# Getting between the balance sheets

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### A new book by IESE Prof. Heinrich Liechtenstein demystifies finance, helping entrepreneurs take crucial decisions leading to successful business ventures.

Grace Inge, a rising business star, has been short-listed for a major business prize. At the award ceremony, her cell phone rings. It's her bank manager, calling to inform her that the bank is shutting her company down. "But why?" she gasps. "Have you seen your balance sheet?" he replies.

For many entrepreneurs, like Inge, finance is a mystery that few can afford not to understand. Starting, growing and selling a new venture is difficult enough without having to worry about the finances, right? Surely if the product is good enough, good financial results will follow? If only it were that easy.

Few entrepreneurs spend as much time on finance as they do on building their products and customer base. They might not even be aware of the key financial areas they should be focusing on. But a little financial knowledge, planning and well-timed action can make all the difference, as a new book reveals.

Serial entrepreneur David Frodsham teamed up with IESE Prof. Heinrich Liechtenstein to demystify the intimidating world of finance for entrepreneurs. Using the fictional character of Grace Inge, an amalgam of real-life entrepreneurs, the authors chart her progress as she launches a fashion start-up - a venture purposely chosen to combat the perception that all innovative start-ups are technology-related. They explain the financial challenges she faces every step of the way, and propose workable solutions.

Underpinning their recommendations is a comprehensive survey of the Venture Capital community in Europe. This serves to highlight which aspects are particularly important for investors, which ones can be negotiated, and which ones an entrepreneur simply has to live with.

## Four make-or-break factors

According to the authors, there are four key factors that determine whether a business venture will make money for all stakeholders.

- *How you calculate, manage and reduce the cash needed to run the company.* Everyone has heard of "working capital," but rather like the word "marketing," it means different things to different people. Few have a strategic objective to reduce the cash tied up in the company, and fewer make it a key element in product management and other business decision making.
- *How you slice the cake between entrepreneur and investor.* The "cake" is the proceeds from the sale of the business. There are many examples of successful companies where the entrepreneur realizes all too late that owning, for example, 40 percent of a company that is being sold for 20 million euros does not mean a cheque for 8 million euros. In fact, it could mean getting nothing at all. The way the company is divided up in terms of economic value is much more important than percentage ownership and valuation.
- *How you attract top talent at less than market rates.* Share options have gotten bad press recently, because they rarely make money for the holders. Using an equity exit model, the authors show how to create a good share option plan, and how to sell it to investors. Without this, start-ups risk either paying money they can't afford for the right talent, or not hiring the right people.
- *How to manage liquidity events, such as selling the company.* There is only one shot at getting the valuation right and selling the company to the right buyer. Yet more often than not, the investors and management team will fight every step of the way - when to sell, whom to sell to, how much for - because each has different objectives. The authors clarify what is meant by an "exit," which is not a door to the outside, but a door to a different place. They prefer to call it a "liquidity event," a time when some or all of the shareholders get to convert some or all of their ownership into cash.

Blockbuster start-ups that are sold for millions may not concern themselves too much with these finer points, because the multiples they are sold for are likely to disguise any structural problems financially.

But the vast majority of ventures provide more modest returns, and mastering these four items can mean the difference between success and failure. This new book makes seemingly complex balance-sheet concepts such as assets, liabilities and equity easier to understand and analyze. This will come as welcome relief to the Grace Inges of this world.