AN ENTREPRENEUR ACADEMY WORKBOOK

ACCESS TO CAPITAL

Washington State Department of Commerce

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Lesson 4: Business Model Canvas

“I made my money the old-fashioned way. I was very nice to a wealthy relative right before he died.”

- Malcolm Forbes

The old adage that "it takes money to make money" is as true today as it was when JP Morgan was building his empire. Whether its startup capital to get your idea off the ground or bridge funding to get you through slow times, money can be a make or break the proposition for any business.

Great ideas take money. If you want to be the next Bill Boeing, you need a lot of money. And a really big garage to get your idea off the ground – literally.

But most businesses start small and build slowly. Incoming revenue balances nicely with expenses, and there's a little left over for expansion and growth. Many legendary companies started out on a shoestring. Jeff Bezos started Amazon in his garage. His desk was a spare door. He and his wife couldn't run the company's server and vacuum at the same time without blowing a fuse.

As you start your business, give careful consideration to your financial resources as it is your pathway to growth and sustainability.

You've already done some of this work in Lesson 3: Business Model Canvas. For instance, the revenue streams in your canvas combined with your expenses become your cash flow – money in, money out.

Startup & expansion costs

There is no standard formula for this. Every business is different. The mistake many first-time entrepreneurs make is not being honest about what these costs will be. Think long and hard about the costs you will incur to start your business.

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Fixed costs refer to costs that remain constant:

- *Professional fees*
- *Insurance*
- *Rent/Overhead*
- *Staffing and employment*
- *Equipment and supplies*
- *Interest paid on capital*
- *Sales and marketing*
- *Depreciation*
- *Web site/Technology costs*
- *Property taxes*

Variable costs refer to costs that change as a result of the output:

- *Individual product cost (raw materials)*
- *Packaging*
- *Delivery*
- *Contractors*
- *Commissions*
- *Income*
- *Taxes*
- *Credit card fees*
- *Other operational costs*

Cash flow

Think in terms of monthly cash flow. In the beginning, more money will be going out than coming in. This is natural since you have more startup costs than customers. You want to run your projections out for at least 24 months and provide as much detail as possible, so you not only know how much money is supposed to go in and out, but where it is going.

When combined with your startup costs, these projections will give you an idea of how much cash you need to have on hand to take your business through its first two years. Obviously, you want to start moving into the black (i.e., you're profitable) as quickly as possible, but you need to be honest with yourself and expect to run at a loss for some time. It's easy to think that a friendly handshake in a meeting or a signed purchase order will turn into money in the bank. Remember, however, that the only number that counts is the balance in your bank account at the end of the day, week or month. Be conservative in your projections and spending. Question every expenditure before you approve it and don't count a single cent until it shows up as a deposit.

Profit & Loss (P&L)

Your Distribution Channels establish how you As noted above, cash will come in and go out. The Profit & Loss Statement expresses this in monthly terms for the first two years you're in business. The formula is expressed as: Revenue – Expenses = Profit or (Loss).

Balance Sheet

The Balance Sheet should also cover Year 1 and Year 2. A Balance Sheet shows you the big picture of your business' health and is expressed like this: Assets – Liabilities = Net Worth or (Equity)

The good thing is that these days there are lots of resources online to do all these calculations and planning. Our SizeUp tool (MyStartup365.com/tools/sizeup) is an excellent place to start. You can enter your projections and see what other businesses in your area or state report as their averages. This can help you develop your two-year projections for cash flow, profit & loss and your balance sheet.

Now, to answer the big question: Where do you get the money to either open a business or expand it?

Bookkeeping & Record Keeping

If you set up a bookkeeping system, and you should, these things take care of themselves. For the do-it-yourself crowd, a program like QuickBooks will do the trick. If you want some online options, Freshbooks has a wonderful invoicing system and GoDaddy has an online bookkeeping system that ties in your credit cards and bank accounts so you can manage all of your account categories, view trends and manage your paperwork in a single interface. You may want to hire a bookkeeper too, to do your annual tax filings. This is a snap, since QuickBooks and GoDaddy organize all your records to parallel IRS filing requirements.

Financing options

There was a time when a businessperson could simply walk into their local bank and walk out with a small business loan.

But banking as a whole has changed over the last few decades. Large national and international banks have become commonplace in communities across the state, displacing smaller community banks. By nature, these large banks are more risk-averse than a smaller bank where you were a customer and neighbor. Big banks typically don't handle loans under $50,000, and many small businesses don't need that much money or more important, don't want to carry that much debt.

Since the banking industry isn't going to change any time soon, the only choice for small businesses and entrepreneurs is to seek alternate sources of financing.

There are many ways to get funding for your new endeavor. Some are pretty straightforward; many more are very out of the box. We've outlined them all in our book, Startup Wisdom, 27 Strategies for Raising Business Capital.

Here are just a few of the strategies outlined in Startup Wisdom:

Dip into your own pocket

Most businesses start this way. Over time, an entrepreneur has saved some money and uses it to finance a new enterprise. Some so-called “experts” will tell you to use other people’s money whenever possible. Great idea! On the surface. Using money from someone else may mean that you’ll incur near-term debt that works against your cash flow projections. Going deep in debt and facing an impossible repayment schedule will put you in a defensive posture right from the start. This negative cash position will compromise your ability to make critical decisions because you’re always worried about how much money you owe instead of focusing on how much money you should and could be making if you had the luxury of taking measured risks.

In action: *GoPro, Inc. founder Nick Woodman was disappointed in the cameras that were available to capture photos of him surfing in Australia. Deciding to make an all-in-one camera, Nick raided $10,000 selling beads and shells out of the back of his van, moved back with his parents and took odd jobs to pay for the design of his new idea. At the end of 2004, GoPro had $150,000 in revenue. In 2019, sales were $1.2 billion*

The family and friends plan

Family and friends are another potential source, and they are often more than willing to kick in some dollars for an idea that shows promise. Just remember that owing relatives and friends can be costly in more ways than one. If your business goes south, your friendships and relationships can become severely strained. Even if there are supposedly no strings attached, there may be unspoken strings. Judging by the chart, this is a fairly popular option, so don’t discount it. But do go into it with your eyes wide open.

A loan again, naturally

While banks have more restrictive lending policies, credit unions may be an option if you need a small business loan. Credit unions are there for their customers, who are also members and shareholders. They typically serve a specific audience, such as employees of a large company or a particular community or a demographic, such as a branch of the military. You’ll want to do some research to find out which credit union would be best for you in terms of loan products and rates. Of course, you’ll also need to become a member and open an account.

If you are seeking a personal or secured loan, whether it’s through your bank or a credit union, pay close attention to the 5 Cs of Credit: Capital/Cash, Capacity/Cash Flow, Collateral, Character and Conditions. Many loan programs want you to kick in 25 to 30% of the total amount you are requesting and want to see proof that you will be successful from the standpoint of cash flow and business acumen. You may also need to put up some collateral. This is where a business plan comes in handy.

In action: *A Wenatchee photographer’s equipment had become outdated since the world has gone digital, and his equipment was all film. To find financing, he decided to open an account at his local credit union. His credit wasn’t the best, but because he is a member, they offered him a secured credit card so he could raise his credit score. Six months later, he got a small loan and paid it back. With his credit score improving because of these loans, his loan officer connected him to a Small Business Administration loan for $10,000, so he could buy new equipment to grow his business.*

Crowdfunding as a strategy

There have been amazing success stories and some colossal failures. Remember the Coolest Cooler? It took in a cool $13 million, but because of the inexperience of its management team and an inability to source reliable suppliers, the company never delivered all the high-tech coolers it promised to Kickstarter investors and ended up going out of business. If you’re going to go the crowdfunding route, have an idea that you can actually execute and be sure you have a large social media pool to draw investors from. You need to really nail your marketing, promotion and fulfillment to make it all work, especially since your funding window is limited and if you don't reach your goal, it all goes back to the people who believed in you.

In action: *Internet cartoonist Matthew Inman wanted to create a card game for kids seven and older so he started a Kickstarter campaign. Exploding Kittens became one of the most quickly funded campaigns on the site, bringing in $8,782,571. Exploding Kittens has raked in more than $50 million since.*

Picking someone else's pocket

Before you seek investors or private lenders, make sure you research the applicable securities laws. The investing space is tightly regulated, and you don't want to become embroiled in a regulatory nightmare. That said, many entrepreneurs have had great success with attracting investors and using their capital to build successful businesses.

Venture capitalists rarely invest in startups, as it is too risky for their investment model. Angel investors, on the other hand, love to provide money to innovative startups and are willing to accept the risk. Angels use their own money to fund ventures, and with the investment, you may also end up with a mentor. Angels can bring more money to the table and offer more flexibility than other borrowing strategies.

Angels fund businesses in a couple of different ways. They may issue a promissory note, deferring interest payments for a year or two and converting debt into equity at specific milestones. Another funding strategy is a convertible preferred stock position so the company can defer payment of fixed cash dividends for four or eight fiscal quarters. This does mean that you will need to make performance benchmarks that were agreed to as part of the deal. Finally, the angel may want a voting equity position, which means they will be involved in company management and bring in assistance for specific operations, such as marketing, operations or distribution.

Before you approach an angel or a venture capitalist, do your homework. Find out what types of products, services or industries they invest in and the process they use. You want to be both strategic and tactical in your approach. This is a long-term relationship, not a short-term sale, and if you are viewed as a pest, you'll never get your foot in the door again.

In action: *Apple Computers was not even a year old and had sold just a couple of hundred computers when Mike Markkula arrived on the scene in 1977. He told Steve Jobs and Steve Wozniak that he was willing to invest $250,000 in the new company in exchange for a third ownership in Apple. Mike not only brought money to the company but experience and connections. These connections helped Apple get the venture capital it eventually needed to grow into the multi-billion dollar company it is today. Without Mike, there never may have been a Macintosh or an iPhone.*

Other options available

It's no secret that securing financing can be a challenge for some, particularly in underserved and underrepresented communities. Between 2007 and 2017, minority-owned businesses grew by 79%, about 10 times faster than the overall growth rate for small businesses in general over the same period. Before the pandemic, that put the number of minority-owned companies at about 11.1 million.

Despite leading in business creation, minority business owners historically have a much harder time accessing small business loans than their non-minority counterparts. Even if they are approved, the interest rates may be statistically higher and the total loan amounts lower. Many business owners won't even apply for small business loans, either because of the poor terms or the fear of being rejected.

This disparity in access to capital can create additional barriers to starting a business. For instance, Hispanic and African-American business owners report wealth levels that are 11 to 16 times lower than their white counterparts. The U.S. Census Bureau

estimates that half of all Hispanic families have less than $8,000 in wealth, and half of African American families have less than $5,550. These lower levels of wealth and liquidity can create a substantial barrier for entry into business as there is less available cash to finance a startup. This problem is exasperated by geographical and industrial distributions, which may be deemed as risky by traditional funders.
There are other options available, such as business plan competitions, industry-specific contests, microloans and funding through the Community Development Institutions Fund, or CFDI Fund.

The Community Development Institutions Fund is a network of banks and credit unions that serve people who are otherwise locked out of the financial system. CDFI's focus on developing long-term relationships with members of the community to strengthen financial literacy, establish savings strategies, build credit, and fund small businesses, microenterprises, nonprofits, commercial real estate and affordable housing.

Business plan competitions are another avenue. Many of these not only come with cash prizes but mentorship, technology tools, coaching and marketing support. There are numerous business planning competitions conducted by nonprofits, business startup organizations and corporations throughout the country. The U.S. Department of Commerce's Minority Business Development Agency (MBDA), which helps minority firms with access to markets, contracts and consulting, also has opportunities such as the Enterprising Women of Color Grant Competition and Inner City Innovation Hub Competition.

Microloans are another possibility. These small loans are particularly suited to businesses in the startup phase that don't require large amounts of cash. Microloans can range from $500 to $35,000 and are funded through private institutions and the Small Business Administration. The term of the loan can be two to six years with favorable interest rates. A business plan is essential for any startup seeking a microloan. The downside is that microloans typically have higher costs to administer the loan since it costs a lender the same to lend $1,000 or $100,000.

In action: *OlyKraut is a small, woman-owned, gourmet sauerkraut company in Olympia , Washington that began in 2008. Early on, the owners took advantage of training from Enterprise for Equity that led to microloan funding for expansion. The owners started their small enterprise on a shoestring, and once their product became popular, used two consecutive microloans under $10,000 to expand production with a kitchen upgrade and some additional equipment. They recognized that honoring their values by sourcing locally, using only organic ingredients and paying their employees well would give them an edge in the market. The infusion of cash was vital to the company's success and enabled them to grow.*

Read the book!

There are many other ways to fund a business or expansion. To guide you, the Washington State Department of Commerce has created a great online resource guide, Startup Wisdom: 27 Strategies for Raising Capital.

Assignments

1. Use Commerce's SizeUp tool to make initial projections for your business, if you haven't done so already. This will help you model cash flow and perform profit and loss projections.

2. Talk to other entrepreneurs and small businesses in your area about how they financed their business and how well their projections matched the realities of starting a business.

3. Research upcoming business plan competitions to see if any match your business idea. Check out past winners and see what they did to win the competition and what they are doing now.

4. Visit a nearby Startup Center or Small Business Development Center to discuss your business idea and capitalization. These centers offer consulting, mentorship and resourcing to help you get your business up and running more quickly and with more confidence.

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