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Financial Fitness for Entrepreneurs

While creating a growth business can be exhilarating, many entrepreneurs—especially those starting a company for the first time—don't pay enough attention to some core issues surrounding the financial management of their businesses. *continued* ▸

by Brad Feld

Often, founders don't have formal training in finance—they're "techies" launching the next Apple Computer or Netscape, professionals putting together advertising, management consulting, or human resources agencies, or super-salesmen types who've figured out how to sell a pizza or deliver a package faster, better and cheaper. Always, they're intimately involved with their core product or service. Often, they are too busy to burrow into the details of some of the company's functions, of which finance is the most critical.

These entrepreneurs are savvy enough to know they must work with financial professionals, such as their CFO and outside auditors or CPAs. However, no matter what their background or inclination about finance, founders need to have a working understanding of the basics. An elementary level of financial literacy means they'll work more intelligently with their financial advisors and become the first line of defense for spotting potential problems in the young company.

What follows are some fundamental financial tenets that all early-stage entrepreneurs should be aware of, understand, and heed.

CASH IS KING

No matter what, don't run out of money. Nothing else in this article matters if you run out of money. This means know your burn rate (the net cash that is flowing out of your business each month) and be aware that your low cash point for any given month may not be at the end of the month. In other words, don't get caught planning based on full month figures only to find that you do not have enough money to pay your most important vendor on the 15th because your customers don't pay you until the 30th.

PUT IN REAL FINANCIAL SYSTEMS FROM DAY ONE

Lots of entrepreneurs figure that they'll "get around to putting in real financial systems someday soon." Of course, that rarely happens, especially if no one on the founding team has a strong financial background. The cliché, "It's better to build on a strong foundation," applies. Put the foundation in place early so that as your business grows, you are on solid financial footing.

MEASURE EVERYTHING

If you have real financial systems in place, you can measure everything. Be obsessive about it. Some things that you'll measure will be similar to what most other businesses measure, such as your P&L, balance sheet, and cash flow statements. Other things will be unique to your business—oriented around your specific customers or products. As your business grows, make sure you evolve and expand what you measure to best reflect the current state of your business. Look especially for metrics that will help tell you where your business is going, not just where it has come from. Financial systems can and should capture more than just historical financial results.

BUILD AN ANNUAL OPERATING PLAN

Be disciplined about creating an annual operating plan and budget every year. You should have it finished before January 1. This is your easiest benchmark to measure against—your own expectations. If you don't set them, you won't know how you did.

USE YOUR VENDORS TO FUND YOUR BUSINESS

Vendors love to get paid on time (or early). However, as a young business, your vendors will appreciate consistency of payment over timeliness. While most vendors will want to be paid within 30 days (or less), it's typical to stretch payables 45 to 60 days. The key is to pay consistently—if you have a vendor from whom you continually use services or buy products, don't store up your bills and pay in one lump sum sporadically. Instead, send regular payments. Also, don't dodge calls from vendors about paying late. Tell them when you are going to pay them, and then make sure you follow through.

USE YOUR CUSTOMERS TO FUND YOUR BUSINESS

Customers—especially ones that value your products and services—will often be willing to pay on very short terms. Don't be bashful about asking them to prepay, especially if you are a service business.

BE CAREFUL OF PERSONAL GUARANTEES

Banks love personal guarantees. Entrepreneurs hate them. You should avoid them if you can – only sign one as a last resort. You are already investing a huge amount of your personal assets and energy in your business. If you can't get financing based on the strength of your business, you should question whether it's the right kind of financing. In the upside scenario, when your business succeeds, the personal guarantee doesn't matter. It's the downside case you should be worried about, because you could lose major personal assets like your house.

IF IT SOUNDS TOO GOOD TO BE TRUE, IT PROBABLY IS

While this is generally true in life, it's especially true concerning financial issues surrounding an early stage company. Your books should always balance, financings will always have a cost, and investors are always going to have strings attached to their money. Ask questions, be wary, and know what you are getting into.

FINANCE YOUR BUSINESS APPROPRIATELY FOR WHAT YOU ARE TRYING TO CREATE

One of the most common mistakes an early stage entrepreneur makes is trying to raise the wrong kind of money for the business. It makes no sense for a service business that could potentially be a $5 million company within three years to try to raise $10 million of venture capital. Correspondingly, it doesn't make sense for a capital-intensive company that needs to build a plant to raise $250,000 of angel money.

CHOOSE PROFESSIONALS CAREFULLY

It may be tempting to use your wife's brother's friend's neighbor as your lawyer, because he will give you a great rate and you see him at the neighborhood barbecue, but you get what you pay for. The same is true for accountants and other services that your business will use. Find professionals who know what they are doing and have experience with young companies.

DON'T TAKE ANYTHING FOR GRANTED

Double-check everything. If you have the right systems (did I mention that you should have good systems?), this is easy. If you don't, reread the second bullet point and put in the right systems.

PAY YOUR TAXES ON TIME

Unlike customers and vendors, our local, state, and federal tax authorities don't appreciate being used as financing sources for your business. In addition to potentially incurring onerous penalties, missing or delaying tax payments is often a serious crime.

That's the list. Read it over, familiarize yourself with it, and begin developing a lay entrepreneur's understanding of finance. You'll then be able to work deftly with your pros to put the company of your dreams on the sound financial footing necessary for success.

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In 1995, he founded Intensity Ventures, a company that helps launch and operate software companies. Intensity Ventures was a venture affiliate of SOFTBANK. In 1987, he founded Feld Technologies, a software consulting company that was acquired in 1993 by AmeriData Technologies. Mr. Feld serves as director of a number of Internet-related and software companies. He holds S.B. and S.M. degrees from the Massachusetts Institute of Technology.

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