

Season Two Webinar One

Session Summary

Running on Empty: Growing your Business through Bootstrapping

March 11, 2009

Presented by:



Technology Marketing
Resource Centre



Canadian Innovation Centre

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Introduction

The Ready Set Grow series presents webinars featuring subject matter experts and Canadian tech execs discussing topics of interest to the executives of young Canadian technology companies.

On March 11, 2009, Ready Set Grow looked at the topic of Bootstrapping through a session featuring a presentation from Andrew Maxwell of the Canadian Innovation Centre, a discussion with Steven Black CEO of Suited Media and questions from the audience.

This document captures the content of this session.

Speakers



Andrew Maxwell

Director Business Partnerships, Canadian Innovation Centre

Andrew Maxwell's experience includes the founding of two environmental technology companies, the creation of a wireless, medical device and web company and a technology incubator that helped create 30 technology businesses. He is currently with the Canadian Innovation Centre and pursuing a Ph.D. in the area of new venture creation at the University of Waterloo. He teaches at UTM and Waterloo in the area of technology entrepreneurship.



Steven Black,

CEO and Founder, Suited Media

Steven attended the University of Waterloo's Software Engineering program and played 2 years of professional poker before moving on to the life of an entrepreneur. He started Suited Media in late 2006 focusing on web development and marketing. The company's flagship website, Pokerspace.com, is a social network for poker enthusiasts around the world looking to meet new players and improve their game.

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Running on Empty: Growing your Business through Bootstrapping

What is Bootstrapping and Why do I care?

Bootstrapping refers to “a collection of methods used to minimize the amount of outside debt and equity financing needed from banks and investors” (source Ebben and Johnsen, 2006). That rather dry definition belies the fact that successful application of bootstrapping techniques is one of the most critical factors for the survival of young technology companies.

Essentially, bootstrapping is about cash flow management and making scarce cash resources go farther. It is an approach to business decision-making based on cash flow. Cash is a precious commodity for the young technology company. Most companies are founded without the benefit of Angel or Venture investors, or even bank loans. Over 65% of companies are financed by the founder and less than 20% of companies attract equity investment. Technology companies in particular are vulnerable in their early days, as they typically need to finance product development. “Insufficient Cash Flow” is the number one cause of new business failure. Bootstrapping is an approach designed to preserve cash flow and reduce the likelihood of business failure.

There are a number of stages in the development of a company when bootstrapping is important. During the business’s early lifecycle, it can be used to survive the initial negative cash flow. Later it is used to deliberately defer the acquisition of outside capital until the company is in a more favourable position; buying time to validate a concept or build a base of initial customers. Sometimes it is about maximizing the company’s bottom line to increase its valuation in advance of either financing or an exit.

Sources of Bootstrap Financing

- o *Owner and non-equity financing*
- o *Minimization of accounts receivable*
- o *Joint utilization/Overhead reduction*
- o *Delay payment/Minimize inventory*
- o *Subsidy finance*
- o *Identify other revenue opportunities*
- o *Strategic partnering*
- o *Guerilla Marketing*

When you adopt a bootstrapping approach it means that every business decision has to be looked at based on its impact on cash flow, as opposed to sales or profitability. This has a lot of implications for a business. To take a cash flow focus can actually reduce the growth of a company, as we will explain.

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On the other hand, bootstrapping does bring a very real and valuable financial discipline (no \$6000 wastebaskets here!) that can have a valuable impact on the bottom line regardless of the capital situation.

This document will look at 8 sources of bootstrapping financing available to the young tech company, and best practice tactics to leverage them.

The Origin of the Term Bootstrapping

The term bootstrapping comes from the eighteenth century phrase "to pull oneself up by one's own bootstraps", as an example of an impossible task. The term is widely believed to be derived from the Tales of Baron Munchhausen by Rudolph Erich Raspe. The Baron, known for his tall tales of impossible adventures (e.g. riding a cannonball, visiting the moon, etc.) tells of lifting himself out of a swamp by grabbing his own bootstraps and pulling (although some versions say he pulled himself out by grabbing his hair).

This colourful metaphor for "a self-sustaining process which proceeds without external help" has a number of modern applications, such as the "booting" of a computer. A versatile concept, bootstrapping also has specific meanings in linguistics, law, biology and even quantum physics.

In business, bootstrapping refers to starting a business without external capital, something only slightly less difficult than lifting yourself by your shoelaces.

Source: wikipedia

Owner and Non-equity Financing

This is the single-most important source of financing for a start-up. Figure 1 below shows the sources of financing most commonly used at start-up.

One of the inescapable realities of starting a business is that you are going to have to put a significant amount of your own financial resources into it. Aside from the fact that often other sources of financing are not available, both equity investors and banks expect that the founders will have "put some skin in the game" before they will be willing to inject capital. In addition to savings, second mortgages and secured

Sources of owner and non-equity financing:

- Credit cards
- Second mortgages
- Personal savings
- Friends, and family
- Advances from professional advisors
- Bank loans (secured and unsecured)

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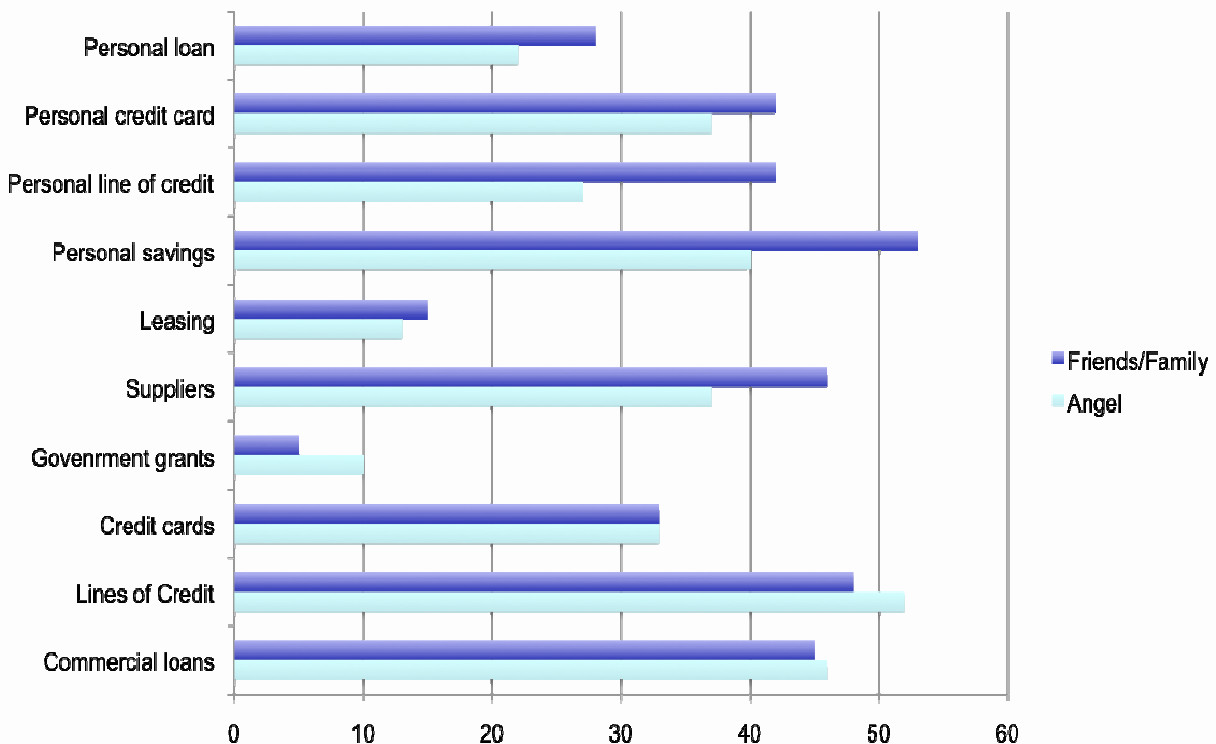
bank loans are common sources of startup funding. So even when a company – rather than an individual – borrows money, it often requires personal guarantees.

For most entrepreneurs, their own resources are not sufficient to get the business off the ground and so before going to third parties they must look at other sources of cash. Another common source of initial capital is debt or equity from family members and friends. Two pieces of advice if you want to remain on good terms, and are going to ask them to invest in your business, ensure that realistic expectations are set and that the terms of the arrangements are clear and clean.

If you have an experienced entrepreneur as a mentor or advisor, it is possible (although rare) that they may be a source of some financing. Or they may be able to lead you to other sources.

One final thought to bear in mind – the raising of financing is a continuous activity for most business and it is likely that you will require multiple injections of capital, so it is best to plan for this from the start.

Figure 1: Sources of Financing at Start-up



Source: SME Financing Data, Statistics Canada, 2004

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Minimization of Accounts Receivable

This is an area that is often neglected, especially by first-time entrepreneurs. As hard as it is to ask bankers or family for money, it can be just as hard to push your early adopter customers to pay their bills. And yet, if they do not pay promptly, your working capital requirements increase.

Without resorting to threats and harassment, there are more positive ways to encourage prompt payment. You can offer a discount for prompt payment and/or impose a penalty for late payment. Although a discount cuts into your margin, this may be cheaper than financing additional working capital, especially if you build the discount into your pricing from the start.

If you have a problem with customers who always pay late or not at all, you may want to consider "firing" your worst customers. It may sound harsh, but an analysis may reveal that the negative cash flows that you have because of these customers may be too expensive for you to afford – especially if there is a risk that they never pay. You may actually be better off without them.

Other possible accounts receivable strategies include factoring or insuring your receivables through an organization like Export Development Canada. Although this again cuts into your margin, it may have significant positive cash-flow implications.

Joint Utilization / Overhead Minimization

"As an entrepreneur, your time and attention are precious – spend your time on the things that need to be done by you and outsource the things that don't."

Andrew Maxwell, Canadian Innovation Centre

The costs of equipping a business can be high, but there are ways to reduce them, or at least reduce the cash flow impact.

For example, don't buy what you can lease or rent. Use second hand equipment or share equipment. Work from your garage or basement or share facilities with a like-minded business. Share employees or use

Joint Utilization/Overhead Minimization

- Share office space or work from home
- Share equipment or use second hand
- Share employees
- Outsource functions
- Make costs variable
- Develop online support tools to reduce support costs

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part-time or contract employees. Outsource functions that you don't absolutely have to have inside the company. Turn fixed costs into variable costs (e.g. pay sales commission instead of a salary).

The objective is to ensure that you are spending as little as possible on overheads, so you can be more flexible, preserve cash and conserve it for use on things that will add value to your business.

Delay Payment / Minimize inventory

Just as some of your customers may have tried to reduce their working capital needs by delaying their payments to you (you put a stop to that, remember?), you can reduce your cash flow needs by delaying payment to your suppliers. Doesn't seem fair, does it? But you're going to do it the right way – with their permission. In today's economy, everything is negotiable. You may be able to negotiate favourable terms for deferred payment with your suppliers. Alternately, you can choose to deal with the suppliers who will offer the most favourable terms. They may not provide the cheapest price, but their terms may fit better with your current situation.

There are also a number of ways to reduce the cash impact of inventory, such as stocking partly finished items to avoid some of the cost of storing fully finished items, or planning your supply chain so that you can utilize supplier or distributor inventory to your advantage.

Delay Payment/Minimize Inventory

- *Lease or rent equipment*
- *Negotiate terms with suppliers*
- *Manage inventory to maximize utilization*
- *Stock partly finished items*
- *Utilize supplier or distributor inventory*
- *Shorten supply chain*

Note that a number of these tactics have a favourable impact on cash flow but have a negative impact on margin. This is one of the trade-offs of bootstrapping.

"In today's environment, you can and need to negotiate everything."

Andrew Maxwell, Canadian Innovation Centre

Identify other Revenue Opportunities

As a young company, it may take time for your new product to live up to its revenue potential. In the interim, you have bills to pay, so it would be advantageous to find ways to generate additional revenues.

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There are a number of ways to do this. For instance, you can offer additional consulting or other professional services. Ideally, these would be directly related to your core business, such as consulting on the implementation or use of your product. In effect, these become an extension of your business. Another option would be to provide implementation, consulting or support services on related products - these have the advantage of helping you understand your customers better (and often lead to insights that help your own product development).

However, it is not uncommon for young companies to take on non-core work to generate the extra cash flow (the “anything for a buck” approach). This may be necessary, but it should be undertaken cautiously as it comes with a number of risks. There is the risk of losing focus on your core business. This can reduce the time you have available for developing your core product or supporting your initial customers. The biggest danger can be that this

increases your time to market and may lead to a reduced likelihood of success that can influence potential investors. As with all bootstrapping activities – it is a balance between taking short term cash management decisions – and staying with the long term implementation of your business plan.

On Generating Additional Revenue

“Early on, we needed to generate cash flow while we were doing our core product development, so we looked at taking on other projects. Most of them turned out to be a waste of time, but one in particular was instrumental in providing much needed cash. It also allowed us to learn more about our business and our target market. But projects were very distracting. There came a time where we said “no more!” – we need to focus on the core business.”

Steven Black, CEO, Suited Media

Strategic Partnering

Breaking into a new market can be difficult and having the door opened by a strategic partner who is already in that market can be a great advantage. A partner with a complementary product and existing customers in your target market can greatly accelerate your growth. You benefit from their credibility, their customer base and their field force may replace your need for a sales or delivery team in that market. They can also give important insights about customers, ways of doing business and even your product. They can make available to you important resources – that otherwise you would have to fund yourself.

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Having a strategic partner may also open up new business model opportunities for you, such as licensing your technology to them or to competitors in other markets that you can't address directly. They can enable you to offer leasing, rental or hosted versions of your solution. They can also give your start-up a level of credibility that can make it easier to attract other customers and sources of finance.

Strategic Partnering

- Pre-sell customers at an early stage
- Identify strategic distributors
- License technology to competitors or into other markets
- Choose strategic suppliers
- Develop leasing or rental solutions for your customers

However, they also may want things that you don't want to give, such as exclusivity or customizations that fit only with their products. Alternatively, what appears as a "good deal" when offered, may create pricing or performance issues in the longer term. Initial partners should be chosen carefully, and be conscious of the end-game. Sometimes partnerships end as initial partners may not be the right ones for you in the long-term, alternatively, the right initial partners may eventually be interested in acquiring you. The opportunity to work with them at arms-length may help them get a good understanding of the potential value that you can bring to their business.

"Having a strategic partner gives somebody else a vested interest in your business."

Andrew Maxwell,
Canadian Innovation Centre

Subsidy Finance

For young Canadian tech companies, there are a number of grants, subsidies and tax credits available from government and quasi-government organizations. For tech companies, one of the most valuable programs is the Federal government's Scientific Research & Experimental Development (SR&ED) tax credit. This widely used program provides a tax credit on R&D carried out in Canada and because it is a refundable credit you will get a cheque even if you have no profits. However, SRED often doesn't help with cash flow as it is paid about 18 months after the expense is incurred. (Although you can borrow against this future payment – this is difficult for early stage companies).

"Hiring an expert to prepare your SRED filing pays for itself – there is less demand on your valuable time and they will probably recoup twice what you would have."

Steven Black. CEO. Suited Media

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Other valuable programs include the IRAP, SDTC and Precarn programs. The Industrial Research Assistance Program (IRAP), run by the National Research Council, provides technical and business advisory services, as well as funding opportunities. Sustainable Development Technology Canada (SDTC) is a foundation created by the Government of Canada to support the development and demonstration of clean technologies. Precarn supports the development of automation systems.

These organizations can often help in other ways as well, connecting you to a network of other useful organizations, like-minded companies or even potential customers or investors.

For more information on the programs available, see <http://www.canadabusiness.ca/>

Guerilla Marketing

Guerilla marketing is the term for marketing tactics that can be executed without a lot of money. The most common and inexpensive tactic is networking. Word of mouth has always been one of the most effective sales techniques and if you can get your customers talking about your company, you have harnessed a powerful tool. There are many ways to do this both in the real and virtual worlds.

The virtual world creates an unprecedented opportunity for guerilla marketing. While, search based advertising has become a very cost-effective multi-billion dollar industry thanks to Google, there are many other ways to use the internet to expand the marketing activities for many companies. Simple techniques, such as allowing customers to provide unbiased feedback on your site – is a very valuable tool. It provides potential customers with relevant insights on your product and creates an active feedback mechanism for you to address as you enhance product support or develop the next generation of products. Blogging, either on your website or in industry blogs, can be effective in raising awareness of your business. Social

On Guerilla Marketing

"We wanted to invest in marketing, we wanted to make a big splash, but we didn't have the money. So we were driven to guerilla marketing by necessity. We started a referral program to incent our customers to refer us to their friends. We incented them with status and recognition on our website. It was amazingly effective and it cost us very little. Eventually 80% of our leads came from existing clients. We learned that our customers were our best sales people, and we didn't even have to pay them."

Steven Black, CEO, Suited Media

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networking using Twitter, Facebook, LinkedIn, or others can help you build and leverage a network of contacts.

Although a valuable source of information, trade shows are becoming increasingly expensive and resource consuming. As a result they are generally a poor return on investment, however reviews on industry websites and networking through industry organizations are more likely to create increased awareness and provide a source of future business opportunities.

Creating information about your industry, developing on line white papers and developing webinars and podcasts, are all a proven, cost-effective way to get your message out and help you develop customer and partner relationships.

Drawbacks of Bootstrapping

Bootstrapping to preserve cash flow may be a necessity, but it is also a double-edged sword, as it has a number of disadvantages. As already mentioned, bootstrapping can actually slow the growth of your business. As you make day-to-day business decisions, the choices faced require a fine balance between choosing the options of rapid growth and the preservation of cash flow to ensure survival.

While bootstrapping may make you less likely to run out of cash before attracting investors, it does not necessarily prepare the company properly for the explosive growth that investors are looking for. Again, it is a balance issue, fraught with the risks of all decisions made in a high growth business. However, the one issue that you can be sure of, is that if you run out of cash, you will not even be in the position to make these decisions in the future, as the company will either have folded or be out of your hands.

While bootstrapping may allow you to survive, it cannot provide sufficient cash for the business to grow quickly beyond the early stages. As they say, you can't cut your way to growth. However, most technology entrepreneurs are reluctant to make the hard cash flow decisions, and fail to realize that attracting external finance is a long process, with a high failure rate. A pro-active approach to cash flow management, in every aspect of the business, can increase the long-term prospects for the company. Ultimately, the use of bootstrapping is a balancing act, and you will have to decide on the best mix of benefits and tradeoffs.

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Action Plan

In this document, we have looked at a wide variety of ways that you can improve your cash flow. You do not have to employ all of them, but you should look for the initiatives which will provide the most significant benefits and that will be manageable for you to implement. Your strategy should likely include a mix of initiatives that reduce your cost with initiatives that increase your revenues.

There is room for creativity, and your strategy should change over time, based on the needs of the business. We suggest that you should look at each of these bootstrapping ideas are discussed in your company, to identify opportunities for improving your cash flow and increasing the long term chances for survival. Many entrepreneurs view it as a game – there is a story about the late Ted Rogers, who when starting his business put all the accounts payable each month in a hat and then kept drawing amounts until his cash was exhausted. It was reported that suppliers who complained were simply not put in the hat!!!

Bootstrapping is a reality for most young businesses and it is important to be able to employ all the tools available to help all aspects of your business and, given the wide areas in which it can be applied, should be the role of everyone in the company.. And even when external financing is finally secured, the financial discipline that was acquired through bootstrapping will serve you well for years to come.

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Results of Real-time Poll

Below are the results of the three polls conducted during the webinar:

Poll #1 What stage is your business in?

- Business or technology concept stage 11%
- Business plan development 3%
- Seeking initial financing 8%
- Product development stage 5%
- Product launch stage 15%
- Have clients and revenues 22%
- Seeking expansion capital 15%
- None of the above 17%

Poll #2 Have you had to sacrifice profitability for cash flow? Which of the following have you had to do?

- I have not sacrificed profitability for cash flow 20%
- I have discounted sales price for prompt payment 56%
- I have not utilized supplier early payment discount 26%
- I have used shared resources (when I would have preferred to have dedicated resources) 40%
- I have turned down business (because I could not afford the negative cash flow) 17%
- I have reduced inventory (even though it has cost me sales) 14%
- I have taken on positive cash flow, non-core business (even though it has diverted resources from the main business) 33%

Poll #3 As a result of today's webinar, which of the following Bootstrapping tactics will you use more in future than you have to date?

- Owner and non-equity financing 12%
- Minimizing accounts receivable 26%
- Joint utilization / overhead minimization 32%
- Delaying payment / minimizing inventory 26%
- Additional revenue sources 38%
- Strategic partnering 53%
- Subsidy finance (government grants) 38%
- Guerilla marketing 44%
- None of the above 6%

Note that questions 2 and 3 allowed multiple answers, therefore percentages will not add to 100%.

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Links of Interest

- Canada Business <http://www.canadabusiness.ca/>
- Canadian Business Online <http://www.canadianbusiness.com/entrepreneur>
- Export Development Canada <http://www.edc.ca>
- Business Development
Bank of Canada <http://www.bdc.ca>
- Canadian Innovation Centre <http://www.canadianinnovation.ca>
- Technology Marketing
Resource Centre <http://www.tmrc.ca>

Articles and Books of Interest

“6 Sources of Bootstrap Financing”

<http://www.entrepreneur.com/money/financing/selffinancingandbootstrapping/article80204.html>

“The Handbook of Financing Growth: Strategies and Capital Structure”

Kenneth H. Marks | John Wiley & Sons | March 18, 2005

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