OPEN Forum Growth Guide:

Move Your Business Forward

John Suh

HELLA BITTER
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MEMBER SINCE 99

AMERICAN EXPRESS OPEN forum

As CEO of LegalZoom,

I've had a unique vantage point over the last decade. Our amazing account team talks to hundreds of thousands of small-business owners every year about a wide set of needs. At the same time, we have forged partnerships with many of the best small-business service providers across multiple categories. And on a personal level, I've started seven companies and invested in many more, from tech startups to restaurants.

Based on my experiences, I'd like to share some lessons learned about raising capital and driving growth. I hope you find them helpful as you think about your own road to success.

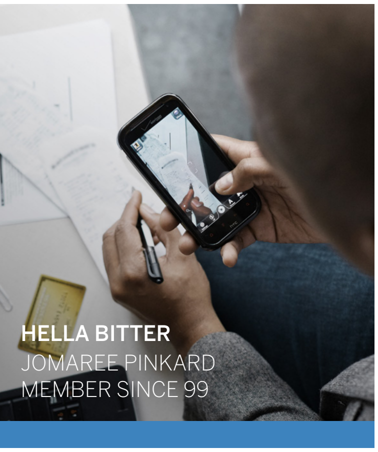
ABOUT JOHN SUH:

John Suh joined as executive chairman of LegalZoom in 2005 and transitioned to his current role as CEO in 2007. He has helped grow LegalZoom from a promising startup to a company of more than 700 employees with revenues well over $200 million. Previously, he served as CEO/co-founder of StudioDirect and CEO/co-founder of the Castling Group.

Raising Capital: Try a Hybrid of Sources

MKG
MANEESH GOYAL
MEMBER SINCE 96

When talking to small businesses about the unpredictability of funding, I like to share the LegalZoom story. Our founders had their first-ever venture capital meeting in March of 2000, the morning NASDAQ crashed and effectively ended the dot-com boom. At least the meeting was efficient: The venture capital head said, “The Internet is over,” and went back to his office before our team even had a chance to present.



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So what did we do? We tried a variety of funding sources:

Traditional Sources. LegalZoom went old school. The LegalZoom business concept required too much capital for the tried-and-true bootstrap techniques of tapping savings, borrowing against a 401k or financing through rotating personal credit cards. We did not have an existing business that could facilitate a Small Business Association (SBA) loan or some kind of factoring arrangement. So the team went down the "friends and family" route, raising $1 million in two separate tranches over a year. To date, that's the only primary capital ever tapped to grow the company.

The lesson is clear: Fundraising is an exercise of persistence. If the most direct route does not work for you, switch gears and try another. Whether due to macroeconomic conditions or local circumstances, you have to adjust and understand your options.

The Alternatives. Access to capital has changed drastically in the last few years. Although small-business lending remains an established source of funding, it can be difficult for many companies—especially new businesses—to get the loans they need. Today, a number of non-traditional funding methods have emerged:

- Crowdfunding gives people the ability to put money into ideas, projects and companies they care about. It's currently not ideal if you need to raise widespread equity, but that could change quickly if legislation enables non-accredited investors to buy stock. Keep an eye on this megatrend, as enabling the average person to invest in private companies could bring millions of new investors to the table.
- Customer-based financing can be both a standalone strategy and a type of crowdfunding. Essentially, you can use your customers' money to temporarily fund your company by pre-selling goods and services to them ahead of time. For example, the backers may receive copies of creative output (a book, a movie or a piece of music) in return for their backing.
- There are also new types of alternative lenders emerging to serve those with less-than-perfect credit. It often revolves around a different insight into credit risk and a lower range of loan amounts.

Raising funds has always been an exercise of exciting the imagination of others and selling your vision of what's possible. Today, you can take that approach to new, innovative channels and that's good news for small-business owners.

LALA PRESS
MABLE LEE
MEMBER SINCE 00

What's your next step? Try taking a hybrid approach to financing by pursuing both traditional and alternative funding options.

Monitor Your Cash Flow and Reserve

Not understanding cash flow or the skills needed to manage it effectively is one of the most common pitfalls among entrepreneurs, and unfortunately it's why a lot of small businesses fail.

Imagine diving into the sea without knowing how much oxygen you have—the last thing you want is to be 100 feet underwater and not know if you have enough air to make it back up to the surface. It only takes one instance of not having enough cash to meet your monthly operating expenses to realize how important it is to plan in advance.

Cash-flow management is a discipline. To master it, you need to answer the following questions and understand when those answers might change:

1 What is your monthly burn rate?

Burn rate is defined as your monthly negative cash flow. Cash flow can be roughly defined as revenues less expenses less working capital less investments. Just see what your checking account is doing over a typical six-month period, and you can get a pretty good estimate of your average monthly burn. If you have $500,000 of capital and are burning cash at $50,000 per month, you have 10 months remaining.

I've seen most business owners instinctively project that cash flow will improve in the future, generally from revenue growth. We entrepreneurs are an optimistic bunch or we wouldn't do what we do. However, I would advise rooting your burn rate based on recent history and only include improvement if there are true cost cuts (e.g., if you eliminated a lease).

2 How much capital do you need in reserve?

Your capital reserve should be composed of both A) your monthly burn rate (if unprofitable), and B) a set aside to cover unforeseen expenses that could be incurred in the future. I call this second part your rainy day cushion. It's critical, because in the early days of any small business, it always rains at some point. Effective reserve planning requires identifying potential problems and being prepared before things go wrong.

Say your bakery typically sees a 5 percent sales drop in the summer. Run a projection to determine how revenue and cash flow would be affected by a 10 percent or 20 percent drop, and then build a capital reserve sufficient to meet operational expenses if a steeper drop happens.

Also, don't forget working capital. Ironically, many businesses go bankrupt or hit a wall because they grow too fast. Certain businesses (e.g., retail) require buying inventory, often months in advance, to fund growth. That means you need to invest in inventory to achieve growth. What working capital do you need for every $100,000 or $1 million of incremental revenue? Many business owners don't know this number until it's too late.

3 How long will it take to raise more capital?

It's also critical to take lead times to raise new funds into account. It often takes considerable time.

Let's say you are not profitable, have funding for nine months, and there's a three-to-six month process to raise additional capital. You need to start fundraising (or cost-cutting) now.

A good rule of thumb is never raise funds close to your fume date, which is the estimated day you're expecting to run out of cash. For obvious reasons, you lack leverage.

In the early days of LegalZoom, we were able to operate with a pretty small cash cushion. We were lucky that our only inventory was ink and paper. Eventually we managed to obtain a line of credit that gave us a large reserve and a higher comfort level in case times got tough.

MASPETH WELDING
JEFFREY ANSCHLOWAR
MEMBER SINCE 76

What's your next step? Answer the three questions for your business and don't forget to revisit those answers when something material changes.

Research Your Options and Negotiate

At LegalZoom, we've helped thousands of companies grow over the years, and in the process we've fielded an enormous range of operational questions from small-business owners, like...

"Where do I get my business cards from? or "Who should I use to do my bookkeeping?"

Of course, every owner is concerned about meeting essential needs without running up major expenses.

Being able to control your company's costs is one of the pillars of financial health, and in order to do that you need to identify the right services, tools and platforms that will help you streamline operations.

There has been a welcome explosion of new companies targeting small-business needs. There are many—perhaps too many—choices, and while that level of variety may seem intimidating, it also makes it easier to find the exact service you need at an affordable price. The Internet can be your best friend, helping you perform essential tasks at a fraction of the cost. There are tons of services in the cloud that can help you on recordkeeping, communications, data storage and various other activities.

MASPETH WELDING
JEFFREY ANSCHLOWAR
MEMBER SINCE 76

Also, don't forget to negotiate. At some companies, there's only one person cutting all the deals, and usually it's the founder or the owner. What can be worse is too many people cutting deals. Whatever your situation, the person negotiating your deals should be your best negotiator. If that's not your strong suit, ask someone else to take this on.

What's your next step? Use the Internet to research many of your many options and don't forget to negotiate.

Don't Target the Top-Line and Bottom-Line Simultaneously

This sounds odd. The best companies often both improve both the top and bottom lines. But these are often large corporations with lots of resources. So how does a small business balance profitability with growth?

I've found it's more practical for smaller businesses to focus on one or the other in a given year. Cutting costs while investing in new ideas can send confusing messages. It's hard for small companies to do both, and it may be more productive to have a single objective.

At LegalZoom, we continually re-invested profits back into growth, whether that was in the form of marketing or investing in new products or services. This was our de facto priority in the early years. However, when 2009 hit, we shifted gears and tightly controlled expenses to quadruple our cash reserves. In return, we could be even more aggressive in 2010. Now that we're a bit larger, we are doing both… but this is after more than 10 years.

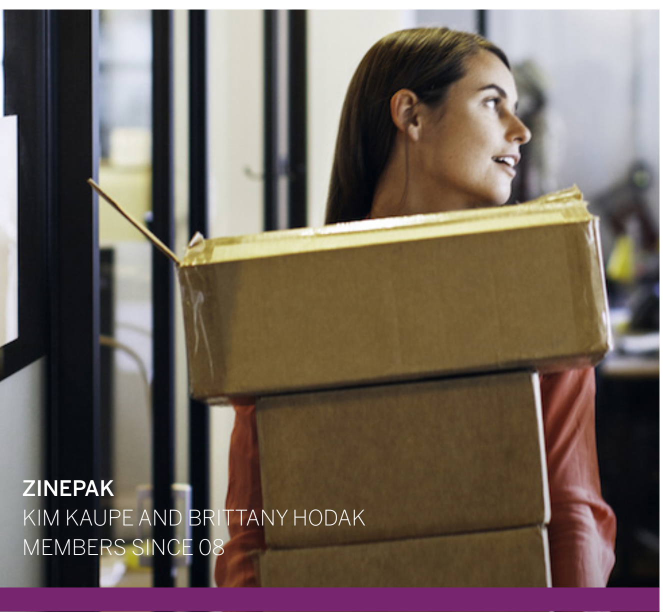
In a given year, think about whether it makes sense to sow or to reap. In the early days, it's important to invest in many seeds. You don't want to be a spendthrift. However, as long as you're scrappy, I would not overly worry about efficiency. The number one priority of young or smaller companies should be getting the customer experience right. As a company matures and becomes larger, you can and should shift gears. Just be thoughtful about what you can accomplish with limited resources.

What's your next step? Craft a long-term strategic plan and thematically align a given year around top-line or bottom-line improvement.

SUNSHINE LIGHTING
MORDY KOHN
MEMBER SINCE 88

Remain Nimble: Read and React

One big mistake I see with regularity is that companies forget to account for economic factors like cyclicality. The market can change from year to year, and it's important to have the flexibility to adjust accordingly.



ZINEPAK
KIM KAUPE AND BRITTANY HODAK
MEMBERS SINCE 08

I'm less concerned with seasonality, which is easier to accommodate. A consumer goods retailer who sees an uptick in demand during the holiday shopping season will naturally increase inventory going into the fourth quarter and trim thereafter. With seasonality, you clearly want a variable cost structure so you can flex up and down with demand.

What can be the bigger mistake is not understanding when you are in a highly cyclical business. Cyclical simply means demand for your product/service grows when the economy grows and demand shrinks when the economy shrinks. Real estate or automotives are oft-cited examples of cyclical industries, but by definition there are many industries affected by the economy.

Too often, I see small businesses invest in expansion simply when they've got the money to do so. They ignore or misread the signals telling them to do otherwise. They often double-down right before a downturn and disaster strikes.

You need to think carefully about your expansion plans. When the economy turns, it can turn very fast. No one has a crystal ball, but you can still prepare for the inevitable, because a downturn is a question of "when," not "if." Be wary of commitments that extend over multiple years, like signing a lease on a new location. When you make long-term commitments to partners, employees or landlords, just consider the potential ups and downs of your core business.

What's your next step? Stay flexible and take a long hard look at long-term commitments. Don't rush into expansion simply when you can afford it, and pay attention to broader conditions to identify the best time to invest in growth.

It can be a long and winding road to financial stability, and there are certainly obstacles your business will encounter. At LegalZoom, one of the most common challenges we've seen is that small businesses are often afraid of getting advice when they need it.

So remember:
When you're on the road to success, it's okay to ask for directions.