Venturing Your Concept

Start-up Funding — Breathing life into an idea 6

Our very life style and standard of living rest upon the shoulders of ideas, sometimes giant ones, like the bow and arrow, wheels, agriculture, animal husbandry, steam power, and home computers. Capital came into being in step with each such innovation. And so it is today. What follows comes from my own experiences with funding startup companies.

Let's assume that we have applied for a strong patent and that we want to embark on the cruise ship "Venturing" and stay the course. Let's assume also that our funds are sufficient to pay the admission, but not the fare, baggage, freight, and promotion for the voyage. For the typical inventor, the funding crunch begins at patent application time. Sometimes even before, at least in my experience.

To minimize the capital we must raise, we can make the most of what we have. Too often the inventor is not willing to sacrifice much in the way of living standard or commit to the time and hard study needed to learn the turf, write a strong patent, and chart a course. Those that do, become entrepreneurs.

Each of us typically has some amount of capital in each of its three forms: human, property, and money. To briefly review, human capital arises from two types of labor, physical and mental. Properties are similar; they can be real or intellectual properties. Money, the exchange medium, differs a bit—it has a time value in the form of interest. My basic point is that our labor can create property of value, worth money to others. Our hands, our heads, and our pockets are all we need to start a venture.

True entrepreneurs are willing to put up all they own to turn their ideas into a venture that works. They dig in and do whatever it takes to learn about the road ahead. They live and breathe the issues, continually on the lookout for shoals as well as sailable water. Those who put the "good life" first usually shoot down their own venture ambitions.

So there is a strong emotional component to venturing. Courage and well-considered daring capture the essence. Drive—also known as inner-motivation, ambition, and self-starting—characterizes both captain and crew of our venturing ship. Insight is equally vital. Unless our view of the real world and how things work is balanced and tempered with understanding and wisdom, we risk tripping in our search for the "Promised Land." It also helps if one of our pockets has a little brain in it as well as desire. We can be creative in stretching the sawbuck while navigating the shoals and getting there in time.

Working out returns on investment or equity for the various options is good practice. But be aware that numbers can give a false sense of security—they are only as good as the assumptions going into them. Interest rates may be known, but the dynamics of the market place are rather more vague; so also for reactions by competitors. The latter should lead us to be modest in our expectations and plan accordingly.

The form of our business organization matters. Sole proprietorships face different challenges than do limited partnerships or corporations. Lenders have different attitudes about various business entities as classes. The same is true for our overall goal. Are we "for profit," "not for profit," or "nonprofit"? These, too, make a difference. And what business are we in? Personal services and high tech will find different receptions. Staffing matters, too. Sophisticated and experienced people will find more sympathy than will the lone and untried inventor.

So how do we embark on raising money? Some common financing methods include equity (family, friends, third parties, institutions), commercial debt (lending institutions), trade debt (customers and suppliers), the Small Business Administration, and various government programs at national, state, and local levels.

But how do we choose a lender? The simple answer is that we do our homework, investigate all options, organize the information gathered concisely, and list the pros and cons. A rule common to selecting law firms, venture capitalists, and manufacturers is to choose one with experience in the area of our invention. An omnibus rule is to check prior customer or client satisfaction—always. The best avenue is usually obvious only after study and more than a few conversations with our potential sources of funds. We discover first what our potential financing sources need before considering our project, and proceed from there. Remember, relationships are often as important as pedigrees. So get to know your lenders, pick their brains, and above all be straight with them.

With this preamble I would like to walk through a short example from my own experience. Four of us had an idea—high purity titanium for the computer chip industry. We knew early on that the metal might be useful for interconnecting individual transistors in integrated circuits. One of us had retired from an executive position as treasurer of a large utility—he knew the financial ropes. Another of us understood how to refine commercial titanium for this demanding application. Another was a whiz at finding new customers. Another of us had the good fortune of finding and bringing us all together while adding a much-needed pair of hands to the start-up crew. Each of us put up everything we had, including second mortgages on our homes. We also had a well-rounded team with an expert to deal with any type of weather.

In preparation, we went through some three dozen pro formas, testing first this business model and then that. A pro forma is most simply a forecast of revenues and expenses with a monthly bottom line. Avenues requiring large amounts of capital were discarded since it meant giving up control and rewards before they even existed. But we eventually found an avenue all felt would work. In short, we adjusted what we wanted to do toward what was possible. Flexibility was the most important planning ingredient as The Alta Group came into being as an S corporation.

Having elected to boot-strap, we worked fourteen hour days, seven days a week without salary for the better part of a year just to get into operation. Then, once in operation, two things conspired against us: titanium wasn't yet the "in material" in the chipmakers' minds, and the market crashed just as we began producing metal. This was mid-1985; it took about three years for the real market to materialize. Yep, you guessed it; we had big trouble financing the early period.

To save the day, and our non-existent fortunes, we manufactured other things that we had previously considered. Still we needed capital. About a third of our financial needs was provided by banks on the basis of: 1) who we were as individuals and as a corporate entity, 2) our business plan, 3) our projections, 4) how well we met projections, 5) our own collateral and 6) the value of the facilities. The other two-thirds came from private investors, state guaranteed loans, and reinvestment of profits. All of these were arranged for, or engineered by, our treasurer.

Our fast footwork was enabled in part by all the planning, projecting, and fine tuning of the business model. Once in operation, the key was finding ways to survive when the model failed. There was no time to plan, so we reverted to what I knew best, research for hire and research materials for aerospace firms designing hypersonic vehicles. The latter eventually amounted to our production of over 300 advanced research alloys for others while the former led to an advanced beta titanium alloy for prosthetics now marketed by Pfizer. All the while we kept working on and developing our original model.

What we didn't realize at the time was that titanium for computer chips was a technology-driven market and that manifold uses would be found, eventually. When Alta made electronic grade material readily available, the chipmakers of the world took notice. By mid-1988, the market was exploding. The moral here is that by having flexibility and backup options, we lived for another day.

Once we got over the initial hurdle, the financing rules changed. Instead of loans at prime plus two or more percent, banks were knocking on the door to lend us more money than we could use. But look at this from the lender's point of view.

Business is risky at best. Established, proven companies go bankrupt regularly. Startups have a worse record. (Alta purchased its main facility from its original owner who was in bankruptcy.) So banks need security. And they will want a hard look at your credit rating.

I know one company with a poor credit rating that used trade financing to survive and eventually thrive. Here is how it worked. They demanded immediate payment for every item sold while dragging out paying their suppliers to 90 days and more. At times they were operating with over a million dollars in trade credit, interest free. That went on for years before their suppliers wised up. Only once did Alta need trade credit. Because we were open about it, our supplier extended his due date without penalty. I offer this as an example of creativity in action. Creativity is needed all along the venture trail, not just in the inventive period.

Time now to summarize a few tips on minimizing capital needs early on.

- Go to the well for internal and private equity funding.
- Rent only needed space and lease expensive equipment rather than buy.
- Contract out business services such as accounting, payroll, and HR.
- Contract out as much manufacturing as possible.
- If facility construction is necessary, act as your own general contractor. (This one carries risks to be sure, but Alta saved millions—something like a third to a half of the general contractor quotes. We hired talented folks and put them in charge of all construction.)
- Wear many hats. This cardinal rule includes getting hand dirty and latrine duty.
- Price your product to maximize total profit.

There are as many ways to convert ideas and physical labor into facilities and cash flow as there are entrepreneurs. What all these ways have in common is that they leverage the value of our labor way beyond the hourly rate we could command working for others. And of course this avenue affords the true entrepreneur a way to leave a mark with his name on it. And these are just two reasons why the market economy is at once so successful and exciting.

For further information visit www.toolkit.cch.com or purchase their book, “Small Business Financing”, Alice H. Magos, Editor, ISBN 0-8080-0239-2.

These are many other excellent resources available that provide the nuts and bolts.

Next visit I will discuss facility design.