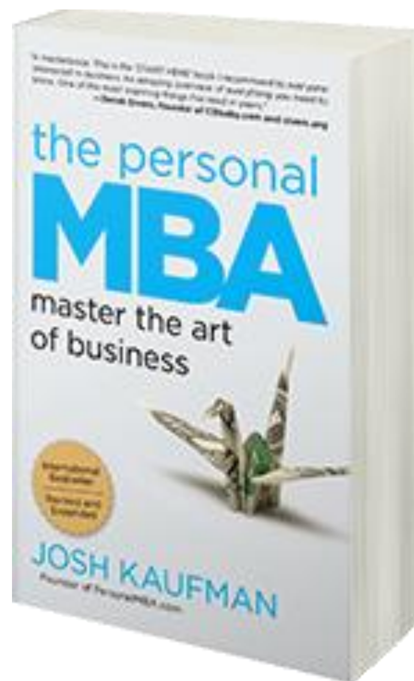
6. FINANCE BY JOSH KAUFMAN

A CHAPTER SUMMARY FROM THE BOOK 'THE PERSONAL MBA'



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FINANCE (KAUFMAN 2012)

- ✓ Finance is the art and science of watching the money flowing into and out of a business, then deciding how to allocate it and determining whether or not what you're doing is producing the results you want.
- ✓ Yes, there can be fancy models and jargon, but ultimately you're simply using numbers to decide whether or not your business is operating the way you intended, and whether or not the results are enough.

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- ✓ Business is not about what you make—it's about what you keep.
- ✓ Profit is a very simple concept: it's bringing in more money than you spend.
- ✓ In order for a business to continue to exist, the revenue it brings in must exceed expenses at some point in the foreseeable future.
- ✓ Profit Margin is the difference between how much revenue you capture and how much you spend to capture it, expressed in percentage terms—if you spend $1 to get $2, that's a 100 percent Profit Margin.
- ✓ If the owners don't find their investment worthwhile, they'll simply close the business.
- ✓ Profit is critically important, but it's not the be-all and end-all of business.

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- ✓ Every business must capture some percentage of the value it creates in the form of revenue as Profit.
- ✓ If it doesn't, the business will have a difficult time generating enough resources over time to continue operation.
- ✓ Value Capture is the process of retaining some percentage of the value provided in every Transaction.
- ✓ If you're able to offer another business something that will allow them to bring in $1 million of additional revenue and you charge $100,000, you're capturing 10 percent of the value created by the Transaction.
- ✓ Value Capture is tricky.
- ✓ In order to be successful, you need to capture enough value to make your investment of time and energy worthwhile, but not so much that there's no reason for your customers to do business with you.
- ✓ People buy because they believe they're getting more value in the Transaction than they're spending.
- ✓ The more value you capture, the less attractive your offer becomes.
- ✓ Capture too much, and your prospects won't bother purchasing from you.
- ✓ There are two dominant philosophies behind Value Capture: maximization and minimization.

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MAXIMIZATION

(THE APPROACH TAUGHT IN MOST BUSINESS SCHOOLS) MEANS THAT A BUSINESS SHOULD ATTEMPT TO CAPTURE AS MUCH VALUE AS POSSIBLE.

- ✓ It's easy to see the appeal of maximization—more Profit is a good thing for the owners of a company.
- ✓ Would you spend $999,999 in order to make a million?
- ✓ It may be rational (after all, you'd be $1 ahead), but most people won't bother.

MINIMIZATION

MEANS THAT BUSINESSES SHOULD CAPTURE AS LITTLE VALUE AS POSSIBLE, AS LONG AS THE BUSINESS REMAINS SUFFICIENT (DISCUSSED LATER).

- ✓ While this approach may not bring in as much short-term revenue as maximization, it preserves the value customers see in doing business with the company, which is necessary for the business's long-term success.
- ✓ When something is a "good deal," customers tend to continue to patronize the business and spread the word to other potential customers.
- ✓ When a business tries to maximize revenue by "nickel-and-diming" their customers or trying to capture too much value, customers flee.
- ✓ As long as you're bringing in enough to keep doing what you're doing, there's no need to fight for every last penny.
- ✓ Create as much value as you possibly can, then capture enough of that value to make it worthwhile to keep operating.

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- ✓ Sufficiency is the point where a business is bringing in enough profit that the people who are running the business find it worthwhile to keep going for the foreseeable future.
- ✓ You can track financial sufficiency using a number called "target monthly revenue" (TMR).
- ✓ Your target monthly revenue helps you determine whether or not you've reached the point of Sufficiency: as long as you bring in more than your TMR, you're Sufficient.
- ✓ If not, you have work to do. Sufficiency is subjective—how much is enough to continue what you're doing is a personal decision.
- ✓ Once you reach the point of Sufficiency, you're successful—no matter how much (or how little) money you make.
- ✓ Business is not necessarily about maximizing Profits.
- ✓ Profits are important, but they're a means to an end: creating value, paying expenses, compensating the people who run the business, and supporting yourself and your loved ones.
- ✓ Your business does not have to bring in millions or billions of dollars to be successful.
- ✓ You can't create value if you can't pay the bills.
- ✓ If you're not bringing in sufficient revenue to cover the operating expenses, that's a major issue.

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4| FOUR METHODS TO INCREASE REVENUE

✓ Believe it or not, there are only four ways to increase your business's revenue:

- **INCREASE THE NUMBER OF CUSTOMERS YOU SERVE.**
- **INCREASE THE AVERAGE SIZE OF EACH TRANSACTION BY SELLING MORE.**
- **INCREASE THE FREQUENCY OF TRANSACTIONS PER CUSTOMER.**
- **RAISE YOUR PRICES.**

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PRICE ELASTICITY

- ✓ Pricing Power is your ability to raise the prices you're charging over time.
- ✓ Pricing Power is related to concept economists call "price elasticity."
- ✓ If customers are very sensitive to the price of your offer, you'll lose many customers with even a slight increase in price, meaning demand is "elastic."
- ✓ Established semi commodity markets like toothpaste are good examples - dramatically increasing your prices is a good way to ensure that everyone stops buying your product and starts buying from your competitor.
- ✓ If your customers aren't price sensitive, you could quadruple the price with little change in sales.
- ✓ Take luxury goods, for example—customers purchase them because they're expensive Social Signals (discussed later) that are exclusive because they're costly.
- ✓ Increasing the price of designer handbags, clothing, and watches is likely to make those items more desirable, not less.

SUFFICIENCY

- ✓ The higher the prices you can command, the more reliably you'll be able to maintain profit Sufficiency.
- ✓ If you have a choice, choose a market in which you'll have Pricing Power—it'll be much easier to maintain Sufficiency over time.
- ✓ Economists like to spend time graphing and calculating price elasticity, but it's not necessary—unless you already have accurate Norms, you can't really know how much Pricing Power you have until you actually change your prices and watch what happens.

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- ✓ Fortunately, unless you're an established player in a large and active market (in which case you'll have Norms to work with), changing your prices very rarely has permanent effects unless your prices are broadly publicized and scrutinized; you can Experiment to find what works.

INFLATION + INCREASED COSTS

- ✓ Pricing Power is important because raising your prices allows you to overcome the adverse effects of inflation and increased costs.

- ✓ Historically, currency issued by any government tends to decrease in value over time—there are many strong incentives for officials to increase the supply of currency, which debases that currency's purchasing power.

- ✓ As a result, it takes more currency to purchase the same products and services necessary to stay in business, increasing your business's Sufficiency needs.

- ✓ Without adequate Pricing Power, your business may not be able to remain Sufficient in the face of higher expenses.

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6| LIFETIME VALUE

- ✓ Lifetime Value is the total value of a customer's business over the lifetime of their relationship with your company.
- ✓ Instead of making a single sale to a customer, Subscription businesses focus on providing value—and collecting revenue—for as long as possible.
- ✓ The more a customer purchases from you and the longer they stay with you, the more valuable that customer is to your business.
- ✓ The higher your average customer's Lifetime Value, the better your business.
- ✓ Maintain a long-term relationship with profitable customers, and you win.

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7| ALLOWABLE ACQUISITION COST (AAC)

- ✓ Allowable Acquisition Cost (AAC) = Marketing cost spent to capture a customer = Cost of "acquiring" a customer.
- ✓ How to calculate?
- ✓ Here's an example:
  - Average Lifetime Value per customer = $2,000
  - Cost of Value Creation and delivery = $500
  - Fixed Costs (discussed later) = $1,000 per customer
  - $2,000 - $1,500 = $500 in revenue before marketing expenses.
  - Assuming $500 = 100%
  - But you're aiming for 60 percent profit margin ($300),
  - You can afford to spend 40 percent ($200) of that $500 on marketing, which gives you a maximum AAC of $200 per customer.
  - AAC = $200
- ✓ Knowing that, you can test various forms of marketing to see if they work—if your assumptions are correct, any customer you can attract for $200 or less will be worth the investment.
- ✓ To calculate your market's Allowable Acquisition Cost, start with your average customer's Lifetime Value, then subtract your Value Stream costs—what it takes to create and deliver the value promised to that customer over your entire relationship with them.
- ✓ Then subtract your Overhead (discussed later) divided by your total customer base, which represents the Fixed Costs (discussed later) you'll need to pay to stay in business over that period of time.
- ✓ Multiply the result by 1 minus your desired Profit Margin (if you're shooting for a 60 percent margin, you'd use 1.00 - 0.60 = 0.40), and that's your Allowable Acquisition Cost.
- ✓ The more each new customer is worth to your business, the more you can spend to attract a new customer and keep them happy.

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8| OVERHEAD

- ✓ Overhead represents the minimum ongoing resources required for a business to continue operation.
- ✓ This includes all of the things you need to run your business every month, regardless of whether you sell anything: salaries, rent, utilities, equipment repairs, and so on.
- ✓ If you don't spend much, you don't have to make much to cover your expenses.
- ✓ Venture capitalists and other forms of investment can provide "seed capital"—a fixed amount of money you can use to start the business.
- ✓ The more money you raise in capital and the more slowly you spend it, the more time you have to make the business work.
- ✓ The faster you "burn" through your capital, the more money you need to raise and the more quickly you need to start bringing in revenue.
- ✓ If you burn through all of your start-up capital and can't raise more, game over.
- ✓ That's why investors and savvy entrepreneurs watch the business's "burn rate" very closely—the slower the burn, the more time you have to create a successful business.

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9| COSTS: FIXED AND VARIABLE

- ✓ Watch the costs and the profits will take care of themselves.

  —ANDREW CARNEGIE, NINETEENTH-CENTURY INDUSTRIALIST

- ✓ Fixed Costs are incurred no matter how much value you create.
  - Your Overhead is a Fixed Cost: no matter what you do in any given month, you still have to pay your salaried employees and the lease on your office space.
- ✓ Variable Costs are directly related to how much value you create.
  - Raw materials, usage-based utilities, and hourly workers are all Variable Costs.
- ✓ Reductions in Fixed Costs Accumulate;
- ✓ Reductions in Variable Costs are Amplified by volume.
  - If you can save $50 per month on your phone bill, that savings Accumulates to $600 per year.
  - If you can save $0.50 on each T-shirt you produce, you'll save $500 on every 1,000 T-shirts you make.
- ✓ The better you understand your costs, the more likely you are to find ways of producing as much value as possible without spending everything you make.

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- ✓ Saving money doesn't help you if you degrade the quality of your offer.
- ✓ Cutting costs can help you increase your Profit Margin, but it often comes at a steep price.
- ✓ If your goal is to increase your profitability, cutting costs can only take you so far.
- ✓ Creating and delivering value will always cost at least some amount of money, so there is a lower limit to how much you can cut costs before the cuts begin to diminish the value you provide.
- ✓ Cutting costs that are wasteful or unnecessary is certainly a good idea, but Diminishing Returns (discussed later) always kick in—be careful not to throw the baby out with the bath water.
- ✓ Creating and delivering more value is a much better way to enhance your bottom line.
- ✓ Control your costs, but don't undermine the reason customers buy from you in the first place.

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11| BREAKEVEN

- ✓ Breakeven is the point where your business's total revenue exceeds its total expenses—it's the point where your business starts creating wealth instead of consuming it.
- ✓ After that, the business will really be making money—before that, it just looks like the business is profitable.
- ✓ Your Breakeven point will change constantly. Revenue naturally fluctuates, as do expenses.
- ✓ Keeping a running tally of how much you spend and how much revenue you collect from the start of your business's operations is the only way to figure out whether or not you've actually made money.
- ✓ The more revenue you bring in and the less you spend on an ongoing basis, the more quickly you'll reach Breakeven, making your business truly self-sustaining.

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DEFINITION

- ✓ Amortization is the process of spreading the cost of a resource investment over the estimated useful life of that investment.
- ✓ Amortization can help you determine whether or not a big expense is a good idea.

EXAMPLE

- ✓ For example, a book designer may choose to purchase a copy of Adobe InDesign, the software commonly used by professionals to typeset books.
- ✓ Compared to most software packages, InDesign is pricey: a single-user license costs $700. Is it worth it?
- ✓ The answer depends on how many books the designer uses the software to typeset.
- ✓ If they never complete a project, they've wasted their money.
- ✓ If they use it to typeset ten books for $1,000 each, they've earned $10,000 by making a $700 investment—not bad at all.
- ✓ Amortized across ten projects, the cost of the software is only $70 a project, or 7 percent of the revenue each project brings in.
- ✓ The designer's credit card may hurt when the purchase is made, but the tool offers the ability to earn more money than would be possible otherwise.

PREDICTION

- ✓ Amortization depends on an accurate assessment of useful life, which is a prediction.
- ✓ Amortization doesn't work well if you don't sell what you produce or if your equipment wears out more quickly than expected.
- ✓ Predictions are a tricky business—if you're wrong in your estimate, your investment may cost a lot more on a per-unit basis than you originally assumed.

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EXAMPLE

- ✓ Crocs makes funny-looking rubber shoes.
- ✓ After becoming an unexpected hit, the company ramped up for huge volumes: they opened a factory in China and started producing millions of shoes in the expectation that they'd continue to sell each unit produced.
- ✓ As it turned out, Crocs were a fad—sales plummeted, and the company was stuck with a lot of expensive manufacturing capacity and huge amounts of inventory it couldn't sell.
- ✓ Amortization couldn't save the company from careening toward bankruptcy.

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- ✓ The job of the entrepreneur is to make sure the company doesn't run out of cash.
- ✓ —BILL SAHLMAN, PROFESSOR AT HARVARD BUSINESS SCHOOL
- ✓ Here's an old business adage you may have heard: "Cash is king."
- ✓ It's true. You can have millions of dollars in orders on the books, but without cash in the bank, it doesn't matter.
- ✓ Purchasing Power is the sum total of all liquid assets a business has at its disposal.
- ✓ How much cash do you have in the bank?
- ✓ The more Purchasing Power you have, the better off you are.
- ✓ Instead of constantly worrying about paying the bills, Purchasing Power gives you room to breathe, secure in the knowledge that you're not going to suddenly run out of money.
- ✓ Always pay close attention to how much Purchasing Power you have left—it's the difference between a business that stays open and a business that fails.

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- ✓ Think of your business's bank account like a bathtub.
- ✓ If you want the water in the bathtub to rise, you add more water and keep it from leaking out via the drain.
- ✓ The more water that flows in and the less that flows out, the higher the level of water in the tub.
- ✓ Revenues and expenses work the same way.
- ✓ Debt is a promise you make to pay someone at a later date.
- ✓ If you can't cover your debt service, you're in trouble.
- ✓ Debt can be useful, but there's also a catch: Debts typically cost additional money in the form of interest.
- ✓ Many businesses have closed with millions of dollars of "sales" on the books.
- ✓ Increasing your product margins, making more sales, and spending less of what you bring in will always improve your cash flow.
- ✓ Deferring or negotiating a longer repayment period with your creditors can also help alleviate a cash crunch.
- ✓ Borrowing $1 to make $10 is a good trade; it's even better if you're able to do that for months before the first bill comes due.
- ✓ To bring cash in more quickly, it's best to speed up collections and reduce the extension of credit.
- ✓ It's common in many industries to extend credit to customers, but that doesn't mean you have to as well.
- ✓ Always remember that you're a business, not a bank (unless your business involves Loans)—collect any outstanding payments as quickly as possible.

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- ✓ Opportunity Cost is the value you're giving up by making a Decision.
- ✓ We can't do everything at once—we can't be in more than one place at a time or spend the same dollar on two different things simultaneously.
- ✓ Whenever you invest time, energy, or resources, you're implicitly choosing not to invest that time, energy, or resources in any other way.
- ✓ Opportunity Cost is important because there are always other options.
- ✓ Opportunity Cost is important because it's hidden.
- ✓ As we'll discuss later in Absence Blindness, humans have a hard time paying attention to what's not present.
- ✓ Paying attention to what you're giving up by making a Decision helps you consider all of your options accurately before making a decision.
- ✓ Obsessing over Opportunity Cost too much can make you needlessly crazy, however.
- ✓ Don't get bogged down with all of the options available—consider only what appear to be the best alternatives at the time of your decision.
- ✓ If you pay attention to the Opportunity Costs of your decisions, you'll make much better use of the resources at your disposal.

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16| TIME VALUE OF MONEY

- ✓ A dollar today is worth more than a dollar tomorrow.
- ✓ How much more depends on what you choose to do with that dollar.
- ✓ The more profitable options you have to invest that dollar, the more valuable it is.
- ✓ Calculating the Time Value of Money is a way of making Decisions in the face of Opportunity Costs.

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17| COMPOUNDING

- ✓ Compounding is the Accumulation of gains over time.
- ✓ Whenever you're able to reinvest gains, your investment will build upon itself exponentially—a positive Feedback Loop (discussed later).
- ✓ Compounding is important because it creates the possibility of huge gains in surprisingly short periods of time.
- ✓ If you reinvest the revenue your business generates and your business is growing rapidly, you can multiply your original investment many times over.
- ✓ Compounding is the secret that explains how small companies that reinvest their profits become large companies in a few short years.
- ✓ Accumulating gains inevitably produces huge results over time.
- ✓ The trick is to be patient enough to wait for the reward.

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18| LEVERAGE

- ✓ Leverage is the practice of using borrowed money to magnify potential gains.
- ✓ Leverage is a form of financial Amplification—it magnifies the potential for both gains and losses.
- ✓ When your investment pays off, Leverage helps it pay off more.
- ✓ When your investment tanks, you lose more money than you would otherwise.
- ✓ One of the major contributing factors of the recession of 2008-9 was the use of enormous amounts of Leverage by investment banks.
- ✓ Millions (or billions) of dollars were made or lost when the value of a particular stock went up or down by a single percentage point.
- ✓ When the market crashed, a bank's losses were magnified by the amount of Leverage they had taken on, which was more than enough to threaten the entire firm's existence.
- ✓ Using Leverage is playing with fire—it can be a useful tool if used properly, but it can also burn you severely.
- ✓ Never use Leverage unless you're fully aware of the consequences and are prepared to accept them.
- ✓ Otherwise, you're putting your business and personal financial situation at risk.

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19| HIERARCHY OF FUNDING

- ✓ Funding can help you do things that would otherwise be impossible with your current budget.
- ✓ If your business requires expensive equipment or many workers to create and deliver value, you'll probably need outside Funding.
- ✓ Few of us have enormous sums of money in our bank accounts waiting to be used, but it's surprisingly easy to reach out to those that do.
- ✓ Funding is the business equivalent of rocket fuel.
- ✓ In order to obtain access to Funding, it's often necessary to give up a certain amount of control over the business's operations.
- ✓ Businesspeople won't give you money for nothing—they always ask for something in return.
- ✓ They're also looking for a way to decrease their risk of losing everything if the business goes under.
- ✓ To alleviate this risk, they ask for control: the ability to influence the operations of the business.
- ✓ The more money you ask for, the more control they'll want.
- ✓ The higher you climb, the more Funding you get, and the more control you give up in exchange.

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PERSONAL CASH

- ✓ Let's examine the Hierarchy of Funding, starting at the bottom: Personal Cash is by far the best form of financing.
- ✓ Investing cash you already own is quick, easy, and requires no approval or paperwork.
- ✓ Most entrepreneurs begin by financing themselves out of cash as much as possible.

PERSONAL CREDIT

- ✓ Personal Credit is another low-cost method of financing.
- ✓ As long as your needs don't exceed a few thousand dollars, it's easy to finance expenses via Personal Credit.
- ✓ Approval is generally quick if you have good credit, and payment over time helps increase your cash flow.
- ✓ You risk ruining your personal credit rating (a form of Reputation) if you can't make your payments, but for many entrepreneurs, that's a risk worth taking.
- ✓ I financed my entire business out of cash and personal credit.
- ✓ If your needs are modest, using personal credit to finance your start-up costs is a good option as long as you watch your budget.

PERSONAL LOANS

- ✓ Personal Loans are typically made by friends and family.
- ✓ If you need more money than you can cover via Personal Cash and Personal Credit, loans from friends and family are not uncommon.
- ✓ Just be wary: the risk that you won't be able to pay them back is very real and can have a devastating effect on important personal relationships.
- ✓ For that reason, I'd advise avoiding asking your parents or grandparents to gamble their life savings on your idea—there are better ways.

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UNSECURED LOANS

- ✓ Unsecured Loans are typically made by banks and credit unions.
- ✓ You fill out an application, ask for a certain amount of money, and the bank will evaluate your ability to pay the loan back with interest over a certain time period.
- ✓ The loan can be either a lump sum or a line of credit that can be used at any time.
- ✓ The bank doesn't ask for collateral for smaller amounts (a few thousand dollars), so the interest rate will probably be a bit higher than a credit card or secured loan.
- ✓ Secured Loans require collateral.
- ✓ Mortgages and automotive loans are good examples of secured loans: if you don't make the payments, the lender can legally seize the property promised as collateral.
- ✓ Because the lender can then sell that property to recoup their funds, Secured Loans are much larger than Unsecured Loans: tens or hundreds of thousands of dollars.

BONDS

- ✓ Bonds are debt sold to individual lenders.
- ✓ Instead of asking a bank for a loan directly, the business asks individuals or other companies to loan them money directly.
- ✓ Bond purchasers give money directly to the business, which is paid back at an agreed-upon rate for a certain amount of time.
- ✓ When the time expires (i.e., the Bond "matures"), the company must give back the original loan amount in addition to the payments already made.
- ✓ The legal and regulatory process that surrounds the Bond market can be extremely complicated, so Bond issues are typically conducted through an investment bank.

RECEIVABLES FINANCING

- ✓ Receivables Financing is a special type of secured lending unique to businesses.
- ✓ Receivables Financing can make millions of dollars in credit available, but at a cost: the collateral for the loan is control over the business's receivables.

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- ✓ Since the bank controls the receivables, they can ensure their loan is paid before anything else, including employee salaries and vendor commitments.
- ✓ Large amounts of funding are available, but you're giving up a great deal of control to the lender.

ANGEL CAPITAL

- ✓ Angel Capital is where we shift from Loans to Capital.
- ✓ An "angel" is an individual private investor—someone who has excess wealth they'd like to invest in a private business, typically $10,000 to $1 million.
- ✓ In exchange, they'll own 1 to 10 percent of the business.
- ✓ Taking on an angel investor is a bit like taking on a silent partner—they give you Capital, and in exchange you give them partial legal ownership of the business.
- ✓ Some angels offer advice and are available for consulting, but they generally don't have the power to make business decisions.

VENTURE CAPITAL

- ✓ Venture Capital takes over where angels leave off.
- ✓ Venture Capitalists (VCs) are extremely wealthy investors (or groups of investors who pool their funds) with very large sums of Capital available: tens (or hundreds) of millions of dollars in a single investment.
- ✓ Funding via Venture Capital happens in "rounds" that start small, then grow as more Capital is needed.
- ✓ Later rounds can dilute the ownership percentage of current shareholders, so there's typically a great deal of negotiation involved.
- ✓ VCs also require large amounts of control in exchange for large amounts of Capital, which usually means seats on the company's board of directors.

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PUBLIC STOCK OFFERING

- ✓ A Public Stock Offering involves selling partial ownership of the company to investors on the open market.
- ✓ This is typically done via investment banks: companies that will provide a business with enormous amounts of Capital in exchange for the shares of that company to sell on the public stock market.
- ✓ The investment banks make money by selling the shares they've purchased at a premium to individual investors on the open market.

INITIAL PUBLIC OFFERING (IPO)

- ✓ An initial public offering (IPO) is simply the first Public Stock Offering a company offers on the open market.
- ✓ Any investor who purchases shares is legally a partial owner of the company, which includes the right to participate in management decisions via electing the board of directors.
- ✓ Whoever owns the most shares in the company controls it, so "going public" creates the risk of a hostile takeover: the mass purchasing of shares in an effort to control the company.

PUBLIC STOCK OFFERINGS

- ✓ Public Stock Offerings are typically used by angel and Venture Capital investors to exchange ownership for money.
- ✓ Investors can collect their returns in one of two ways: reaping dividends that distribute the Profits of the company or selling their shares to another investor.
- ✓ Public Stock Offerings enable investors to sell their shares in exchange for money, so it's common for angels and VCs to push successful companies to "go public" or be acquired by another company as quickly as possible in order to "cash out" of the investment.
- ✓ The more control you must give up for each dollar of Funding obtained, the less attractive the source of Funding.
- ✓ The more people you're required to consult with before making decisions, the slower your company will operate.
- ✓ Investors increase Communication Overhead (discussed later), which can adversely affect your ability to get things done quickly.

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- ✓ It's also not uncommon for investors to remove executives of a company that's not performing well, even if those executives are the founders of the company.
- ✓ Even high-flying executives aren't immune: when Apple was performing poorly in the 1990s, the board of directors fired Steve Jobs from the company he cofounded.

- ✓ A word to the wise: before you take on large amounts of Capital, be aware of how much Power (discussed later) the business's board of directors will have over the operation of the company.
- ✓ Funding can be useful, but be wary of giving up control over your business's operations—don't do it lightly or blindly.

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- ✓ Felix qui nihil debet. (Happy is he who owes nothing.)

  —ROMAN PROVERB

- ✓ How much financing you need depends largely on what you're trying to do.
- ✓ If your intent is to be self-sufficient and free to make your own decisions, it's much better to avoid financing in favor of retaining control.
- ✓ Bootstrapping is the art of building and operating a business without Funding.
- ✓ Don't assume that the only way to create a successful business is by raising millions of dollars of Venture Capital—it's simply not true.
- ✓ By limiting yourself to the use of Personal Cash, Personal Credit, the business's revenue, and a little ingenuity, you can build extremely successful businesses without seeking Funding at all.
- ✓ Bootstrapping allows you to grow your business while maintaining 100 percent control over the business's operations.
- ✓ You don't have to get anyone else's approval to make the decisions you think are best.
- ✓ The drawback is that growing the business can take much longer—prudently used.
- ✓ Funding can help make things happen much more quickly than they'd happen otherwise.
- ✓ If you accept Funding, make sure that you use it to do things that you couldn't do any other way.
- ✓ For best results, Bootstrap as far as you can go, then move up the Hierarchy of Funding only as needed.
- ✓ Having 100 percent ownership and control of a profitable, self-sustaining business is a beautiful thing.

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21| RETURN ON INVESTMENT (ROI)

- ✓ When you invest in something, you expect it to provide more value than you paid for it.
- ✓ Return on Investment (ROI) is the value created from an investment of time or resources.
- ✓ Most people think of ROI in terms of currency: if you invest $1,000 and you collect $100 in profit, that's a 10 percent return on your investment: ($1,000 + $100) / $1,000 = 1.10, or 10 percent.
- ✓ If your ROI is 100 percent, you've doubled your initial investment.
- ✓ The usefulness of Return on Investment extends far beyond money: you can use it for other Universal Currencies as well.
- ✓ "Return on Invested Time" is an extremely useful way to analyze the benefits of your effort.
- ✓ If you were forced to work twenty-four hours a day nonstop for a year in exchange for $1 million, would you do it?
- ✓ When you look at the return versus the cost to your time and sanity, it's not worth it.
- ✓ The return on every investment is always directly related to how much the investment costs.
- ✓ The more you spend (in terms of both money and time), the lower your return.
- ✓ Even "sure bets" like buying a house or getting a college degree aren't wise if you pay too much for them.
- ✓ Every estimate of return is speculative—you never know how it'll actually turn out.
- ✓ Every future ROI estimate is a semieducated guess.
- ✓ Nothing in this world is a sure bet—always take into account the risk of something going wrong before making an investment, no matter how high the potential ROI appears to be.

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- ✓ Sunk Cost is easy to understand conceptually but much harder to put into practice.
- ✓ You've invested so much that it feels wrong to "give it up for nothing."
- ✓ "Throwing good money after bad" is not a winning strategy.
- ✓ In reality, there's nothing you can do about your past investment—it's gone.
- ✓ Continuing to invest in a project to recoup lost resources doesn't make sense—all that matters is how much more investment is required versus the reward you expect to obtain.
- ✓ If you could turn back time, you'd do things differently.
- ✓ Unfortunately, you can't.
- ✓ There will always be other projects, provided you don't double down on a risky project to recover your losses.
- ✓ All you can do is act based upon the information you have now.
- ✓ Don't continue to pour concrete into a bottomless pit—if it's not worth the additional investment, walk away.
- ✓ If the reward isn't worth the investment required to obtain it or the risk, don't invest.

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ABOUT THE AUTHORS

ABOUT JOSH KAUFMAN

Josh Kaufman is the bestselling author of books on business, entrepreneurship, skill acquisition, productivity, creativity, applied psychology, and practical wisdom.

More about him at www.joshkaufman.net

ABOUT DR. ALVIN ANG

Dr. Alvin Ang earned his Ph.D., Masters and Bachelor degrees from NTU, Singapore. He is a Professor as well as a personal/business advisor.

More about him at www.AlvinAng.sg

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