor, if your business doesn't meet the traditional criteria, is if the purpose of your business is aligned with a personal interest or passion of the investor. For instance, if you're starting a company to make a safer car seat for infant children and meet an angel investor who has an intense interest in child safety products, you could capture the investor's attention even if your firm isn't capable of a 30–40% per year growth rate.

Most business angels remain fairly anonymous and are matched up with business owners through referrals. If you're interested in pursuing angel funding, you should discreetly work your network of acquaintances (bankers, lawyers, accountants, successful entrepreneurs) to see if anyone can make an appropriate introduction.

The second type of equity investor are *venture capitalists*. Venture capital firms are limited partnerships of money managers who raise money in "funds" to invest in startups and growing firms. Some of the better known venture capital firms are Kleiner Perkins, Sequoia Capital, and Redpoint Ventures. Similar to business angels, venture capital firms look for a 30–40% annual return on their investments and a total return over the life of investments of 5 to 20 times the initial investments.[13] The major difference between venture capital firms and business angels is that venture capital firms lend very little money to start-ups (preferring to wait until a firm proves its product and market) and normally don't invest less than $1 million in a single firm. As a result, venture capital funding is only practical for a very small number of business startups.

Grants

A potential source of small business funding that does not get enough attention are *grants*. A grant is a gift of money that does not have to be repaid. While there is no nationwide network for awarding grants to start-up firms, almost every state, city, and local community is trying to find ways to encourage people to start businesses as a means of growing their economies. As a result, there are a growing number of programs available at all levels of government, through the private sector and via foundations, to provide grant money to promising business startups.

Obtaining a grant takes a little detective work. Granting agencies are by nature low-key, so they normally need to be sought out. The best place to inquire about the availability of grants for a particular business is via the SBDC, SCORE, small business incubators, and similar organizations. Although these groups might not have grant money available, they might be able to direct you to organizations that are awarding grants to small businesses in your area.

A typical scenario of a small business that received a grant is provided by Rozalia Williams, the founder of Hidden Curriculum Education (www.hiddencurriculum.com), a for-profit company that offers college life skills courses. To kick-start her business, Williams received a $72,500 grant from Miami Dade Empowerment Trust, a granting agency in Dade County, Florida. The purpose of the Miami Dade Empowerment Trust is to encourage the creation of businesses in disadvantaged neighborhoods of Dade County. The key to William's success, which is true in most grant awarding situations, is that her business fit nicely with the mission of the granting organization, and she was willing to take her business into the areas the granting agency was committed to improving. After being awarded the grant and conducting her college prep courses in four Dade County neighborhoods over a three-year period, Williams received an additional $100,000 loan from the Miami Dade Empowerment Trust to expand her business. There are also private foundations that grant money to both existing and start-up firms. The MacArthur Foundation, for example, is a private grant awarding agency which recently dedicated $2 million to fund projects dealing with digital media and learning.

The federal government has a pair of grant programs for technology firms. The Small Business Innovation Research (SBIR) program is an established program that provides over $1 billion in cash grants per year to small businesses that are working on projects in specific areas. Each year, 10 federal departments and agencies are required by SBIR to reserve a portion of their research and development funds for awards to small businesses. A list of the agencies that participate, along with an explanation of the application process, is available at www.sba.gov/sbir. A privately owned Web site, SBIRworld (www.sbirworld.org), provides useful tips and advice on how to apply for SBIR grants.

The second program, the Small Business Technology Transfer (STTR) program is similar to the SBIR program except it requires the participation of researchers working at universities or other research institutions. Information about the STTR program can be obtained from the Web sites just identified.

Other Potential Sources of Funding

There are other potential sources of funds available for business startups. Similar to locating grants, finding the money takes a little detective work but could be time well spent. For example, there are an increasing number of business plan competitions held across the United States. Many of the competitions offer cash prizes. There are also an increasing number of small business contests sponsored by companies that sell products to small businesses. An example is the Visa Business Breakthrough Contest, which offers five $10,000 awards to businesses that submit essays explaining how they can become more efficient in one of five categories (finance, marketing, organization, team building, and technology). A simple Google search using the keywords "small business contests" will produce similar examples.

More sophisticated ways of obtaining start-up funds involve asking for cash advances from suppliers or potential customers. Some suppliers, if they recognize that your business has the potential to become a regular customer, will invest in your business or provide your business financing to help it get off the ground. Similarly, if you feel that your product or service will add considerable value for a particular customer and save the customer money, the customer might be willing to prepurchase a certain amount of product, which is a way for you to generate start-up funds. If you're buying a franchise, you can typically obtain financing through your franchisor. These alternatives need to be investigated on a case-by-case basis.

There are also ways that business owners tap into personal funds, beyond using savings and cash-on-hand. Examples include borrowing against the cash value of a life insurance policy and tapping into a retirement account. You'll normally need advice from a tax accountant to draw funds from a tax deferred retirement account to finance a business venture.

Summary

It's important to have the right frame of mind regarding money and the start-up process. Often having abundant funds isn't necessarily the best thing. Many business owners look back on their start-up years and recall that it was the lack of money that caused them to get creative and develop sound financial habits—attributes that are still serving them well today. Money is also a topic where it pays to be somewhat of a sleuth. There are many sources of start-up funds available, such as grants, business plan competitions, and SBDC guaranteed loans. These sources of funds, however, have to be sought out and tracked down to make an impact on a new company.

The next chapter focuses on the myth that it takes a lot of business experience to start a successful firm. Because most of the businesses we deal with are established companies, it's easy to believe that they were started by experienced business people and have always run as smoothly as they do. In reality, most businesses were started by people just like you. There are also many forms of experience that are helpful in the business start-up process. You might have vastly underestimated the value of the skills and experiences that you presently have.

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