Funding Entrepreneurship:
When 'Chutzpah' Spells Failure

2010, Olen Soifer, Quest Funding Services, All Rights Reserved

We could probably all agree that the very nature of most entrepreneurs includes a measure of boldness; a sort of "can do" attitude. It might even be said that such an attitude is a necessity for the success of a venture that other, more timid, persons would shy away from. In that regard, it can be said that the very action of taking the risk, that others would avoid could even be called 'chutzpah', which implies an audacity that exceeds mere risk-taking. [Leo Rosten gave, as an extreme example of 'chutzpah', a man who kills his parents…but pleads for mercy from the court because he is now a poor orphan.]

The problem that we see is that the same impertinent spririt, in the face of "good sense", that prompts many entrepreneurs to undertake a risky venture, also causes many of them to undertake certain aspects of the startup which are more appropriately the purview of specialized professionals. We believe that such decisions to "do it myself" often dooms the ventures. By splurging their time on activities that they are ill-prepared to undertake, they are taking time away from other activities which are a necessary part of the start or growth of any venture, and within their capabilities. When their exuberance or boldness causes them to produce an inadequate work product, it can also be the major cause of the failure of the venture "before it even gets off the ground". The same boldness that allows the entrepreneur to "go where no man has gone before", consigns sinks the venture.

The smartest entrepreneurs are those who can property assess their strengths and weaknesses and determine when to bring the appropriate professionals on board. They are the ones who, in addition to knowing what they know, and can do, also know what they don't know and can't do! An awareness of when a third-party professional should be employed, and the ability to, both, find and pay for qualified professionals is as important as the idea that formed the basis of the venture.

When dealing with funding requests, day and night, one is likely to find one's self going through stacks of paperwork. That is part of the nature and the basis of the funding process. But, the quality and completeness of funding requests is, often, extremely poor. The reviewer often finds that the venture is not well-planned; the paperwork is incomplete; and the information or calculations are incorrect. The reviewer finds himself saying, over and over again, "Now, I've seen it all." Yet that paperwork is the foundation of capitalizing the venture; funding is impossible because the entrepreneur didn't seek the support of third-party professionals when that help was needed most. Unfortunately, when the funding request is denied, the entrepreneur can often be found blaming those who denied their financial salvation, as lacking vision or imagination, rather then putting the blame on themselves…where it belongs.

While a venture starts with the seed of an idea, whether that seed grows successfully, or not, depends on several things: Money; (project) management skills; attitude of boldness tempered by caution; supportive staff and outside experts; location; etc. These aspects are closely tied into each other. Our goal is to get the money for funding applicants, but when an entrepreneur's weak management skills, or "chutzpah", prevent them bringing expert support, we find

ourselves fighting a losing battle when trying to capitalize the venture. And, the biggest battle we have, which we often lose, is convincing the entrepreneur that they brought the failure upon themselves by trying to do it all by themselves.

Here are some of the paperwork requirements for funding ventures:

1. Complete, accurate application disclosing the "who, what, when and where" of the project, the venturers, the funding sought, etc;

2. Documentation of income, assets and experience of the venturers;

3. Documentation evidencing and analyzing past performance, acceptance of, and need for, the venture;

4. Third-party reports documenting value and quality of capital aspects of the venture (appraisals; environmental studies; architectural &/or engineering plans; survey; "as-built" reports; marketing studies; professional cost &/or construction estimates; management studies; etc);

5. Marketing efforts (paper, digital/online, photos, videos, presentational);

6. Business Plan;

7. Financial pro forma projections predicting future performance of the venture;

8. Private Placement Memorandum;

9. Disclosures to the funding applicant, investors, buyers and the public;

10. Mandated filing documents.

As you can probably see, this can be a large mound of paperwork and documentation, that can overwhelm a venturer. But, it something the venturer cannot avoid if they are to be successful in obtaining the funding needed to pay for their dream. Unfortunately, we find that most entrepreneurs focus on the marketing efforts, without realizing that everything else in this list supports, enables and enhances the venture, and its chances for successful fruition, more than "slick" brochures and the like. And, we also find that the entrepreneurs are often dumbfounded when investors or lenders don't see, what the entrepreneurs think should be obvious, and don't "jump on board."

The source of the misconception that funding is easy, or even guaranteed, has been the easy money" of the middle of the first decade of the 21st century. The optimism of continued explosive economic growth was so extreme, that thousands, even millions, of loans were originated, or projects funded, that a false security was generated concerning the availability of funding. Unfortunately, as the shaky ventures have failed, and the extent of inflation of property values has become obvious, "the chickens have come home to roost." The optimism is gone; the lenders are overloaded by properties and projects they funded, but now own; and their cash is more of a comfort to them when it remains in their pockets; and the federal penalty for lying on a funding application has now reached one million dollars!

There are all kinds of lenders and investors available, and non-residential funding still offers more options than are now available for owner-occupant home buyers. But, don't kid yourself: All investors are more cautious than they used to be. Document requirements are going up, and approvals of venturers with inadequate income, assets or experience is going down. There are always some investors or lenders who will take a chance if the equity, rates, points and fees are high

enough to offset their risk. But, you will only be fooling yourself if you think you own unsupported enthusiasm is a guarantee for funding.

Does this mean that ventures, projects and property cannot be funded in the midst of this economic down turn? Not at all. But it does point out the necessity that funding requests and offerings be, as much as possible: accurate, legal, professional and comprehensive, as well as persuasive.

To meet those characteristics, most entrepreneurs cannot do it all by themselves. The very nature of this disclaimer should point that out: We are not attorneys or accountants. The information contained in this article is intended to convey the need to bring those experts on board to prepare the bulk of the listed paperwork. Bold, but foolish, venturers will try to do it all by themselves. They will not take our cautionary tips as legal or financial advice.

Anyone who takes this discussion to be more than that simply topics of concern; reminders of things to discuss with their qualified counsel and financial advisors; the strongest possible incentive to hire and rely on the advice of those professionals; or who acts upon our information as a substitute for the professional counsel that we advise, has only themselves to blame when investors, lenders, etc, reject their proposal out of hand; or when they find themselves in trouble for having violated legal and regulatory guidelines that control their venture or its funding.

The following guidelines are only provided to give a idea of what can be involved in explaining, documenting and justifying a venture. No implication should be made that these requirements are comprehensive. In actuality, these are the basics!

Business Plans:

It that bad business plans stem from two misconceptions of those that produce them: What they are intended to accomplish; Who they should be aimed at; what should be in them and the amount of divergence from form that is acceptable:

Business plans are not, in the usual sense of the word, marketing documents. Yes, they do contain some "selling" language. But marketing brochures, no matter how detailed, are not adequate replacements for business plans. Unfortunately, financiers and investors are routinely presented with such brochures, with all of their usual unsubstantiated opinion and "puffing", as business plans. Business plans are meant to inform and educate "money men" and convince them to lend or invest in a business, venture or idea. Any selling is based on opinions and facts being substantiated, or at least logical. They should excite the lender or investor without putting forth inflated, unsupportable figures or opinion.

In addition, while there is much that can be done to enhance the appearance, readability and impact of a business plan, they should conform to standard formats and order, in terms of minimum content, and they should not be inordinately long. Most inadequate business plans are light on content; don't comply to the expected order of specific topics; and they are either much too short, or much too long. Remember, the document should be aimed at people who look at them all of the time. They expect specific information in a specific order.

Can an entrepreneur prepare his own business plan? Certainly. There are books, how-to articles, inexpensive software and templates available. But, just as owning

a brush does not make someone an artist, owning a pen or word processor doesn't make someone an author, whether we are talking about novels or business plans. For that matter, it might be easier to be a novelist than a business plan author. Novelists are expected to be creators of fiction; while business plans are expected to be, or imply, the truth.

Good business plans are expected to be between 15 and 30 pages long. We have seen them as much as 50% longer, but it is rare. Professional preparation can cost anywhere from $1,500 to $7,500 or even more. The differential in cost is often based on the amount of market analysis that is required, as well as the preparation, verification and professional review of the supporting documentation and pro forma financials.

As with anything, most people get what they pay for. It is certainly not impossible for an entrepreneur to create a fine, adequate convincing business plan. But, our experience is that first attempts at this are woefully inadequate. We have seen investors, literally, laugh at some business plans. So, use your own judgment, but we suggest that your time and efforts are better utilized in different directions. The worst thing you can do is "burn" your chances with an investor by submitting an incomplete, amateurish business plan to him.

You should also note that business plans are for specific sources of funding: Primarily, these are what would be consider to be the more conventional lender. They can raise tons of money if directed to the right investor or lender. However, they can be inadequate, by themselves, for equity funding or when your funding should come from limited partners. That kind of funding request is, often, most appropriately documented with a private placement memorandum (see below) which includes a business plan as just one part of itself.

A typical business plan includes the following major sections: (But, in the preparation of the report, each section is further divided into as many as 10-20 subsections or textual expansions of information.

1. Executive Summary
1.1. The Products and Services

1.2. Financing
1.3. Mission Statement

1.4. Management Team
1.5. Expansion Plan
2. Company and Financing Summary
2.1. Registered Name and Corporate Structure 2.2. Required Funds
2.3. Investor Equity
2.4. Management Equity
2.5. Exit Strategy
3. Products and Services
3.1. Product
3.2. Product

4. Strategic and Market Analysis

4.1. Economic Outlook
4.2. Industry Analysis
4.3. Customer Profile
4.4. Competition
5. Marketing Plan
5.1. Marketing Objectives
5.2. Marketing Strategies
5.3. Pricing
6. Organizational Plan
7. Financial Plan
7.1. Underlying Assumptions
7.2. Sensitivity Analysis
7.3. Profit and Loss Statements
7.4. Cash Flow Analysis
7.5. Balance Sheet

Financial Reports & Pro Forma Financial Projections:

They are complicated to prepare and, to those who have little interest in them, boring to read. But, to those who they are directed at, they are important. "Financials" are much of the real substance of both a business plan and a PPM, tedious as they may seem to those who have no interest in them. The accuracy of the figures, the relationship of the figures to each other, and the soundness of the logic and basis for the figures, is often the heart of an approved funding proposal.

What data is included will depend upon the industry, as well as whether the venture is a start-up, or already exists. If it is a new venture, the financial will be "pro form", which are predictive in nature, but the justification and assumptions for the predictions must be stated and, of course, logical. If the venture already exists, the financials will include past figures for 2-3 years. If the future figures bear little resemblance to the past data, the assumptions must include justification for the wide variations.

Again, inexpensive spreadsheets are available to produce these documents. But, the mere fact that the numbers "add up", doesn't make them accurate or trustworthy. These financial sheets are of such importance that accountants are not covered, for their preparation, by their normal errors and omissions insurance.

Basic financial reports or pro forma's often consist of:

1. Income statement, monthly for first year
2. Income statement, quarterly for year 2, yearly for years 3-5 years
3. Cash-flows, monthly for at least 1 year
4. Balance Sheet
5. Break-Even Analysis
6. Industry-specific data and predictions

Private Placement Memorandum (PPM):

PPM's are the most complicated, most expensive, of documents that are often needed in the quest for funding. They must meet specific legal requirements and are much less likely to have innovative formats. Why? Because people go to prison when they are omitted, in accurate or inadequate, when they are required. As one of our mentors says, "State prisons may be overcrowded, but Federal prisons have plenty of unused capacity. Their attitude is, 'Come on down!'"

A PPM is required to comply with the exemption provisions of Regulation D of the Securities Act of 1933. Exemption from what? Exemption from the, even more, expensive registration of your funding request/offering as a security.

Unfortunately, preparing a PPM that is correct and comprehensive, is only part of the process of complying with these exemption provisions. Who you approach to invest in your project; as well as how and when you solicit investments, is also important. Again, get it wrong and your freedom is at stake, especially if you are in violation of RICO statutes, adding years to your possible "time away from home."

PPM's provide specific protections for the entrepreneurs that use them: As hinted at above, they eliminate the need for extremely time-consuming securities registrations. They eliminate the need for securities dealers whose pockets take more to fill than what lenders or mortgage brokers/consultants charge. And, probably most important of all, they often provide ironclad protection from further financial liability if a "deal goes sour."

For that savings in time and money, and for the protection they afford, PPM's can, themselves, be very expensive. Consider that the PPM, itself, contains virtually every aspect of a business plan within itself, in addition to meeting the disclosure and disclaimer requirements of the law. They also contain all of the financials and pro forma's mentioned above. Finally, as part of the PPM process, there are additional documents and filings required at the federal and, often, the state level.

For all of the above, it takes a much longer, much more comprehensive document than a business plan. As a matter of fact, a PPM includes a full business plan within itself, along with the financials mentioned above. This can result in a document that runs over 200 pages long. We have seen PPM's soliciting $10,000,000 that were over 180 pages long. That may not be the norm, but PPM's are rarely shorter than the longest business plans.

It can take 40-50 hours of an attorney's time. We will leave it to you to do the calculations considering that attorney's fees can range for $100 to $500 an hour. Unfortunately, we are talking about securities attorneys, and you are unlikely to find an associate attorney, just out of law school, who is qualified to prepare a PPM for the bottom end of that pay scale.

It is true that you can find PPM templates for under $100. And, you can spend innumerable hours figuring out how to complete them properly to meet your specific situation. But, there are many complicating factors beyond mastering the "legalese" of the document. There are many variations of PPM, for debt vs equity financing and for specific sections of Regulation D which define the various exemptions. Get the document wrong and it may be worth no more than none at all.

This is another case where being penny-wise and dollar-fortune can be very foolish. A good PPM can raise millions of dollars. In the long run, they are often worthwhile. If it is appropriate funding vehicle for you, please contact us. We have arrangements for PPM's, including legal review, that usually cost less than $2,500. That is about 90% of the usual cost for a securities attorney, but you are still assured of having a powerful, funding tool.

PPM's should include at least the following:

1. The name, address, and telephone number of the issuer.
2. A description and the price of the securities offered.
3. The amount of the offering (minimum and maximum amounts, if any).
4. The plan and cost of the distribution of the securities.
5. An identification of the officers and directors of and advisors to the issuer.
6. A description of a problem which creates an opportunity for the company.
7. A description of the issuer's business and products or services and how they solve the problem referred to above. This should include a thorough review (excluding the disclosure of trade secrets) of any technology which is a key to the issuer's proposed business.
8. A thorough discussion of the market for the issuer's products and services.
9. A description of risk factors, which should include at least the following:
A. The fact that the issuer has no operating history;
B. The fact that the issuer has had no profits from operations;
C. The fact that the issuer has an uncertain financial position;
D. A risk assessment of the issuer's products or services and technology.
E. The fact that the issuer is subject to competition, and a description
of the competition,
F. A description of the risks of the issuer's securities and their lack
of liquidity,
G. A warning that the issuer might become insolvent or bankrupt,
H. A specific warning that an investor might lose his entire investment in
the issuer.

10. A recent balance sheet which can be prepared without audit. It is better if the balance sheet is prepared by an outside accountant.
11. Recent statements of income and assets prepared without audit.
12. Projections for future revenues, expenses, and profits or losses.
13. A description of the use of the proceeds to be realized from the offering.
14. A statement detailing that neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of the securities or passed on the adequacy or accuracy of the disclosures in the prospectus.
15. A statement describing how the offering price was determined.
16. A description of the issuer's present capitalization and a calculation of dilution.

17. A description of prior offerings, stock plans, and stock options.
18. A description of the restrictions on the resale of the issuer's securities and the fact that no market now exists or may ever exist for them, together with a

description of legends to be placed on the issuer's securities.
19. A disclosure of any contracts or agreements with management, and a disclosure of the shareholdings and compensation of management.
20. A disclosure of all material contracts with, or commitments to others.

21. Exhibits, such as Articles of Incorporation, founders agreements, tax opinions (if any), etc.
22. An offer for the investors to meet with management, tour the issuer's facilities, and ask questions and receive answers to questions.

Other requirements that are associated with the creation and offering of a private placement:
1. Federal and/or state "Blue Sky" documents
2. Form D and Letter of Memorandum

3. Verification of accredited investors & qualified investors
4. Actions and verifications regarding prohibition on general solicitations
5. Actions to ensure privacy regulations are observed
6.

* * * * * * * * * * * * * * * * * * * *

DISCLAIMER: While this information is intended to be topical, accurate and useful, and is from sources deemed to be reliable, it may include personal opinions and information which is general in nature and is not guaranteed to be current or fully comprehensive. This information is, also, not guaranteed to apply universally as everyone's situation is different and the laws, and the application, or the practicality of the above information or advice can substantially vary with time, specific circumstances and/or location. CONSULT WITH A PROFESSIONAL! We are not, and do not claim to be, attorneys or accountants, whose counsel is suggested to all users before they obligate themselves in any financial arrangement, loan, real estate purchase, etc, or they pursue any course of legal action. Reader acknowledges that they are solely responsible for their own decisions and actions and further acknowledges that the advice of legal/accounting professionals has been suggested in regard to their investing or legal/financial pursuits. Any general discussions of legal issues found in this document cannot replace such professional legal or financial counsel. Any specific legal or financial topics found on this website are only intended to be subjects for discussion with the user's own legal or financial professional. Nothing contained within this website shall be considered to be such counsel, or an adequate replacement thereof. Advice or opinion of the user's own attorney or accountant should always prevail over any contrary information, suggestion, theory or topic found here. HOLD-HARMLESS AGREEMENT: User of this information agrees to indemnify, defend and hold Quest Funding Services (et al: its directors, officers, owners, agents, affiliates, licensors, licensees and employees) harmless from and against any and all liability and costs, including without limitation, reasonable attorney fees, incurred by Quest Funding Services, et al, in connection with any claim arising from user's personal use and implementation of any and all information or services which Quest Funding Services, et al, offers or provides within this document, or otherwise. This includes consequential damages or any damages resulting from alleged negligence by Quest Funding Services, et al.