





# Today's Quotes

The three most important things they teach you at Harvard Business School:

- Never run out of cash
- Never run out of cash
- Never run out of cash

If you don't control your business, it will control you



# Last Week Recap

- Hard work, honesty, varied amounts of business planning, very limited capital, learned on the job, very hands-on, significant commitment, learned a lot by listening, relied heavily on others, flexible and adaptable, family support, value of team, very conservative, open to varied opportunities, had more tenacity than passion, problem solvers, optimists.



# Last Week Recap

- Businesses were not sexy, new, innovative, or unique. They all had lots of competition. They did not require the invention of anything new. They did not require huge cash infusions or prior experience.
- Entrepreneurs had fears and ambiguities that they had to overcome.





## 4 Week Recap

- How do the common items of the businesses we discussed last week relate to what we discussed during the first half of this course?
- What are the implications?



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Did anyone try the interviewing  
technique we discussed?

- Germany
- LSD
- Road-kill
- Teacher Evaluations

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# Teacher Evaluations

- Assume teaching is my business
- Assume score sheet is my financial statements
- Assume comments are the financial drivers
- What action should we take?



New Venture Creation - Course Taught at LFGSM  
Summary of Midterm Feedback Forms

Item Being Evaluated:	School year ending in June:			1999		2000		2001		2002		2003		2004		2005		2006		2007		2007		2009		2010		needs imp	meets	exceeds
	session #	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24					
<b>Instructor Organization</b>																														
Is well prepared for class	1.3	1.3	1.4	1.6	1.8	1.3	1.7	1.5	1.8	1.2	1.3	1.2	1.5	1.1	1.6	1.3	1.5	1.1										8	1	
Has a clear agenda stating expectations and goals of the session	1.4	1.3	1.4	1.6	1.8	1.3	1.6	1.5	1.8	1.0	1.1	1.2	1.5	1.1	1.2	1.1	1.4	1.0	1								7	1		
Has utilized class time well	1.2	1.3	1.3	1.5	1.7	1.3	1.6	1.3	1.6	1.1	0.9	1.1	1.5	1.0	1.3	1.4	1.5	1.0	1								7	1		
Summarizes points previously made	1.5	1.3	1.1	1.4	1.6	1.2	1.6	1.5	1.4	0.9	1.1	1.2	1.5	1.1	1.1	1.0	1.6	1.0	1								7	1		
<b>Instructor Presentation</b>																														
communicates ideas in a clear and organized manner	1.4	1.3	1.1	1.1	1.6	1.3	1.7	1.4	1.6	1.1	1.4	1.2	1.5	1.0	1.4	1.1	1.6	1.3									6	3		
communicates a sense of enthusiasm and excitement for the subject	1.1	1.2	0.7	1.0	1.5	1.5	1.7	1.5	1.2	0.8	1.1	1.2	1.5	1.6	1.2	1.1	1.7	1.1	2								4	3		
listens to the student comments and questions	1.4	1.6	1.6	1.5	1.9	1.6	1.7	1.7	1.8	1.5	1.6	1.3	1.8	1.4	1.2	1.4	1.7	1.4									5	4		
uses a variety of delivery methods in class	0.9	1.4	1.2	1.0	1.5	1.0	1.3	1.1	1.0	0.9	0.8	0.9	1.3	1.1	1.0	1.3	1.2	1.1									8	1		
<b>Instructor Interaction</b>																														
presents challenging questions to stimulate discussion	1.3	1.4	1.4	1.4	1.7	1.5	1.8	1.7	1.8	1.5	1.7	1.6	1.6	1.4	1.8	1.7	1.9	1.4									5	4		
encourages students to ask questions or make comments	1.3	1.6	1.6	1.4	1.7	1.4	1.7	1.7	1.6	1.5	1.6	1.7	1.8	1.4	1.4	1.7	1.8	1.3									6	3		
encourages students to respond to each others questions	1.4	1.7	1.4	1.3	1.7	1.4	1.7	1.8	1.4	1.4	1.7	1.6	1.5	1.3	1.1	1.3	1.6	1.4									5	4		
recognizes when students do not understand	1.1	1.2	1.1	1.4	1.3	1.4	1.5	1.5	1.0	1.0	1.2	1.2	1.5	1.1	1.0	1.3	1.4	1.1									8	1		
<b>Content</b>																														
selects examples relevant to student experiences and course content	1.6	1.7	1.3	1.6	1.8	1.4	1.6	1.7	2.0	1.1	1.7	1.5	1.9	1.5	1.6	1.6	1.7	1.7									3	6		
makes course content relevant with "real world" applications	1.7	1.7	1.6	1.4	1.9	1.6	1.8	1.8	2.0	1.4	1.5	1.6	2.0	1.5	1.7	1.6	1.7	1.7									3	6		
relates lectures to reading assignments	1.1	1.3	1.0	1.1	1.4	1.2	1.4	1.2	1.0	1.3	1.1	1.2	1.3	1.1	1.0	1.1	1.3	1.3									6	3		
relates assignments to course content	1.3	1.3	1.1	1.3	1.6	1.3	1.6	1.5	1.4	1.2	1.2	1.1	1.5	1.1	1.0	1.3	1.4	1.2									7	2		
average hours spent per week	7	6	6	6	6	7	7	7	7	6	5	6	5	7	7	8	8	8												
average	1.3	1.4	1.3	1.3	1.7	1.4	1.6	1.5	1.5	1.2	1.3	1.3	1.6	1.2	1.3	1.3	1.5	1.3												

Notes:

- The school year shows the time period of each course taught.
- Each session number is a different course that was taught in the corresponding year. Consider these to be individual years in a financial statement.
- Each item being evaluated is per a standard evaluation format. Consider these to be line items in a Profit and Loss Statement. The scores range from 0 to 2, with 0 being totally below student expectations and 2 being totally above student expectations. These are averages of student responses. Consider these to be similar to dollar values on a financial statement.
- The average scores in the boxes at the bottom of the schedule are numerical averages of the scores in each corresponding column. Consider these to be the "bottom line" or Net Income on a Statement of Profit and Loss.
- Financial statements are typically analyzed both "vertically" (within a column) and "horizontally" (across periods). Much can be learned about the value of numerical statements by analyzing these results both vertically and horizontally.

## New Venture Creation

## Midterm Feedback Form Term 2/012

	Needs Improvement	Meets Expectations	Exceeds Expectations	Needs Improvement	Meets Expectations	Exceeds Expectations	Needs Improvement	Meets Expectations	Exceeds Expectations
Integrating the competencies listed for the course in teaching		6	5		8	5		2	6
Displaying a thorough knowledge of the subject matter		6	7		4	9		3	5
Demonstrating passion for the subject matter	1	4	8		4	9		2	6
<b>Well prepared for each class session</b>		<b>9</b>	<b>4</b>		<b>4</b>	<b>9</b>		<b>4</b>	<b>4</b>
Using class time effectively		5	6		7	6		2	6
<b>Helping me acquire new knowledge</b>	1	7	5		6	7		2	6
<b>Helping me develop skills applicable to my personal and business situation</b>	1	9	3		8	5	1	4	3
Using the primary traits analysis rubric as an evaluation tool		8	2	1	10	1		4	2
Using grading criteria that are transparent and easy to understand	2	4	3	2	6	2	1	3	3
<b>Giving constructive, actionable feedback</b>	1	4	8	2	8	1	1	4	3
<b>Encouraging and facilitating effective discussion among students</b>		5	8		5	8		3	5
Using technology appropriately to enhance learning		8	4		10	3		3	5
<b>Using relevant real-world examples</b>		5	8		2	11		1	7
Providing clear expectations for teams	1	8	3	1	8	4	1	3	4
<b>Providing connections between various topics</b>		6	7		5	7		4	4

# Comments - positive

- Instructor's real world experience (2)
- Michael is open and encourages using various resources to learn concepts
- Applies concepts rather than gives tests
- Personable and effective style
- Good student discussions
- Makes you think – almost philosophy
- Case studies and discussions are very useful
- Makes me think differently about a lot being taught at LFGSM
- Optional readings are funny and informative
- Fun
- Different perspective on subject



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## Plan your resources carefully

If you use your resources to obtain something, you cannot use those same resources to obtain something else. That is called fraud, and eventually leads to a scarcity of certain other cherished resources.

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# Why do people think this makes sense?

## **State Plan Makes Fund Both Borrower and Lender**

**Published: June 11, 2010**

ALBANY — Gov. David A. Paterson and legislative leaders have tentatively agreed to allow the state and municipalities to borrow nearly \$6 billion to help them make their required annual payments to the state pension fund.

And, in classic budgetary sleight-of-hand, they will borrow the money to make the payments to the pension fund — from the same pension fund.

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# Everything changes!

- Nothing will ever work out precisely as you plan.
- That does not mean you should not plan. On the contrary, you need to better understand the numerical dimensions of your business so you can best respond to change as it does occur.

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Numbers are neither magical, mystical, nor menacing. They merely represent your thoughts and decisions about how your business will run.



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# Components of Projections

- Detailed pro-forma balance sheet
- Detailed pro-forma income statement
- Detailed pro-forma cash flow statement
- Detailed explanation of assumptions
- Detailed sales forecast
- Breakeven point projection
- Capital equipment list

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# Components must be integrated

- This means that they are all tied together, so that any changes made to one component flow through to all of the other components.

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# The Financial Cycle

Assets

Sales

Costs

Assets

Expenses

Costs

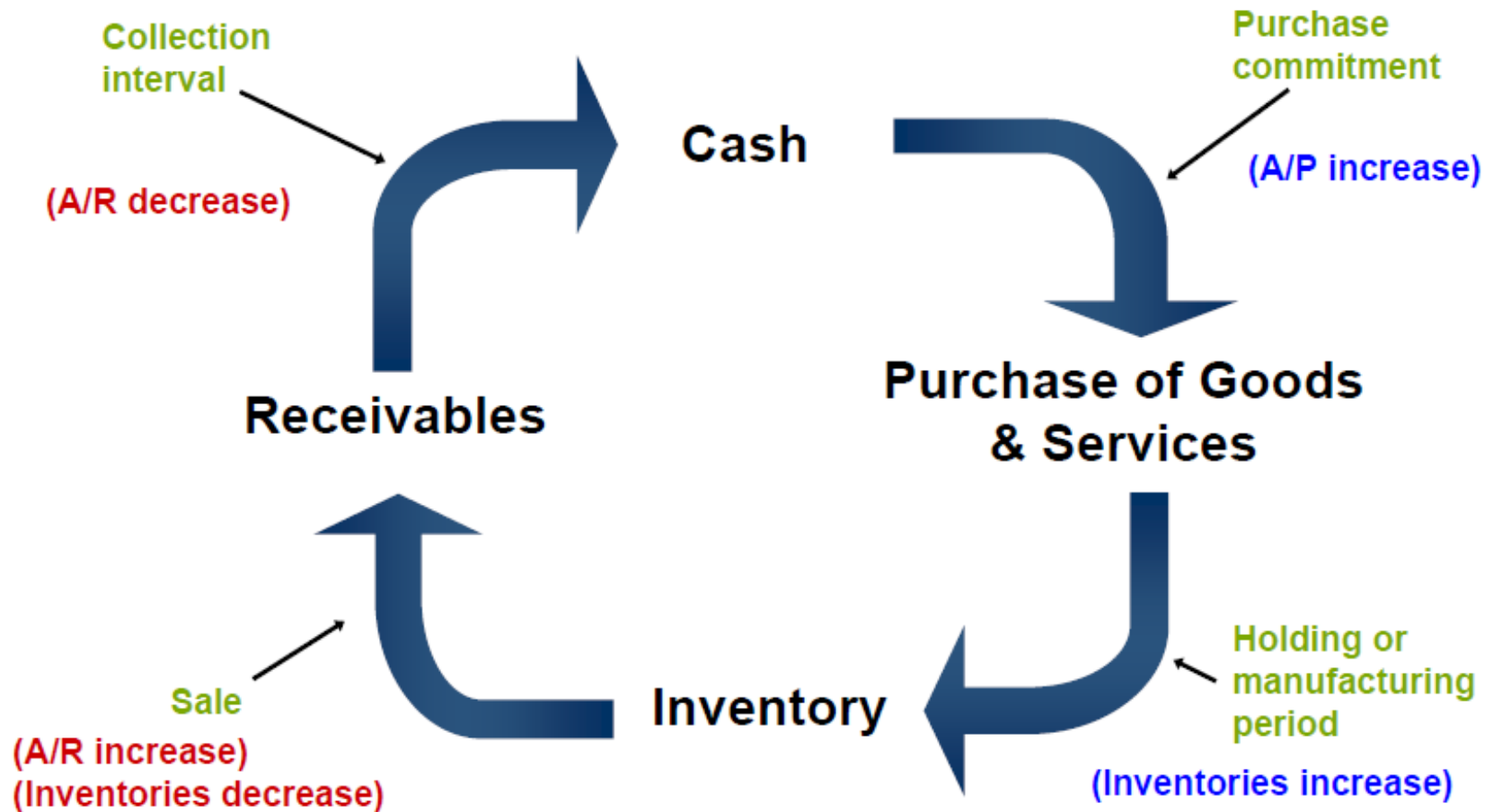
Liabilities

Income

Equity

Value

# The Operating Cycle



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# Most of your numbers will be wrong

- Forecasting errors
- Technical errors

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## Reasons for technical errors

- Incorrect relationships between variables
- Incorrect or missing linkages
- Bad formulas
- Incomplete or inadequate development



## Another “Never”

- Never let someone else build your projections for you.



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# The importance of matching

- Match your sources and needs of cash
- Match your timing - do not fund long-term needs with short-term money



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# Tax Considerations

- Debt
- Equity



# Growth Costs \$

- When your company begins to grow, managing your cash flow will require good financial planning.
- You need to buy or make something before you can sell it.
- You need to have your overhead in place before you can provide a service.



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# There are two types of Growth

- Planned
- Unplanned

# Real world example

- Though Solyndra Inc. was supposed to be a marquee example of how private and public capital could vault innovative companies to commercial success, investors say that the \$535 million government loan guarantee may have ultimately contributed to the company's undoing, the *Wall Street Journal* reported today. The new factory built with Department of Energy funds foisted fixed costs on a company already struggling through an industry shake-out, the investors said. What's more, the debt paradoxically made raising more money difficult. Once the government demanded priority in the event of failure, private investors were less likely to prop up the company. One Solyndra investor said that, in retrospect, **"the worst thing that happened to Solyndra was the loan."** - Wall St Journal



# Advisors

- Putting together a group of advisors and directors in the beginning will help prepare for difficult transition periods





# Growth

- In many ways, business is easier when it is small
- Problems get bigger as the company grows
- Sometimes being smaller is more profitable than being bigger





# Activity Based Costing

- Look at all cost drivers
  - Time (hours spent, interest, etc.)
  - Materials and Supplies
  - Human resources





# Growth and You

- When your company grows, your job will change and you will experience a difficult, but necessary, transition.





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- You cannot solve a problem by throwing money at it.



# Time in relation to equity

- Time works for you when you know your costs and understand your risks
- Time works against you in a business that you do not understand
- Waiting for your business to build wealth can sometimes be the most difficult thing to do. Being an entrepreneur requires tremendous patience.





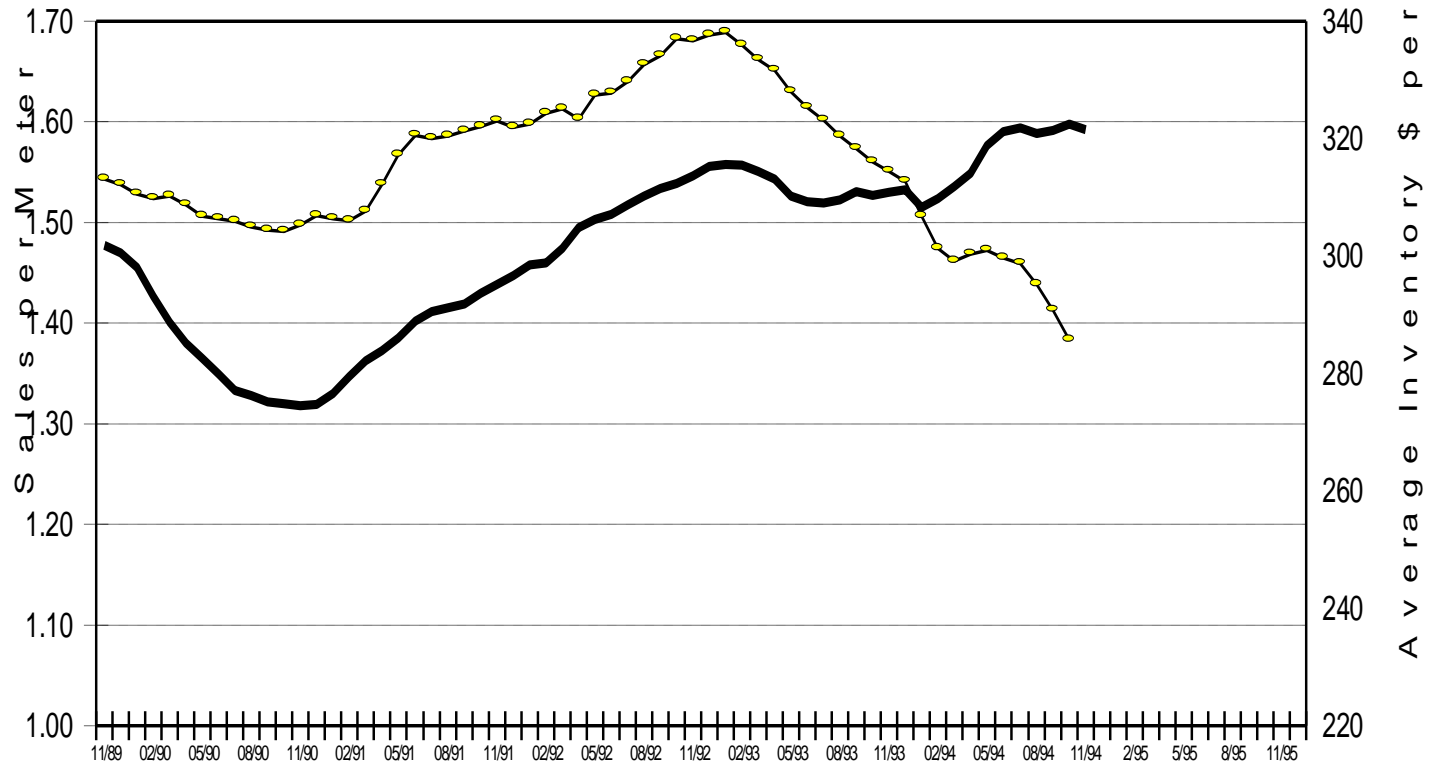
# Trends

- Trends continue until something happens to break them.



## A - OK : 12 MONTHS ROLLING

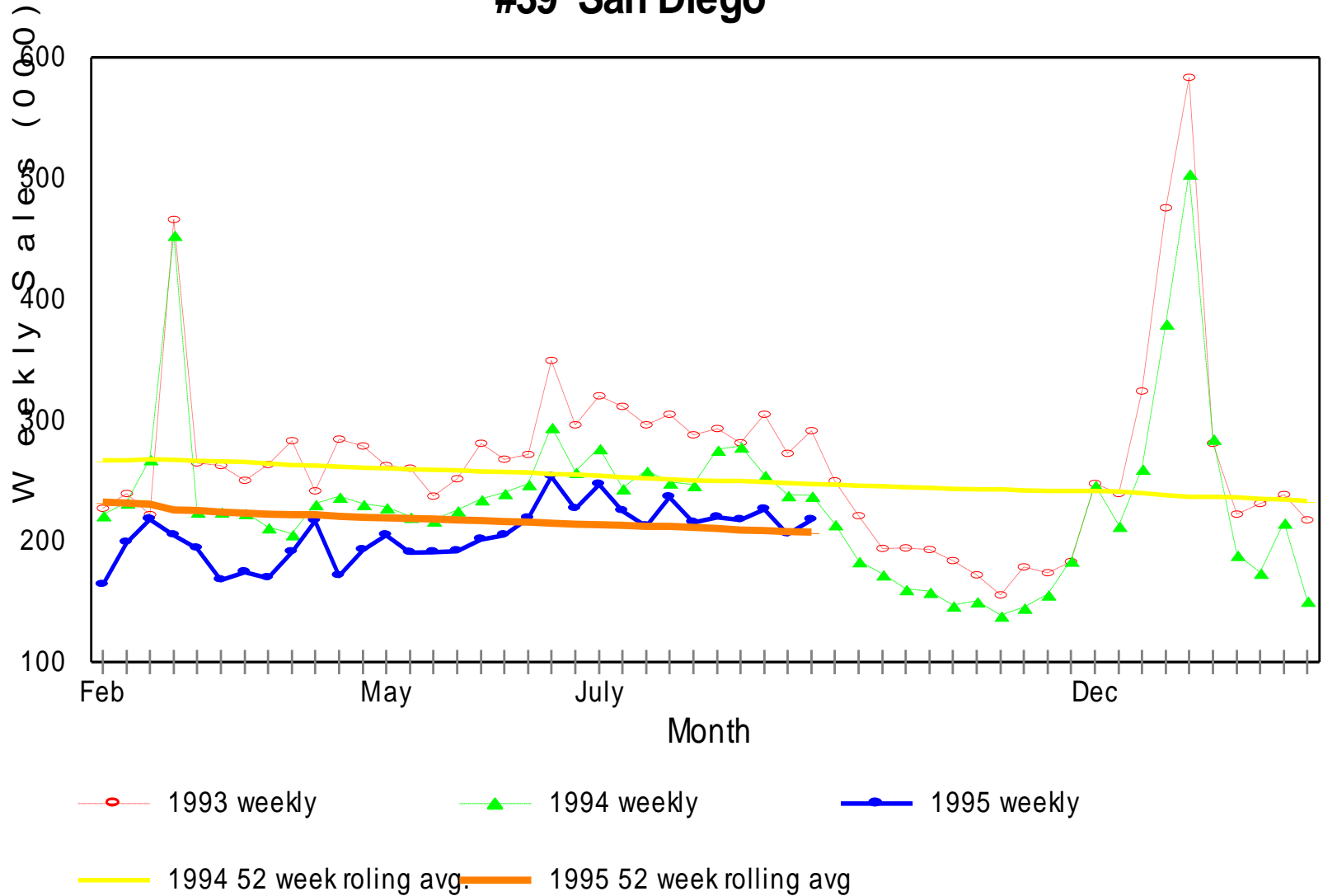
### Sales and Inventory per m2 (stores)



Sales Per m2
  Inventory per m2 at Cost (in dollar)

# SPORTMART, INC.

## #39 San Diego



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## How much \$ do I need?

- Make a detailed cash flow projection
  - first project the revenue stream
  - project expenditures
- Assess your resources

Let's plan a coffee shop !

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Part of strategy and growing a company is deciding what you aren't going to do as much as what you are.

Wood + Glass = No Cash

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# Eugene's Storage Business

- Revenue drivers:
  - Demand for storage by consumers moving to and from area
  - Commercial demand by local businesses
  - Small business owners operating from their homes
  - Local competition
- Cost drivers:
  - Utilities – electric, gas, water, sewer, garbage
  - Insurance – fire, property, liability, legal and general business
  - Administrative – legal and accounting fees, office supplies
  - Marketing – promotional items, direct mail, advertising and sponsorships
  - Capital improvements
  - Operational – foreclosures. This is a significant issue – there is a TV show based on auctioning storage unit contents!



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# My comments on some papers

- You did this backwards. The revenue drivers have to come before the cost drivers. The order that you did this in shows that you are more focused on an activity than an opportunity.
- Customers are not revenue drivers. The things that make customers buy from you are revenue drivers.
- Differentiate between costs and cost drivers. The drivers are the variables that make the costs what they are.
- Buying a business doesn't necessarily reduce your financial risk, it just changes it.

# My Comments cont.

- Fixed costs (franchise fee, furnishings and occupancy) are three of your four biggest costs. Seems like you should do more to take advantage of these – only operating 6 hours a week does not seem efficient. Since your fixed costs are the same no matter what you do and your variable costs don't look too high (\$7 an hour for an assistant vs \$100 an hour revenue for a student), I would strongly suggest that you investigate more ways to utilize those fixed costs and generate more revenue.

This is the reason you prepare models, so that you can find how to optimize resources and minimize risk



## My Comments cont.

- This is all too big picture. You make it seem like it is all out of your control or influence. Are there any drivers that you can manage, or will you just be hanging on for the ride? (the only drivers mentioned were the economy, material prices, technology in general, labor conditions).

You need to personalize your plan, actually make yourself a part of it



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# Your real cash needs

- Accrual accounting vs. cash basis accounting
- Stated terms vs. real terms
  - What you owe
  - What you are owed
- Lead and lag times, production cycles

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# Problems with EBITDA

- EBITDA ignores changes in working capital and overstates cash flow in periods of working capital growth.
- It can be a misleading measure of liquidity (quick access to cash)
- It does not consider the amount of required reinvestment, especially for companies with short-lived assets.
- It says nothing about quality of earnings.
- It ignores distinctions in the quality of cash flow resulting from different accounting policies – not all earnings are cash.
- It can drift from the realm of reality.



# EBITDA

- Earnings Before Investigation, Termination, Deposition, and Arrest
- Show me the money



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## What to do:

- Plan monthly for 3 or 5 years
  - Understand your seasonality - do not just divide by 12
  - Relate costs to cost drivers, not revenue
- If you are in trouble, plan weekly in rolling 13 week segments
  - update weekly, compare actual to plan and adjust assumptions or take stronger action



## What to do (cont.):

- Plan your balance sheet monthly based on business drivers
  - assets when needed
  - liabilities when incurred
  - min / max criteria so that you simultaneously plug cash and borrowings to make the balance sheet balance







## What to do (cont.):

- Make your model interactive
  - assumptions on their own pages
  - all P&Ls, balance sheets, supporting schedules, etc. 100% formula-driven.
  - **NO HARDCODING!**
  - Document your worksheets, use color coding, notes, etc.



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## What to do (cont.):

- Visual presentation often aids in the thought process
- Build a pyramid - top level summaries followed by successively greater levels of detail

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# Understand the cash flow cycle

- You cannot improve it until you understand it
- What it is:
  - investment in fixed assets
  - investment in saleable and selling resources
  - make the sale
  - get paid

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- Cash flow is, by far, the most important financial control in a start-up venture and almost every small business, and every entrepreneur must understand its significance

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## What's the driver?

- Sales?
- Inventory levels?
- Payroll expense?
- Accounts receivable?
- Fixed assets?
- Utilities expense?
- Employee benefits?


# Items to consider

- Seasonal factors
- Financial patterns
- Marketing vehicles
- Marketing tactics
- Sales projections
- Facilities
- Production
- Logistics
- Equipment
- Order fulfillment
- Research & development
- Other operational costs
- Start-up costs
- Compensation, incentives, & benefits
- Taxes
- Everything else

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Knowing your numbers cold  
means hardly ever having to  
guess.



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01/27/2006