Class 13

- Entrepreneurship eBook Extract, Timmons, in ANGEL Lessons
  - "Startup and After":
    - Managing rapid growth
    - Troubled companies
    - Harvesting and beyond
- Allen Ch 16, 17, 18:
  - 16 - Funding a Rapidly Growing Venture
  - 17 - Planning for Growth
  - 18 - Planning for Change

This class's notes are taken directly from Timmons, et al, "New Venture Creation, McGraw Hill.

1

Pitch Schedule

- Team 1 – 6:10 PM
- Team 2 – 6:50 PM
- Break – 7:30 PM
- Team 3 – 7:40 PM
- Team 4 – 8:20 PM

2

Managing Rapid Growth

Entrepreneurship Beyond Startup

- Inventing New Organizational Paradigms
  - Entrepreneurial Leaders Aren't Administrators or Managers (on "brontosaurus capitalism"):
    - Fred Smith (FedEx): "MBAs are Fortune 500 people who make a career out of saying no!"
    - George Doriot (father of VC): "There isn't any business that a Harvard MBA cannot analyze out of existence!"
  - Breakthrough Strategy: Babson's F.W. Olin Graduate School: team MBA teaching on E-ship

3

- Growing up Big
  - Stages of Growth Revisited
  - Core Management Mode
    - "Doing": <$5 million, <25 employees
    - "Managing": <$15 million,< 75 employees
    - "Managing managers": >$15 million, >75 employees
- Central issue facing entrepreneurs:
  - As the size of the firm increases, the core management mode changes from ***doing*** to ***managing*** to ***managing managers***

4

- The faster the rate of growth, the greater the potential for difficulty
- The Problem in Rate of Growth
  - Key: Cash burn vs cash collection rates
  - Decision making (tactical rather than strategic)
  - Expansion & facility growth surprises
- Industry Turbulence: price fluctuations, …
  - Often there are rapid shifts in cost & experience curves
  - Eg., in 1 year OEM prices of 256K chips fell 5-fold, $15 to $3 (12/5/13: *$6.99 for 2GB SanDisk SD card*)
  - Eg., Polaroid's $60/shr (1999) to $2.62 (2001)
    - Bankrupt in 2001, assets sold to a JP Morgan unit; emerged as a new company, then acquired by Petters Group* in 2005

* Tom Petters convicted of a Ponzi scheme in 2009, sentenced to 50 years

5

Distinctive issues caused by rapid growth

1. Opportunity overload
   - Not too few, but ***too many opportunities***
2. Abundance of capital
   - Evaluate investors as "partners", not just "money"
3. Misalignment of cash burn & collection rates
   - Burn races ahead of collections
4. Decision making { Tactics }
   - Strategy has to take a back seat to execution
5. Expanding facilities & space… & surprises
   - Not prepared for delays, interruptions, etc

6

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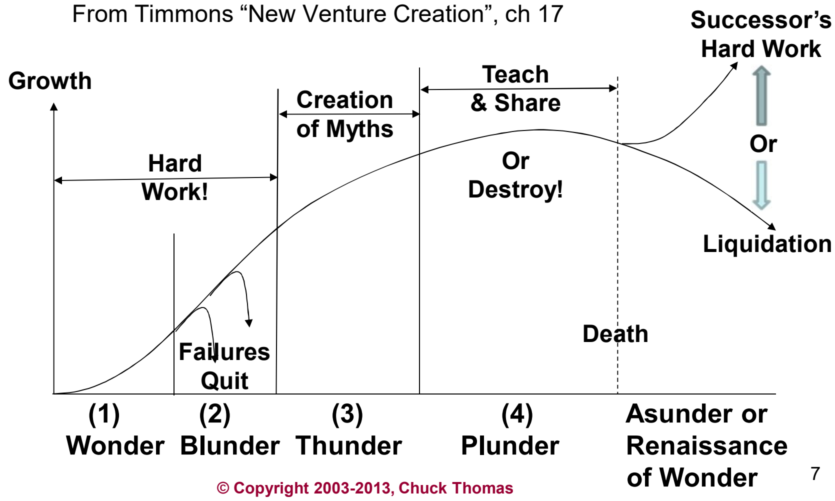
Leading Practices of High Growth Companies

- Growth stages

From Timmons "New Venture Creation", ch 17



 7

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The Importance of Culture and Organizational Climate

- Six Dimensions of the ***organization's climate***
  1. Clarity – well organized, concise, efficient in tasks and assignments & processes
  2. Standards – mgmt expectations & excellence rqmts
  3. Commitment – degree that employees feel committed
  4. Responsibility – personal resp. through organization
  5. Recognition – employees feel rewarded
  6. Esprit de corps – sense of cohesion

8

- Approaches to Management
  1. Leadership
  2. Consensus building
  3. Communication
  4. Encouragement
  5. Trust
  6. Development

9

Entrepreneurial Management for the 21st Century: Two Breakthroughs

1. Ewing Marion Kauffman and Marion Labs
   – (these numbers are several years old):
     – Founded in 1950, market cap is $6.5 billion
     – Over 300 millionaires & 13 foundations created, vs. RJR Nabisco (10x larger) created 20 millionaires
     – Principles:
       1. Treat everyone like you'd like to be treated
       2. Share the wealth with those who have created it
       3. Pursue the highest standards of performance & ethics
     – No org chart; all people are "associates"; fun, too

10

2. Ralph Stayer and Johnsonville Sausage Company
   - Founded 1975, as a butcher shop
   - Now over $200 million revenue
   - McDonald's sausage is their product
   - Everyone is a learner; seek improvement constantly
   - Responsibility/accountability pushed downward
     - Sausage stuffers respond to customer complaints!
     - Went from authoritarian to authoritarian abdication

11

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The Chain of Greatness

Vision
Leadership
Big picture
Think/act like owners
Best we can be

and

Perpetual learning culture
Train & educate
High performance standards
Shared learning/teach each other
Grow, improve, change, innovate

fosters

Entrepreneurial mind-set and values
Take responsibility
Get results
Value and wealth creation
Share the wealth with those who create it
Customer and quality driven

Leads to

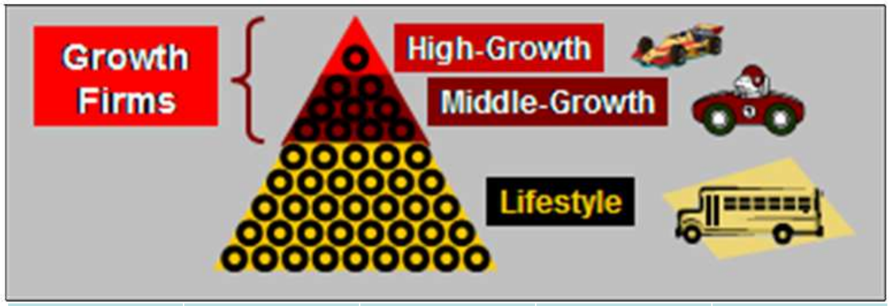
Widespread responsibility & accountability
Understand and interpret the numbers
Reward short-term with bonuses
Reward long-term with equity

which

Results in
Achievement of personal goals
Shared pride & leadership
Mutual respect
Thirst for new challenges

12

Types of Entrepreneurial Firms



Type of Firm	Total Share of Firms	Growth Rate	Innovation	Funding Methods
High Growth	1%	> 50%	Breakthrough	Venture-based
Middle Growth	9%	> 20%	Substantial	Venture-based
Lifestyle	90%	< 20%	Incremental	Asset-based

From Vadim Kotelnikov, 1000Ventures.com

13

Characteristics of Successful Growth Businesses

1. **Sensibly financed** (with prudent mix of equity and debt).
2. **Strong cash position** (with access to follow-on or contingency funds).
3. Offers **above-average profitability** (in terms of return on capital invested).
4. **Aims for rapid growth in revenues** (with profits lagging but in prospect).
5. **Targets expanding**, or otherwise attractive, market segments.
6. Develops a strong franchise or **brand**.
7. Devotes substantial resources to **innovation** (R&D, offerings or market)
8. **Competes on non-price issues** (e.g. differentiation, quality, service, processes).
9. **Very close to customers** and responsive to their needs.
10. **Seeks specialist/leadership image** with superior offerings.
11. **Well managed** with high-grade staff & good people-management.

From: "Devising Business Strategies", White Paper by PlanWare

14

Video Clip

Duration: 2:30

- Under Armour's Kevin Plank:
  - "The best advice I ever got"
  - Former University of Maryland Football Player
  - What do you need to protect?

15

The Entrepreneur and the Troubled Company

- When the Bloom Is off the Rose
  - Getting into and out of Trouble
  - Causes of Trouble
- The Gestation Period of Crisis
  - The Paradox of Optimism
  - Decline in Organizational Morale

We'll discuss these issues

16

Trouble - strategic issues

1. Misunderstood market niche
   – Growth focus: where are the profits?
2. Mismanaged relationships with suppliers and customers
3. Diversification into an unrelated business area (misuse of cash with no synergy)
4. Mousetrap myopia
5. The big project
6. Lack of contingency planning

17

Trouble – management issues

- Lack of management skills, expertise and know-how
- Weak finance function
- Turnover in key management personnel
- Big-company influence in accounting
  – E.g., a focus on accruals, not cash
- Poor planning, systems, practices & controls

18

Predicting Trouble

- Net-Liquid-Balance-to-Total-Assets Ratio

Net-liquid-balance-to-total-assets ration = NLB / Total assets
where
NLB = (cash + marketable securities) –
(notes payable + contractual obligations)
that is, watch the cash!

- Non-quantitative Signals
  - Financials on time? Lead Entrepreneur behavior, management changes, reduction of credit line…
  - Doesn't happen overnight…
  - The paradox of optimism (ignoring the signs, poor decisions, mistruths, …)

19

The Threat of Bankruptcy

- Voluntary Bankruptcy
  - Chapter 11
    - 120 days to develop a plan; 60 days to gain acceptance by creditors of the plan
- Involuntary Bankruptcy
  - Any three creditors whose claims exceed $5,000 or one when there are fewer than 12 creditors
- Bargaining Power – No creditor wants you to go bankrupt, so you can re-negotiate terms

20

- Intervention
  - Diagnosis
  - The Turnaround Plan
    - Quick cash, dealing with lenders
    - workforce reductions
  - Longer-term Remedial Actions
    - Systems & procedures improved
    - Asset plays – liquidation (e.g., real estate)
    - Creative solutions

The numbers

- Determine available cash
- Determine where money is going
- Calculate percent of sales ratios for different areas of the business & then analyze trends in costs
- Reconstruct the business
- Determine differences

The Harvest and Beyond

- ***It is a Journey, Not a Destination***
  - The Journey Can Be Addictive
- ***First, Build a Great Company***
  - Create Harvest Options
  - A Harvest Goal
  - Crafting a Harvest Strategy: Timing is Vital

23

- Harvest Options
  1. Capital Cow
  2. Employee Stock Ownership Plan
  3. Management Buy Out
  4. Merger, Acquisition, and Strategic Alliance
  5. Outright Sale
  6. Public Offering
  7. Wealth-building Vehicles

24

Google example - 2005

- Serge Brin & Larry Page: each sells more than $1 billion in stock per year
- Eric Schmidt & others: > $1 billion
  - Stock: $**1,057.9/shr** { July, 2004, IPO at $100/share }
  - Market Cap: **$353.43 billion**
  - 2012 Revenue/Income: $50.2 billion / $116.3 from opns*
  - Operating margin of 35% (Google operations)
- Each is 40 years old and worth > $24 billion**
- Gates is still the champ at $72 billion**
  - Sold over $2.7 billion last year alone

* Excluding effect of Motorola acquisition losses
** Forbes, 09/2013

25

Beyond the Harvest

- Seven Secrets of Success
  1. There are no secrets. Understanding and practicing the fundamentals discussed here, along with hard work, will get results.
  2. As soon as there is a secret, everyone else knows about it, too. Searching for secrets is a mindless exercise.
  3. Happiness is a positive cash flow.
  4. If you teach a person to work for others, you feed him or her for a year, but if you teach a person to be an entrepreneur, you feed him or her, and others, for a lifetime.
  5. Do not run out of cash.
  6. Entrepreneurship is fundamentally a human process, rather than a financial or technological process. You can make an enormous difference.
  7. Happiness is a positive cash flow.

26

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10 Mistakes to Avoid When Selling Your Company

1. Insufficient Preparation
2. Overconfidence
3. Unwillingness to Leverage Professionals
4. Taking a Hands Off Approach
5. Failure to Pre-Qualify Buyers
6. Misrepresentaion
7. Pricing Problems
8. Entertaining Only All-Cash Offers
9. Breaching Confidentiality
10. Failure to Address Transition Issues

From: Entrepreneur.com, Mike Handelsman, “10 Mistakes to Avoid When Selling Your Company,
http://www.entrepreneur.com/money/buyingandsellingabusinessmikehandelsman/article207026.htm l

27

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Allen: CHAPTER 16

FUNDING A RAPIDLY GROWING VENTURE

This and next 17 slides from Allen text

28

Learning Objectives

- Discuss the cost and process of raising capital
- Explain the role of the venture capital market
- Describe the process associated with the initial public offering
- Discuss how to grow with strategic alliances
- Explain ways to value a business

From Allen's "Launching New Ventures"

The Cost and Process of Raising Capital

- Raising money takes time
  - It takes twice as long as expected for money to reach the bank
  - The chosen financial source many not complete the deal
    - Entrepreneurs always need backup investors
    - Second round investors often buy out first round funding sources
- "It takes money to make money"

From Allen's "Launching New Ventures"

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The Venture Capital Market

- Venture capital:
  - A pool of money managed by professionals
  - The ability to secure funding depends upon
    - The status of the venture capital industry
    - What the entrepreneur brings to the table

From Allen's "Launching New Ventures"

31

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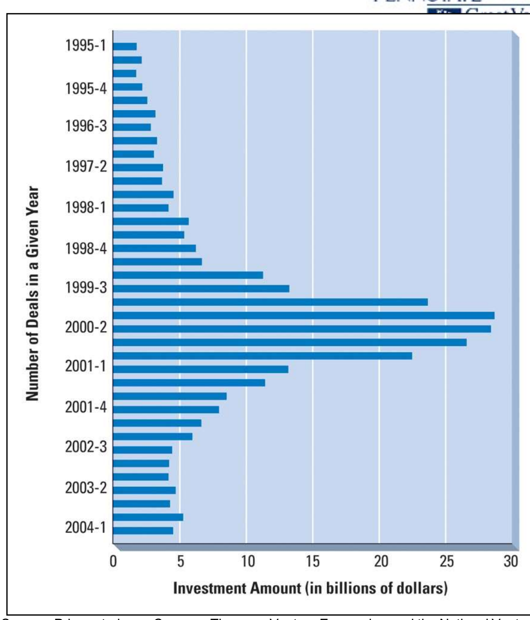
Venture Capital Investment



Source: PricewaterhouseCoopers, Thomson Venture Economics, and the National Venture Capital Association, The Money Tree Survey, 2004, http://pwcmoneytree.com/moneytree/index.jsp

From Allen's "Launching New Ventures"

32

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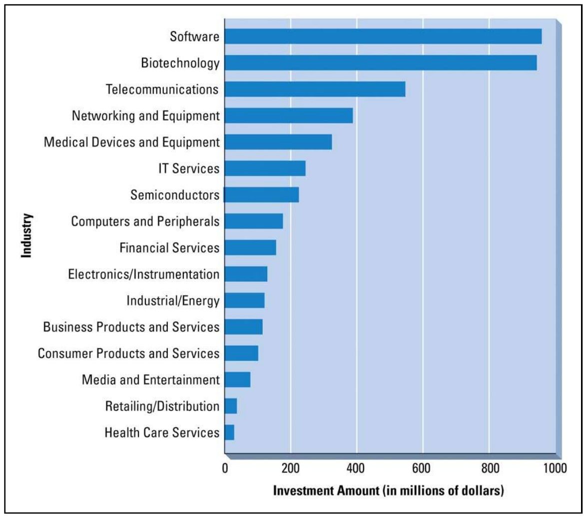
VC Investment by Industry, Q1 '04



Source: PricewaterhouseCoopers, Thomson Venture Economics, and the National Venture Capital Association, The Money Tree Survey, 2004, http://pwcmoneytree.com/moneytree/index.jsp

From Allen's "Launching New Ventures"

33

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The Venture Capital Market (continued)

- The sequence of events in securing venture capital
  - Understand the goals/motivations of the venture capitalists
    - Debt/equity instruments to achieve a long-term appreciation within three-five years
    - Expected rates of return depends upon the risk involved

From Allen's "Launching New Ventures"

34

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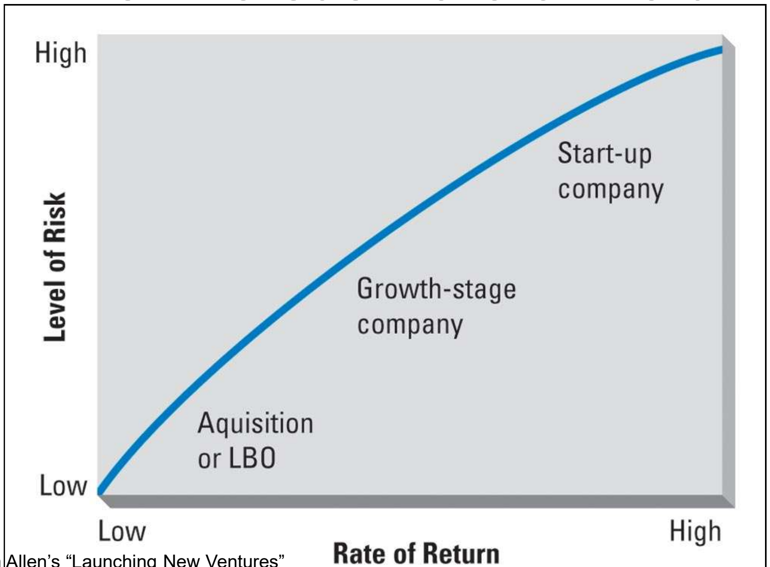
Risk Versus Rate of Return



From Allen's "Launching New Ventures"

35

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Investor Criteria

1. The management team
2. The product and its market
3. Potential for significant growth
4. Potential risk of failure
5. Quality of the business plan
6. Due diligence on the venture activity

From Allen's "Launching New Ventures"

36

Capital Structure

- Components of an investment deal
  - Amount of money to be invested
  - Time and use of the investment monies
  - Return on investment to investors
  - Level of risk involved
- Provisions of the deal
  - Equity and debt positions
  - Anti-dilution provision
  - Forfeiture provision

From Allen's "Launching New Ventures"

37

The Initial Public Offering-IPO

- Advantages-disadvantages of going public
  - Advantages
    - A big source of interest-free capital
    - Future option of additional stock offerings
    - More prestige and marketplace clout
    - Easier for founders to harvest rewards
    - Restricted stock and stock options can be used to attract new employees and reward existing employees

From Allen's "Launching New Ventures"

38

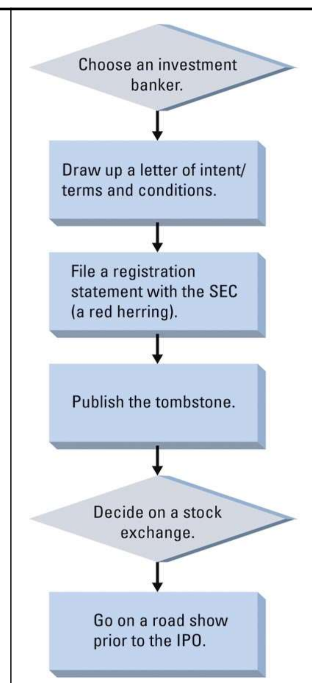
The Initial Public Offering-IPO (continued)

- Disadvantages
  - Dramatic decline in pre-IPO issuer's financial condition and significant rise in failure rate post-IPO
  - Public offering process is expensive
  - Going public is very time-consuming
  - All company proceedings become public
  - Intense pressure post IPO to perform in the short term

From Allen's "Launching New Ventures"

39

The IPO Process Simplified



From Allen's "Launching New Ventures"

40

Growing Via Strategic Alliances

- Advantages of alliances with big companies:
  - Excellent course of growth capital
  - Better financial deal for a growing company
- Cautions:
  - Investigate the potential partner carefully
  - Investigate best business practices
  - Ensure that benefits will flow in both directions

From Allen's "Launching New Ventures"

Calculating the Value of a Business

- Financial yardsticks
  1. Fair market value
  2. Intrinsic value
  3. Investment value
  4. Going-concern value
  5. Liquidation value
  6. Book value

From Allen's "Launching New Ventures"

- Non financial yardsticks
  1. The experience level of the management team
  2. Firm's distribution channels' level of innovation
  3. Nature of the company's relationships in the industry and with customers
  4. Company's ability to be fast and flexible
  5. Amount/kind of the company's intellectual property

From Allen's "Launching New Ventures"

43

Methods for Valuing a Business

- Financial measures
  1. Multiple earnings
  2. Discounting cash flows
  3. Real options model
  4. Hockey stick approach

From Allen's "Launching New Ventures"

44

Preparing for Growth

- Tasks to be performed by the entrepreneurial team
  - Network, research, line up potential capital sources in advance of need
  - Determine the harvest strategy at least three years in advance
  - Update the business plan regularly to reflect the most current information

From Allen's "Launching New Ventures" (Last Allen Ch 17 slide)

45

Kathleen Allen

Launching New Ventures

Chapter 17

Planning for Growth

Next 17 slides

46

Learning Objectives

- Discuss the role of risk management in the entrepreneur's growth planning.
- Explain the various risks that affect startups during early growth.
- Discuss the importance of succession planning for entrepreneurs.
- Discuss the various ways that entrepreneurs can exit and harvest the wealth created by the business.
- Describe the role of bankruptcy in business failure.

From Allen's "Launching New Ventures" Ch 17

47

Preparing for Contingencies: Risk Management

- Risk: when future events occur with measurable probability
- Uncertainty: when the likelihood of certain events is unknown, indefinite, incalculable

From Allen's "Launching New Ventures" Ch 17

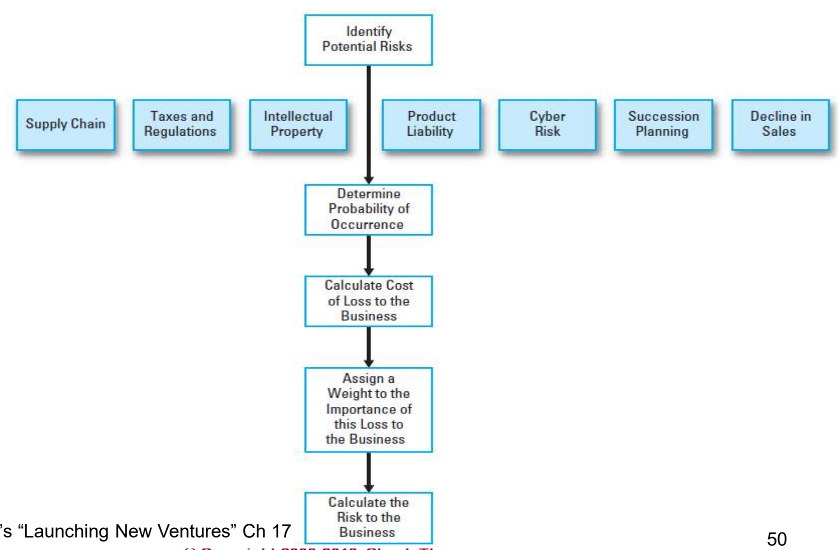
48

- Effective contingency plans answer the following questions:
  1. In event of problem, which suppliers will extend entrepreneur's repayment line?
  2. What nonessential assets can be sold for cash quickly?
  3. Can additional investment capital be tapped?
  4. Are customers willing to repay or purchase earlier than planned?
  5. Has a good relationship with banker and accountant been established?

From Allen's "Launching New Ventures" Ch 17

49

Managing Risk in a New Venture



From Allen's "Launching New Ventures" Ch 17

50

Identifying Potential Risks

- *Process improvement strategies* to reduce the probability of risk through alliances
- *Buffer strategies* to protect against potential risk that can't be prevented
- Types of risks:
  - Supply chain risks
  - Taxes and regulations
  - Intellectual piracy
  - Product liability
  - Cyber risk
  - Decline in sales

From Allen's "Launching New Ventures" Ch 17

Calculating Risk Probability and Cost to the Business

Risk of Loss = (P x C x S)

P = Probability of occurrence

C = Cost to the business

S = Level of significance of impact

From Allen's "Launching New Ventures" Ch 17

Leadership Succession

- *Succession planning:* identifying people who can take over key company positions in an emergency or in a change of ownership
  - External hires
  - Promoting from within

From Allen's "Launching New Ventures" Ch 17

53

Change of Ownership in Small Enterprises

- Simple process for succession planning:
  1. Situation assessment
  2. Announcement of the process
  3. Execution of the search
  4. Transition
- Consider "key person" insurance
- Consultants may be hired
- Cross-training is important

From Allen's "Launching New Ventures" Ch 17

54

Succession Planning in Family-Owned Business

- Issues that require time to work out:
  - Physiological and emotional issues that stem from the interrelations of family members
  - The complexity of succession, particularly since the owner typically has no experience in this area
  - Relevant laws and taxation that impact the financial status of the company

From Allen's "Launching New Ventures" Ch 17

55

- Questions to ask:
  1. Is the next generation being sufficiently prepared to take over the business when the time comes?
  2. What is the second generation's expectation for the future of the business, and is it congruent with the company's vision?
  3. What skills and experience does the second generation need to acquire?
  4. What would the ideal succession plan look like?

From Allen's "Launching New Ventures" Ch 17

56

Planning for Harvest and Exit

- Types of entrepreneurial career paths:
  - Growth entrepreneurs
  - Habitual entrepreneurs
  - Harvest entrepreneurs
  - Spiral, or helical, entrepreneurs

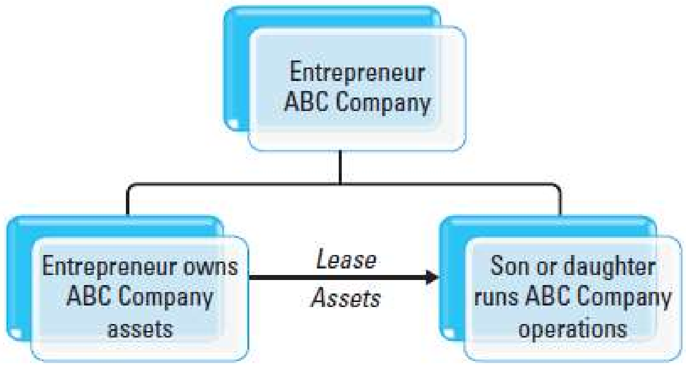
From Allen's "Launching New Ventures" Ch 17

Planning for Harvest and Exit

- Selling the business
  - To another company or an individual
- Cashing out but staying in
  - A phased sale
  - Employee Stock Ownership Plan (ESOP)

From Allen's "Launching New Ventures" Ch 17

Restructuring the Family Business



From Allen's "Launching New Ventures" Ch 17

59

Dealing with Failure: Bankruptcy

- Various reasons for bankruptcy but common denominator is poor management.
- Chapter 11: reorganizes the business so it can continue operating and paying its debt
- Chapter 7
  - An Order for Relief
  - It liquidates the assets and discharges most types of debt

From Allen's "Launching New Ventures" Ch 17

60

Chapter 7

- Advice for making a bad situation better:
  - Entrepreneurs should talk to other entrepreneurs who have been in similar situations.
  - End a business before it affects the entrepreneur's personal life.
  - A business owner should never commingle personal/business funds.
  - Do not ignore the government.
  - Begin looking for opportunity.
  - Pay back investors first.

From Allen's "Launching New Ventures" Ch 17

61

Final Thoughts

- Entrepreneurship is:
  - A mindset
  - A way of viewing the world
  - A skill set that can be learned
- Who should be an entrepreneur?
  - Anyone who wants to experience the freedom and independence that comes from knowing that opportunities and resources to make those opportunities a reality are within their grasp!

From Allen's "Launching New Ventures" Ch 17

62

New Venture Action Plan

- ✓ Identify the risks that could affect the business at various points in the future.
- ✓ Develop a contingency plan for all the high-probability/high-impact scenarios that may affect the business in the future.
- ✓ Set goals for the business that will enable the appropriate exit or harvest strategy.

From Allen's "Launching New Ventures" Ch 17

63

Next Class

The Pitches

Now prepare for the pitch
& polish the plan

64