

Resources

Helpful Books and Materials

The Entrepreneurial Venture by William Sahlman & Howard Stevenson Readings on all facets of entrepreneurship, including innovation, valuation, attracting stakeholders and financing, managing growth and harvesting.

Business Plans that Win \$\$\$: Lessons from the MIT Enterprise Forum by Stanley Rich & David Gumpert Clear and straightforward advice on how to write an effective business plan.

Business Plans for Dummies by Paul Tiffany & Steven Peterson This readable reference covers all the aspects needed to create a clear and comprehensive business plan.

The Complete Guide to Running and Growing Your Business by Andrew Sherman Provides practical advice concentrating on the legal and contractual issues involved in starting and growing a business.

New Venture Creation: Entrepreneurship for the 21st Century by Jeffrey Timmons Topical overview of recognizing new opportunities and creating new businesses.

Article: Sahlman, William A., "How to Write a Great Business Plan", Harvard Business Review, July August 1997 Start-Up Strategies

How to Drive Your Competition Crazy by Guy Kawasaki Not just guerrilla marketing, but guerrilla sales, production and human resources. Everything the cash-constrained entrepreneur needs to get the upper hand.

Inside the Tornado by Geoffrey Moore Once you have successfully crossed the chasm and reached the mass market, you begin to experience the problems and opportunities of "hypergrowth" — Moore's second book provides effective strategies for capturing maximum value.

Start-Up: A Silicon Valley Adventure by Jerry Kaplan This is a vivid and lively rise-and-fall account of a company born to create a pen-based computer. It begins on a corporate jet with the author and fellow industry visionary Mitchell Kapor, founder of Lotus, sharing a vision of pen computing.

The Silicon Valley Way by Elton Sherwin, Jr. Silicon Valley has become the global trendsetter, with governments around the world emulating their high-tech centers. In this book, Elton Sherwin describes the acid tests used by successful executives and venture capitalists, and encapsulates the questions they ask and the tools they employ to pick the winners.

Hypercompetitive Rivalries by Richard D'Aveni and Robert Gunther Using detailed examples from hypercompetitive industries such as computers, automobiles, and pharmaceuticals, D'Aveni demonstrates how hypercompetitive firms succeed by disrupting the status quo and creating a continuous series of temporary advantages.

Books/Marketing and Sales

Marketing High Technology: An Insider's View by Bill Davidow Discusses how to create a complete marketing program for high-tech products. Draws the line between pieces of technology and products.

The New Strategic Selling by Stephen Heiman, et al How to sell in today's competitive market, when you need more than shiny shoes and a firm handshake.

Relationship Marketing by Regis McKenna A classic look at maximizing profit by retaining customers

Crossing the Chasm by Geoffrey Moore The classic book on the marketing challenges faced by high-tech companies. Explains why it's so much harder for these companies to sell to the masses than to the "early adopters."

Webonomics: Nine Essential Principles by Evan Schwartz Cuts through the hype and examines the true commercial realities of the Web.

Design and Marketing of New Products by Glen L. Urban & John R. Hauser A complete and practical, how-to exploration of each step in the strategy, opportunity identification, design, testing, launch, and profit-management stages of new-product development.

Resources for Preparing Financial Statements

Need for Financial Statements:

Financial statements present the reader information about the organization's financial health at a given point in time (balance sheet), and the results of the organizations performance over a period of time (income statement and cash flow statement).

There are three primary financial statements: the balance sheet, income statement and statement of cash flow. Each one of these statements is equally important in communicating the existing or projected financial health of the company. Financial statements are prepared at the end of the financial year.

When making the financial statements one should first start with the income statement, then the cash flow statement and finally the balance sheet. The reason for this is that many items that are to be recorded in the balance sheet come from the other two statements. For example, the cash balance which should finally appear on the balance sheet will come from the ending cash balance on the cash flow statement.

Income Statement

The income statement describes a company's financial performance for a specified period of time. The major elements of the income statement can be broken into two major categories: revenues and expenses. Both revenues and expenses are to be recorded in the year they are earned or expensed, not when the actual cash is paid or received.

Revenues: Revenues represent the money the business receives in exchange for the products or services it provides. In most cases, revenues are associated with the sale of the products or services the company is in the business of selling. However, one must remember that there are other sources of revenue as well, such as loans or the sale of an old piece of machinery.

Some common sources of revenue are sales revenue, service revenue and interest revenue. When estimating the amount of revenue one must ensure the revenues are recorded in the year in which they are earned, such that if sales are made in 2004 but the payment is received in 2005, the revenue should be recorded in the year in which they are earned, i.e., 2004. Hence, if the company receives

\$200 as sales receipts for sales made in 2004 and \$30 as interest payment for any credit/loan given to outsiders, both these amounts will be recorded under revenue in the income statement. See template to see the structure of the income statement.

When estimating the amount of revenues, companies must take into account cost of goods sold (COGS). COGS is the amount the business has spent in order to make the product/service ready for sale. The formula to calculate the COGS is given in the accompanying income statement template. COGS should be subtracted from the revenues to arrive at Gross Profit (Loss).

Let us take an example, Company A earns \$4,000 as revenue for sales made in the current year. In order to make the sale possible it incurred \$2,500 as COGS. In this case the gross profit for the company will be \$1,500.

Expenses: The recorded expenses reflect the amount of resources used in generating the reported revenue. Some common examples of expenses: salaries of executives, staff salaries, R&D expenses, bad debt expense, depreciation for the current year expense, interest expense and income tax expense. A more detailed list is provided in the template.

Suppose a company at the end of 2004 recognizes that it needs to pay \$10,000 as salaries to its employees for that particular year. It will record \$10,000 as salaries expense in the income statement.

To explain bad debt expense, let's take an example. A company made a sale of \$20,000 on credit to its customers. This \$20,000 is what the company calls accounts receivable, and you will see later that this is recorded as an asset on the balance sheet. It is this amount that the company expects to receive in cash in the near future (usually within one year). Now the company's past experience suggests that 2 percent of all its accounts receivable is never received. People just don't pay it. This is what the company calls bad debt. Hence the company records 2 percent of \$20,000, or \$400, as bad debt expense.

Depreciation is the amount by which assets such as machinery have lost value as a result of normal wear and tear. It is the same concept as in automobiles: a truck that you bought at \$15,000 last year is worth \$10,000 today because of normal wear and tear. The difference of \$5,000 is called depreciation. The income statement records only the depreciation that happens in the current year, i.e., the year for which the financial statements are being prepared.

Interest expense shows the interest paid for the current year for any long-term loan taken by the company. The income tax estimated to be paid by the company for the current year is also recorded in the income statement.

Other Income is another sub-heading in the income statement. Two major items under this are gain and loss on sales of assets and interest. Here, interest is from sources peripheral to the main operations of the business.

When speaking of assets under gains and losses, the business looks at assets that are peripheral to the primary operations of the business. Suppose a cell phone manufacturer has old machinery that sold at a profit of \$400 – this \$400 is recorded here. Since the main business of the company is to sell cell phones, machinery is peripheral to the main business.

Cash Flow Statement

This financial statement deals with the cash transactions of the business in a financial year. Each period for which the cash flow statement is prepared begins with a beginning cash balance. To this,

any revenue received in cash is added and expenses paid in cash are subtracted. The only transactions which are recorded in this statement are those which have been made in cash. All cash inflows and outflows for a year have to be recorded here.

Let us say that at the time of starting the business the cash flow statement begins with a zero balance as nothing is being carried over from the past. In year 0, all that was done was that the owners invested \$10,000, there were no cash outflows from the company during this year, hence the ending cash balance is \$10,000. The ending balance for year 0 now gets carried forward to the next year as the beginning balance. Hence, year 1 starts with a beginning balance of \$10,000. During this year, the business made sales and received cash in the amount of \$2,000. This \$2,000 is recorded in the cash flow statement as cash inflow. Also in year one, the company paid \$2,500 to its employees and spent \$1,000 on rent. Both these payments are recorded as cash outflows for year 1. Now to arrive at the ending cash balance for the year, we add all inflows to the beginning balance and subtract all outflows. The ending balance for year 1 and the beginning balance for year 2 will be \$ 8,500.

Some examples for cash outflows are equipment purchase, loan principal paid and equity withdrawn by the owners. For details on the items that are recorded on the cash flow statement please look at the template.

Break Even: When speaking of a new business it is usually the case that for the initial years, the business reflects negative cash flows. How long the business takes to start returning positive cash balances is an important consideration, and financial analysis, such as net present value and internal rate of return are used to gauge the business' viability.

Balance Sheet

A balance sheet reflects the financial health of a company at a particular point in time. In simple words, a balance sheet shows the financial resources the company owns or controls and the claims on those resources (how the resources are financed).

A balance sheet contains three major categories: Assets, liabilities and owners' equity. At all times $\text{assets} = \text{liabilities} + \text{owners' equity}$.

Assets: Represent the things the firm "owns." Assets are the resources of the firm at a given point in time and include things like cash, equipment and inventory. They are listed on the balance sheet in order of their liquidity, which is the ease with which they can be turned into cash. As a result, cash is listed first, plant, property and equipment are listed next and intangible assets (goodwill, patents, and copyrights) are listed last.

For the construction of a balance sheet, assets are subdivided into two categories, current assets and long-term assets.

Current assets are those that can be converted to cash in one year or less. Common current assets include cash, accounts receivable, inventory, prepaid expenses and investment securities.

Accounts receivable can be defined as money owed by outsiders to the company. Let's say the business sold \$400 worth of products to company X but only received payment of \$100. In December when the business prepares its financial statements, it will record \$400 as revenues on the income statement, \$400 as decrease in inventory as products are sold, \$100 as cash inflow on the cash flow statement, and \$300 as accounts receivable on the asset side. If you notice on the balance sheet, the assets increased by $\$100 + \300 and also decreased by \$400, maintaining the balance of the balance sheet.

Prepaid expense can be defined as any payment for an expense that is yet not incurred or payments made in advance for a business expense.

Investment securities are publicly traded stocks and bonds purchased to temporarily invest excess cash. Suppose if a company buys stock/shares of another company just for the purpose of short-term (one year) investment, then that amount invested will reflect as investments securities.

Long-term assets are assets that you can expect to be around next year when you prepare the balance sheet again. These are assets companies buy to keep for a long period of time such as property and equipment.

Accumulated depreciation reflects the wear and tear, or depreciation, of these items and hence should be subtracted to arrive at the market value of the plants and equipment. It is the market value of the assets that needs to be reported on the balance sheet.

Intangible assets also come under the broad category of long-term assets. Intangible assets are those that have no physical or tangible characteristics (patents, trademarks, copyrights, and goodwill).

Liabilities: Liabilities are the sources of funds the business has used to finance its assets. In simple terms liabilities represents what the business owes to its creditors. Some examples of sources to finance assets can be cash, loans, capital or initial investment made by the shareholders/owners of the company. Like assets the liabilities too can be broken down into current and long-term liabilities.

Current liabilities are those obligations expected to be paid in one year. Some common items that fall in this category are accounts payable, accrued liabilities, short-term loan payments and unearned revenue.

Accounts payable arise when the business buys inventory and services on credit. For example, a business purchases \$100 worth of inventory from B&L Inc., but only pays \$70 during the year. In such a case, the inventory account on the asset side of the balance sheet will increase by \$100, the cash payment on the cash flow statement will show an outflow of \$70 and \$30 will be recorded on the liability side of the balance sheet as account payable. Check whether the balance sheet is in balance, is the change in assets = change in liabilities + change in shareholders' equity?

Accrued liabilities are expenses such as salaries and wages that have been incurred but have not been paid. Let's take salaries to be paid at the end of December 2004 to be \$1,000, and the amount actually paid to be \$600. In this case, the income statement will show an expense of \$1,000, which is the actual salaries expense for the year. The cash flow statement will show an outflow of \$600 that is the actual cash paid as salary, and \$400 will be recorded as accrued liabilities on the balance sheet.

Short-term loan payments are formal interest bearing loans to be paid back in one year. So, if a company has taken a one-year loan of \$500 this should reflect under short-term loans on the liabilities side of the balance sheet.

Unearned revenue or advance payments for future sale transaction is another common example of current liabilities. Let's say the company received a payment for \$1,000 in December for goods to be sold in February. In this case, the payment received is yet not earned by the company. The company will actually earn the payment when it will make the transfer of the goods in February. Hence, this \$1,000 is listed under liabilities as unearned revenue.

Long-term Liabilities are obligations that are not expected to be paid within one year. Some examples are long-term notes, bonds, mortgage, loans structured as lease, deferred income tax (income tax that the company should have paid minus what the company actually paid), and other benefits such as employee benefits.

Shareholders' Equity/Capital: The difference between the assets and liabilities is referred to as shareholders' equity. Equity is the residual amount of capital that would remain once the liabilities were satisfied. Two most common items under shareholders' equity are owners' equity or paid in capital and retained earnings. The figure for the retained earnings comes into the balance sheet from the income statement.

Paid in capital can be defined as the amount invested by the owners. This includes the initial amount invested by the owners and any subsequent additions made over time. One must be careful to subtract any withdrawals made by the owner at any time. Let's say at the time of starting the business the owners invested \$1 million in cash, here this \$1 million will reflect both in the cash flow statement for the year of starting the business as cash inflow and the balance sheet as paid in capital. Say in year 4 from the time of incorporation the owners withdrew \$5,000, then this will be recorded in the cash flow statement as an outflow and also will be subtracted from the paid in capital balance on the balance sheet for year 4.

Retained earnings come from a company's income statement. Once a company prepares its income statement for a year the last item on the income statement is the net income. The company may decide to distribute a part of the net income as dividend or return to the owners and then invest the rest back into the business or the company may decide to invest the whole amount back in the business. This amount invested back is retained investment.

Depreciation

When dealing with long-term assets one must keep in mind that the whole asset is not expensed in the year it is purchased. Say the company buys machinery for \$5,000 in year 1 for cash. We see that the cash amount decreases both on the cash flow statement and eventually on the balance sheet, but assets increase by the same amount as another item machinery is added. When preparing the income statement one must ensure that the complete \$5,000 is not expensed in year 1 but instead over the life of the machinery. The two most commonly used methods to calculate the depreciation for an asset for a given year. The first is the straight-line depreciation method. This method makes the assumption that the amount of value lost due to wear and tear is the same throughout the life of the fixed asset. The formula is as below: $\text{Annual depreciation} = (\text{Price of the asset minus salvage value}) / \text{life of the asset in number of years}$. Salvage value is the amount the business expects to receive if it sells the asset at the end of its expected lifetime. This is usually a very low amount. Let's assume \$50 in this case. Another method is the weighted average method. Here, the logic is that the fixed asset depreciates more value in the initial years. For this most accounting books have a weighted average table. For illustration, let's take machinery purchased at \$5,000, has an expected lifetime of 5 years, and has a salvage value of \$50. In that case the depreciation amount by the straight-line method will be \$990 for each year. However the weighted average table tells us that the machinery depreciates by 25% in year 1, 24% in year 2, 22% in year 3 and so on. Hence the depreciation for year one will be 25% of \$4,050 or \$1,012.50.

Internal Consistency Among the Three Statements

The three primary financial statements are not isolated from or independent of one another; internal consistencies exist among the three statements. Following are some examples of these consistencies.

The statement of cash flows contains the detailed explanation of why the balance sheet cash amount changed from the beginning of the year (previous year ending balance sheet) to the end of the year.

The net income figure (in the income statement) minus owners' equity returned (dividend declared) explains the retained earnings on the balance sheet.

The equity paid in the first year of operations will reflect both in the cash flow statement and the balance sheet. On the cash flow statement it will be recorded as cash inflow. This will further be reflected as cash assets on the balance sheet, as the ending cash balance from the cash flow statement is taken and recorded as assets on the balance sheet. Suppose, the ending cash balance on the cash flow statement for December 2003 is \$2,000 then this amount will also be recorded on the asset side of the balance sheet as cash. The equity paid will also be recorded under shareholder's equity on balance sheet.

Financial Ratios

Some ratios help us assess the financial health of a company. These ratios come in handy when comparing your company to competition and when benchmarking the performance of your company.

Ratio	Formula to Calculate	Purpose
Return on Equity	$\text{Net Income} / \text{Shareholders' Equity}$	Number of dollars earned during the year during the year on each dollar invested
Return on Assets	$\text{Net Income} / \text{Total Assets}$	Number of dollars earned for every dollar of asset
Profit margin	$\text{Net Income} / \text{Sales}$	The percent of sales that represent the company's revenue after taxes and expenses
Debt ratio	$\text{Total liabilities} / \text{Total Assets}$	Percentage of total funds (borrowed & invested) that the company acquired through borrowings.
Debt-to equity ratio	$\text{Total liabilities} / \text{Shareholders' equity}$	Number of dollars of borrowing for each dollar of equity investment.

The first three ratios are examples of the profitability ratios; higher value ratios indicate better performance. The last two ratios are leverage ratios. Any creditor would want that the leverage ratios for a company be low. A lower leverage ratio will ensure lower risk on non-payment to the creditor.