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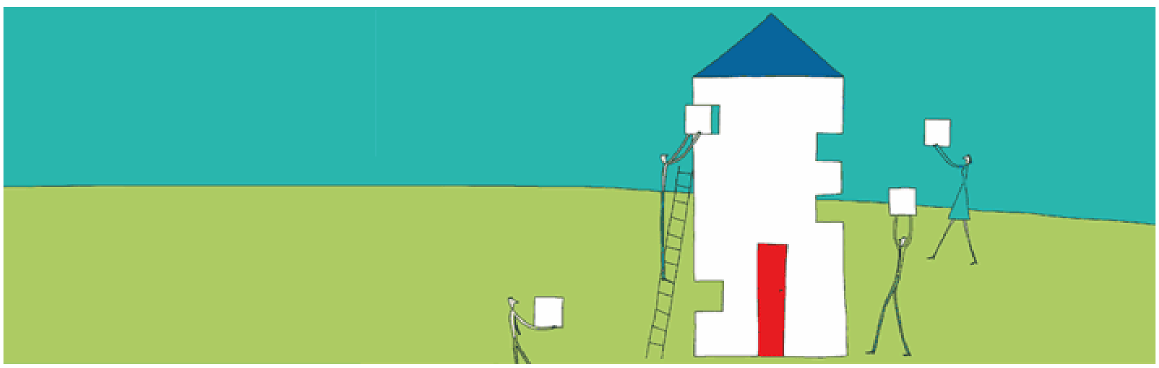
Ideas and Resources – Whitepaper

Bootstrap Your Business for Success



Knowing When & How to Approach VC Firms

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What if I told you that some of the leading public companies got there without taking early venture capital funding?

How it works

Bootstrapping happens when a company develops with little or no outside funding. The company opts to fund its primary development and growth through internal cash flow using real customer revenues. The founders and a restricted set of early employees often forgo salary payments for equity in the company. Eventually these companies operate at a breakeven or profitable performance level by necessity. Some companies formed from breakeven or cash-positive corporate divestitures share these same qualities.

Bootstrapped companies find ways to generate revenue and sustain growth through consulting engagements, non-recurring engineering (NRE) engagements, value-added reseller (VAR) agreements, customer retainer fees, divestitures or protected supplier contracts with a parent company for a defined period of time, the classic "moonlighting," and even waived compensation. They learn to generate revenue that funds growth and expansion until reaching a level of growth where it no longer makes sense to go it alone.

Building great companies

While not conventional for every business, bootstrapping does build great companies. There are numerous justifications for it, namely establishing a solid foundation for future growth, product development, expansion, and market leadership. When a company becomes self-sufficient, early customer focus becomes baked into the company's DNA. Bootstrapped companies must listen to their customers and react to what they are saying. They must develop products the marketplace will purchase, so often market-test their products and involve their customers. Executives who aren't fundraising and appealing to investors are able to focus more time on customers, managing growth and building the company at a time when customer acquisition is necessary for sustainability.

A second salient point is that capital allocation is more rational and less speculative among bootstrapped companies. Investments are more gradual, burn rates are more sustainable, time as a resource can be spread more evenly across the company and not impeded by external forces.

Finally, because there are fewer distractions, managers tend to be more focused and goals more closely aligned when a company bootstraps. Typically teams are smaller and have fewer projects on the go.

And because bootstrapped companies cannot afford to simply throw money at a problem, they must focus on solving the real issue, whether it's an internal matter with employees, external customer issues, or developmental product concerns.

Some of the world's top technology companies were bootstrapped

Companies like:

- *eBay*
- *Microsoft*
- *SAP*
- *Siebel*
- *Business Objects*
- *Sage*
- *Oracle*
- *Cisco.*

Angel capital is patient

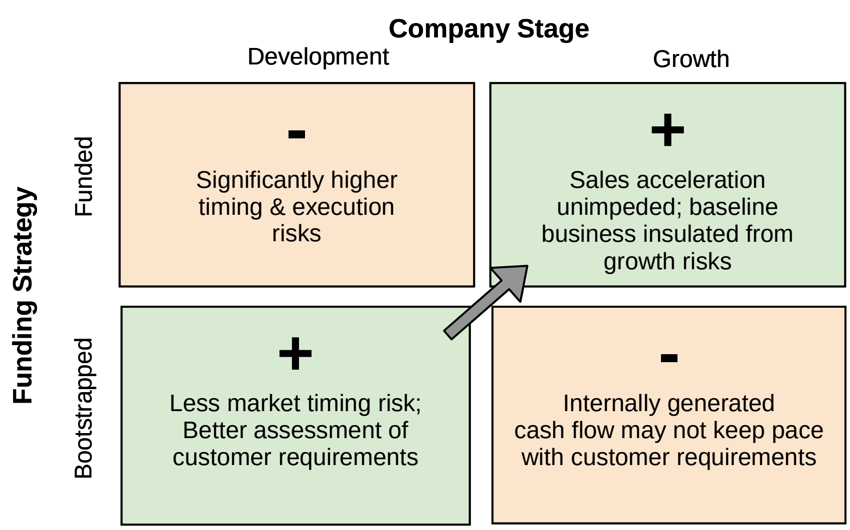
Angel capital can play an important role, and companies often bootstrap with a little help from their “friends and family.” Typically this early capital represents a more patient investment in individuals whom the angels trust. It is different from venture capital, which is third-party investment and carries a different level of accountability. Angel capital offers bootstrapped companies a financial resource without having to seek venture capital too early.

But take note: bootstrapping is not for everyone

Some start-up businesses don't have the luxury of bootstrapping. Their market may be immediate and, therefore, they don't have three or four years to grow the business patiently. Also, their business may be capital-intensive, requiring funding from inception. In some cases, the founders simply can’t invest “sweat equity” in the business by forgoing pay for months and even years. Nonetheless, while bootstrapping doesn’t work for everyone, for the entrepreneur who has the time and wherewithal to grow his business through diligence and hard work, it can lead to a great business and even greater financial rewards. Bootstrapping for many is a sure path to success.

Raising the right money at the right time can transform a bootstrapped company’s growth rate.

With a great product and an efficient sales model, judicious use of external capital can initiate period of explosive growth.



How much bootstrapping is enough?

It is important to know when to raise capital. Companies should watch for signals that they've outgrown bootstrapping:

- **Market growth rate is accelerating.**

  If the market is growing faster than internal funding, you risk losing market share (and equity) by not sustaining growth.

- **Customers are buying products and sales are predictable.**

  You can scale your sales team and/or channel effectively with the money you raise. As a rule of thumb, you should feel confident that you can predictably generate at least $2 in gross profit for every $1 in incurred sales and marketing expense. We recommend a $3:$1 ratio as an even safer barometer.

- **Complementary products or businesses become available.**

  Is it time to expand your offerings through acquisition? Can you economically acquire new customers through a merger? If you are considering M&A activity and need money to finance your growth, it's time to raise capital.

- **The current economic cycle favors growth.**

  The current economic cycle appears favorable to increased technology investment and you see new growth areas on the horizon.

- **Your balance sheets need strengthening or you want to diversify risk.**

  Co-mingled balance sheets can be a major challenge for bootstrapped businesses. A prudent decision for the company may be imprudent for the founder (for example, scaling sales at the expense of cash-flow). Selling some shares offers founders a way to diversify their own risk.

> *"Bootstrapping is entrepreneurship in its purest form. It is the transformation of human capital into financial capital."*
>
> *Bootstrapping business start-ups: entrepreneurship literature, textbooks, and teaching versus … RJ Lahm Jr, HT Little Jr - PROCEEDINGS, 2005*

Where do you go from here?

If you've bootstrapped long enough for any of these events to occur, you've done a pretty good job steering your ship on a steady path, have maintained an equitable stake in your company, and can begin to look for the right partners to help you grow. The question you now may ask is, "What do I look for in an investor?"

Don't simply look for an investor – look for a partner with vested equity interest to help you grow. If you have ambitions of rapid growth, what are the steps to getting there? The right partner will have experience walking the same path as you, and can help to secure your success. The reality is that many parts of your business and how you manage it will need to change internally and externally. The right partner should help you achieve this by offering substantive contributions – not just capital.

About the author

Javier Rojas

Javier Rojas is a managing director at Kennet Partners and leads its US investment activities. He is currently on the board of Daptiv, Adviva, IntelePeer, NetPro Computing, MedeFinance, and Kapow Technologies.

Prior to joining Kennet, he was a managing director of Broadview International and led their West Coast Software and Services practice. Javier specialized in advising high growth, early-stage companies on how to capitalize on emerging technology markets and partnering opportunities.

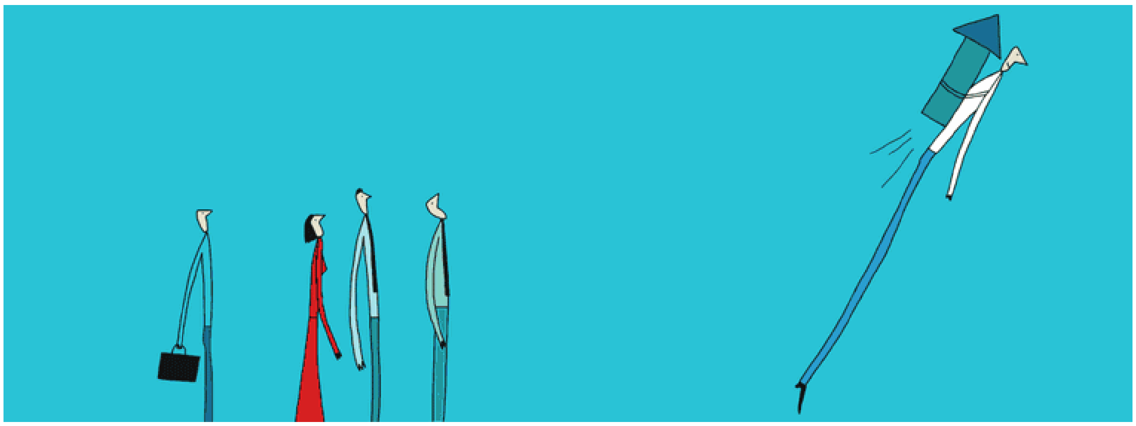
He invested and/or advised on a number of successful companies and high value exits including Etek, Webex, Looksmart, Blue Mountain Arts, When.com and Rightworks.

Previously, Javier was with Morgan Stanley. Earlier, he founded a software firm that developed products for capital markets interest rate and currency swap traders.

He holds an MBA degree from The Harvard Business School and a BAS degree from Georgetown University.

About us

Kennet invests in entrepreneurial technology businesses to help them take the next big jump in growth



We're an experienced growth equity investor with a long track record of building global market leaders and achieving high-value exits.

Since 1997 we have invested over $270 million in companies in Europe and the US.

As a growth equity investor, Kennet focuses on companies that have proven commercial success and are now ready for the next phase of growth.

The companies we invest in often do not need money to survive.

They have options. But the right investment from the right partner can help them keep ahead of their markets, expand internationally, ramp up their sales forces and lead to greater value for shareholders.

Visit us at www.kennet.com to learn more.

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