

Start-Up Part II

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[MUSIC PLAYING]

ERIC RYAN: So for financing we followed a pretty traditional path, which was we broke everything into little bite size steps. [Eric Ryan, Co Founder Method, San Francisco] And the most daunting task for an entrepreneur is, when you start, you look at where you are and where you want to get to, and wow it's a big hill to climb. And oh my god, how are we going to do it? So we made sure we broke everything into the little steps. So you're always focused on that step and it never felt as daunting. [Create funding goals for each phase of the business]

ERIC RYAN [continued]: So step 1 was flush out the idea. And make sure we had an idea. And create that first line of products. So Adam and I put our own money into together. We each did \$50,000 which was pretty much all the money we both had. [Use credit cards and saving to fund your business at launch] My \$50,000 came from my grandfather that he left me when he passed away. He was an entrepreneur, so I use that exact same money.

ERIC RYAN [continued]: And from there step 1 was we developed a product line. Step 2, within proof of concept, we need to actually run product and we need a little bit more capital. So we went to the angel round, which you quickly learn why they're called angels. Because they really have to be, to believe in you and believe in a business, to take a risk at such an early stage.

ERIC RYAN [continued]: So that's friends and family. It was our roommates, our parents, my grandmother, our siblings, between Adam and I we pretty much got everybody to pitch in about \$10,000 apiece and-- which was pretty amazing since my parents had never seen me make my bed throughout my high school career but yet they were willing to back our idea as a cleaning products company.

ERIC RYAN [continued]: And then step 3 is it's time to scale. So you have proof of concept, w we were in a couple 100 stores, and that was our series A. And that in itself is a big story because we were down to \$16 left in the bank. We each had about \$100,000 of payables on our credit cards. None of our credit cards had worked. We had not had a salary in a year. And we were finally about to close our series A.

ERIC RYAN [continued]: The term sheet was scheduled to be signed at 10:00 a.m on the morning of September 11, 2001. So we woke up that morning and clearly the world had changed. And we were very fortunate to find another angel investor to help us along for a few more months before we finally closed that series A.

WARREN BROWN: My first round of financing came from say City First Bank of D.C. It's a local community bank. [Warren Brown, Owner CakeLove and LoveCafe, Washington D.C.] And they worked closely with the SBA to package loans that's our SBA guaranteed. And are with people who are in the community that need that first round of financing or that type of financing. [Apply for a loan at your community bank] It was great.

WARREN BROWN [continued]: It worked out really well, and actually we're very close to paying off the loan entirely for the first bakery. So I'm very psyched about that. And the thing is that a lot of people don't understand what the SBA does, its function. And It acts as collateral. I mean, it acts as an insurance company, it acts as a guarantor of your loan,

WARREN BROWN [continued]: it's a lot of ways to think about it. But basically they offer security to the bank, they offer this guarantee to the bank saying that this borrower Warren Brown, if he isn't able to pay his loan the SBA will step in and pay the loan off. So I don't take a loan from the SBA. A lot of people think you get the loan from the SBA.

WARREN BROWN [continued]: It's from the bank. SBA just stands in the background says, like as a big brother, don't worry. If he can do it I will. And if I'm not able to do it then the SBA turns to me and says, OK, now we have to work together to pay off this loan. Normally the amount's 30% that I will owe to the SBA of the whole loan value.

MARK KLAIMAN: We originally were going to lease property. [Mark Klaiman, Co Owner Pet Camp, San Francisco] And we did all of our finances, we actually had financing arranged, assuming we were going to lease property. But no one would rent to us.

VIRGINIA DONOHUE: So I was at brunch with my father-in-law and he said-- I was moaning and groaning and saying, the dream's dead. I'm never going to-- This is never going to take off. I've spent all the time on this business plan and it's never going to work because no one will rent to me. He said, well why don't you buy a building? And I said are you crazy? It's a new business, don't know if it'll work, why would I

VIRGINIA DONOHUE [continued]: buy a building? And he said, well the worst thing that happens is you go bankrupt. And with San Francisco real estate, maybe you would actually make a little money off the building. You could pay off some of your bankruptcy debt.

MARK KLAIMAN: But none of our financing was geared towards a purchase. [Investors' funds often come with restrictions] And frankly, the lenders all backed out. So we were confronted with a situation where we had money to lease but nothing to lease, and we had property to buy but no money to buy the property. [The SBA can help you secure a loan for commercial property] And we were able to secure an SBA loan based on the property that let us buy the property.

MARK KLAIMAN [continued]: And then we had to secure additional funding, frankly from family and friends, to sort of get the business going.

LON MCGOWAN: The bank on the other hand, they are not entrepreneurs. [Lon McGowan, Founder and CEO iClick, Seattle] They are not risk-takers. And I figured that out very quickly that they don't want to take risk, they want to be backed by cash. And I said, well if I had the cash I wouldn't be asking you for the money. So that quickly got shut down. [Banks typically require collateral] So the only other thing I could come up with in a way of raising money or getting capital

LON MCGOWAN [continued]: was through credit cards. So what I figured out was that I had been working at this company for the last three months. I was making a very small salary, but it was enough to say that I had an income and I had a job. And just as we all do in the mail, we probably get one to two credit card offers in the mail every day.

LON MCGOWAN [continued]: So what I decided was that I'll wait a couple weeks and collect these, all these credit card things, up and I'd fill them out with my same information all in the same day and send them in. So I sent in about 20 different credit card applications. And about two weeks later I got 15 credit cards started rolling in. And I had about \$45,000 in available credit to me along all these different banks. So basically I spread out my risk

LON MCGOWAN [continued]: over a bunch of different banks. And I had this available credit to me, which was actually more than I was making at the time. Which was pretty amazing. And that was the way I funded the company. It was off credit cards and personal debt. [Credit cards often carry high interest rates] It was the only way I was able to pay my suppliers and keep things going. It was extremely high-interest rates, so it was an expensive way of doing it. But it was the only way I could have done it.

ROBERT JOHNSON: If you have a business idea and you don't have a lot of capital, then you've got to find that person who instantly buys into your business vision. [Robert L. Johnson, Co Founder

Black Entertainment Television (BET), Washington D.C.] And you've got to find somebody who's who can look at it and say, I get it. [Find an investor that believes in your vision] I understand exactly what you're trying to do and I know what you need.

ROBERT JOHNSON [continued]: Now I can introduce you to someone who has capital. So you almost got to go, you know, step by step. If the one person who understands it doesn't have capital, you got to hope they know somebody who has capital. Obviously access to capital is a core component. I don't have to tell you that access to capital is tough nowadays. But take my word for it, there's plenty of capital

ROBERT JOHNSON [continued]: out there in the marketplace, you just have to be able to find it by being able to articulate a vision, describe an opportunity, and demonstrate that you're willing to work harder to achieve that goal than the next person.

LON MCGOWAN: When I was first getting going I had the job, but I didn't have any money in the bank account. I don't have a rich family. I really had no resources to go out to get funding. I didn't know anybody here. My first idea, which I think a lot of people's first ideas are to get funding, was to go to the bank. I mean they have big buildings, they have a lot of money, they'd be a great place to go ask for some money

LON MCGOWAN [continued]: to start a company. So I went to my local bank, you know Wells Fargo, I went to Washington Mutual. And I toured a couple of them and I talked to their business bankers. And I told them my idea, I showed them my business plan, I walked through it all. And every one of the bankers looks and said, this is a great idea. You've got a lot of enthusiasm. The business seems like it's going to be successful.

LON MCGOWAN [continued]: You've shown good financial statements and all these types of things that add up to a successful company. And then the next question was, do you own a house? I said, no. And they said, well we don't really have anything to give you money off of. And I said, well what about the business plan? Well the business plan is great but what happens if the business fails? [Banks typically require collateral in return for a business loan] Well then none of us have any money

LON MCGOWAN [continued]: and we default on the loan. And that's not an option for the bank. So the bank, on the other hand, they are not entrepreneurs. They are not risk-takers. And I figured that out very quickly that they don't want to take risk, they want to be backed by cash. I said, well if I had the cash I wouldn't be asking you for the money. So that quickly got shut down.

LON MCGOWAN [continued]: Banks are very risk adverse. So they'd still-- even though you have a good company that may be making profit, what are they banking off of? What are they going to take if things go bad? Now in our industry everybody says well you have a lot of inventory. We have hundreds of thousands of dollars in inventory. So that's an asset, so the bank can take that.

LON MCGOWAN [continued]: But I can tell you that the bank does not want to be stuck with two containers of digital cameras, figuring out what the heck and how they're going to sell these. [Many banks will not accept inventory as collateral] So it's difficult. And so what is the one thing that they want to bank off of? And it really is accounts receivable. So for us, going through that process of working through the bank was getting our financial statements in line, getting them clean,

LON MCGOWAN [continued]: and presenting to them with the proper amount of accounts receivable to support the line of credit that we were looking for. And as a rule of thumb with the banks, it's usually 80%. So if your accounts receivable are \$100,000 they will, on average, loan you \$80,000 in a line of credit.

LON MCGOWAN [continued]: So it was a long process of getting to that number and getting the bank to actually admit that to us so that we could figure out and see how we can adjust our company to support the numbers needed to get those bank loans. At the same time, even to this day, I still have to personally guarantee all of the loans that we're getting in the banks really

LON MCGOWAN [continued]: won't get away from that.

KAREN MACK: We find that the two ratios that we analyze, and the bank analyze along with us, are our current ratio and our debt to worth ratio. [Karen Mack, Controller SAFEBuilt, Loveland, CO] The current ratio shows how well we are positioned for our short-term obligations. And then you go down and look at the debt to worth ratio and that tells you how well we're positioned to take care of our long term obligations. And those are the two major areas that the banks are concerned with.

MARK KLAIMAN: Most banks, when you walk in and you're a brand new business, you have no track record at all, they're looking at you thinking, well, are you likely to pay us back or not? Well you have a nice suit, maybe we'll lend to you. But guidance says we can't lend to anyone without three years of track record. [The U.S. Small Business Administration (SBA) guarantees small business loans] And so you go to SBA and their whole design, their whole structure,

MARK KLAIMAN [continued]: is to help new businesses get started. So I can honestly say that without the SBA loan to buy the property for the main campground Pet Camp would have never started.

MICHAEL BOOROM: I started out by going and talking to some guys that I knew that worked in commercial lending and banks, and they tell me, yeah, well you don't have any assets. [Michael Boorum, Owner U Scoot, Oakland Park, FL] And oh well, you don't have this, or you don't have that. And you know, I really don't want to get messed up with you. I'm like, hey, we're friends. Come on. You know, I mean, we know each other. He goes, oh it goes way beyond that. It just isn't going to work. So that's when I just kind of did a time out and I said, man.

MICHAEL BOOROM [continued]: I've got to I've got to think a little bit smaller. Here I'm talking to Bank of America here and I'm putting my buddy on the spot who works in commercial lending. And he's loaning literally millions and hundreds of millions of dollars to corporations. You know, I need to think smaller. So that's when I went to the SBA. Went on to the SBA.gov website. Read about what I needed to do in order to hook up

MICHAEL BOOROM [continued]: with one of those loans. Found out what bank in my area was tied to SBA lending. [Your local Office of Small Business Development Centers (SBDC) can provide information on which banks work with the SBA] Went and met with that bank and said, hey, is there an opportunity for me to capture this revenue-- these loans? And they said, absolutely. [The SBDC will walk you through the process of dealing with the banks] So I put together a real small business plan, I didn't have to do near the work. I had already done the work for the banks.

MICHAEL BOOROM [continued]: And the banks put me through the wringer only to say no. When I took the same information-- which was totally overkill-- and submitted that to the SBA they're like, looks good to us. And they loaned me the money that I needed to get started.

LON MCGOWAN: Any entrepreneur will tell you cash is king. And it's so critical to know where every dollar is going. And how important it is to know the cash flow of the company. And what too many people focus on is the profit of the company. You can be making a lot of profit but you can be out of business in a week

LON MCGOWAN [continued]: because you don't have the cash to pay your employees, to pay your suppliers, and your customers aren't paying you in time. So there's a lot of management of those

cash flows that is really critical to the success of business. And we've had some very tight times in the last four years, where there could be \$50 in the bank account, but we're doing millions of dollars a year in sales.

STEVE BELL: It's all about managing money. You see thousands of people who are great craftsman. [Steve Bell, Founder & CEO Pacific Crest Industries, Sumner, WA] And they've got a great idea, and they go into business, and they get their first big check and they-- for some reason, they think it's theirs. And they go spend it. The only money that's mine as a businessman is that little tiny amount that's left over after everybody else gets paid. [Pay yourself last]

STEVE BELL [continued]: We as businessmen are only compensated for how well we handle other people's money. It's all other people's money. Every dollar that comes in here, there's only a few pennies that are mine. Every other penny in that dollar goes to pay an employee, a supplier, overhead, rent, whatever it might be.

KAREN MACK: I think the key to keeping a business financially healthy going forward in this environment, or in any environment, is constantly analyzing. Knowing your position, knowing what your numbers are, knowing your profit loss, knowing your balance sheet, knowing your ratios, and knowing your cash flow. I also think that teamwork is vitally important. I think that you need to have a strong leadership team that

KAREN MACK [continued]: can guide you through those areas and that can include both accounting and operations so you get an entire perspective on the business, not just a one sided perspective. [Advise your accounting and operations departments to work together closely and report to you regularly]

JAY GOLTZ: The fact of the matter is they need to understand that, unless they're growing at a really rapid pace, they should be able to finance their own growth. [Jay Goltz, CEO Artists Frame Services, Chicago] And they need to figure out what that is. And the other problem is they all want to get their debt down. So for instance, they'll buy a car. [Focus on figuring out how you can finance your own growth] The dealer says, you can get a 36 month loan, a 48 month loan, or a 60 month loan.

JAY GOLTZ [continued]: Well, they're thinking like consumers. They think, oh, I want to do the 36 month loan because I want to pay the car off sooner. Well what happens is a year later they have no cash and they can't pay their bills. And the fact is the difference in car payments was a difference between \$600 a month or \$400 a month. So now there's another \$2,400 that's been invested in this car they could've used in the business.

JAY GOLTZ [continued]: After three years now there's \$7,000 invested in this car that they didn't need to pay it off that fast. So how did-- Leasing. Terrible misunderstanding in leasing. They think that leasing is, oh, leasing is good because then I can get a new computer when the lease is done. That's not why you lease. When you pay off the lease you're basically buying the merchandise. You're paying more for it.

JAY GOLTZ [continued]: You lease because it's another source of getting cash. They're easier on the credit terms, usually. And lastly the payments are less for a while and-- well like on a car it is less. [Consider leasing equipment] It doesn't go on your balance sheets if it's a real-- If it's an operating lease. If it's a capitalized lease it does.

JAY GOLTZ [continued]: But the point is, leasing is very valuable at certain stages.

MARSHA SERLIN: I have to tell you as an entrepreneur that I tell this to everyone who wants to start a business. [Marsha Selin, Founder & President United Scrap Metal, Cicero, IL] There is no money the first year. There is no money the second year. And by the third year you begin to start to make

some money. Just remember that. If you can remember that you can be successful.

MARSHA SERLIN [continued]: But I think everybody wants instant gratification. They want to go out and make money right away. And it just doesn't work that way. [It may take several years before your business turns a profit] So you've got to be willing to wait three years. When the end of three years, if you haven't done it, then get rid of it. But you've got to give yourself three years.