080.HEY MAN, WHERE'S THE EXIT?

Get your facts straight on starting, and exiting, your company.

BY RICK GIBSON

"We're meeting Saturday morning to form our upstart company. Don't worry, we have it all figured out. We can develop our business plan and raise some venture capital. Then we'll appoint a board of directors, but not one that'll make us lose control. We'll work like dogs, sell a lot of product for cash and be massively liquid. We can do a quick exit by selling out or an IPO. We'll be rich!"

There are several ways to beef up your cash. The best way is to earn revenue for your goods or services. Failing that, you can borrow money or even sell stock for cash. Paying your suppliers later or getting a credit line also improves cash flow. But beware, your company needs to be creating something of material value, or you're just putting off the inevitable.

Would you rather have 45% of a company that's liquid and worth a lot, **or 100% of one that's not?**

EVERY DAY I HEAR conversations that sound a little like this one. One thing is for sure—we're all slogging this terminology around these days. Sometimes you can't help but wonder if everyone in Arizona has a startup company. Or is it just those folks from California?

My objective here is to clarify some of the terminology we use and the misconceptions we have, so we can sound smart as we make those millions.

STARTUP VS. UPSTART *(Now, let's try to be encouraging)*

The word "startup" elicits images of hard work, sacrifice and high potential. The word "upstart" (defined as a 'nonentity, a minion, an unknown') always seems to be accompanied by a big sneer. Unfortunately, the terms got confused a while back and the skewed expression (upstart) caught on. I suggest you do not call your company an upstart. You don't need to start that low.

BUSINESS PLAN *(Like McDonalds, billions and billions served—but not all are consumed)*

The business plan is supposed to be written by the entrepreneur to work out how to make the company successful. These days they're used more as a way to raise money from investors. It's preferable to have a plan that actually says what you are going to do and how you are going to do it.

VENTURE CAPITAL *(Don't count on me, Bub)*

Another misconception. Although VCs often are touted as the secret to success for new businesses, they fund a small share of the plans they see and a micro-share of startups in general. Even friends and family will be more helpful to you—talk to the rich ones. And of course, angel investors fund several times as many deals as do venture capitalists.

CASH FLOW *(More important than profits)*

Cash flow describes the condition of your checkbook. Positive cash flow means you have some money to work with, negative means you're using too much. Experts say that positive cash flow is more important to a startup than revenue, profit or funding. While unprofitable companies can sometimes operate for years, companies with no cash will crash and burn quickly.

FINANCING OR FUNDING *(Bringing in money)*

There are two basic ways to bring in money for your company: debt and equity. Debt is borrowing, and equity involves the sale of company stock. Debt can come from "uncomplicated" sources like credit cards, credit from vendors and loans from friends and family, or from "sophisticated" sources like banks and venture debt firms.

Funding can involve selling stock in your company. Usually the company issues new stock to investors, thus the founder of the company's ownership percentage is reduced—called dilution. This is good for founders if that price *per share* is higher than the price the founder paid.

For example, say the founders originally owned 100% of the company at a total valuation of $100,000. They capitalized the company at $1 per share. Then the company finished its product, sold a hundred units, and got paid. The founders can present a logical case for the company's increase in value. For this funding, the company could issue 25,000 new shares at $2 per share. There would be 125,000 total shares *after* funding, called "post." New investors will own 25,000 shares or 20% post, and founders own 80%. The founders' value is $200,000, but now they own 80% of the company's shares, not 100%. That kind of growth makes a company attractive. Just do it.

CONTROL *(That which you don't want to give up)*

Entrepreneurs worry a lot about control. To push their dreams to reality, other talented people are brought in. This includes investors with lots of money. They end up owning large blocks of stock and want to protect their points of view. And, founders need to accept multiple roles, though some may be conflicting—such as founder, manager, shareholder, board member and/or employee.

In order to attract funds, founders will trade control to speed up the company's capabilities. Other founders will hold on for dear life to control and not give it up for anything. It depends on priorities. Would you rather have 45% of a company that's liquid and worth a lot, or 100% of one that's not?

ILLUSTRATION BY JERRY BURGESS

LIQUIDITY *(You can sell your stock)*
No matter what the cash flow, financing or exit, liquidity means being able to get your cash money out at some price. It can be the result of an investment event or a public offering. Investors like this a lot. The planting has been done and it's time to take some of the yield.

EXIT *(The way out)*
It goes way beyond liquidity. This is where you all get out. That's it. You're done. You get your money and go home. Objectives can be quite different for founders and investors. Smart investors *only* want to get in when they can perceive the exit. They usually love the exit, as all their shares get sold. However, the founder may have started the company based on interest or something more personal. It can be more complicated than money.

IPO *(Not an end, just the beginning)*
First, statistics indicate startups should not plan on exiting through Initial Public Offerings. Second, an IPO is the beginning of a new company—anyone who has taken a company public knows that the real work begins *after the IPO*. Surely you don't think of your marriage as the culmination of your single life?

So, can we agree on a few things here? We like starting new successful companies. We need to have enough money to run them. We may need to raise money to grow them, but we don't want to lose control to folks who see the world differently than we do. Finally, we'd like to make a ton of money, but we might want to stay involved a bit to see our baby grow up. Enough said.

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