INDEX

A
Advertising agency, 102
“Angel” investor, 1
Assessment of entrepreneurs, 47
   industrial psychological approach, 47–49
   case example, 469–475
   intellectual effectiveness, 49
   personal relationships, 50–51
   traits/limitations summary, 51, 465–468
   work approach/style, 50
venture capitalists’ focus/experience
   leadership, 54–55
   market knowledge, 54
   reputation, 55
   track record, 54
venture capitalists’ focus/individual characteristics
   detail orientation, 53
   personality compatibility, 53
   risk management, 52
   staying power, 52
   verbal ability, 53

B
“Bean counters,” 141
“Breakeven,” 3
Brokers, 314
   agreement with, 315–316
   qualities, 314–315
   tips on interaction, 317

C
Company personnel/compensation review, 69, 88
   compensation, 73–74
      bonus plan, 77–78
      compensation system, 74–76
      other benefits, 79–80
      pension plan, 76–77
      profit-sharing plan, 77
      stock option plan, 78–79
   employment contracts, 80
      noncompete agreements, 81
      nondisclosure contracts, 81–82
      and special compensation arrangements, 80–81
Company personnel/compensation review, continued
organization, 69–70, 320
chart, 70–71
management team characteristics, 72–73, 323–324
officers and directors, 71–72, 320–323
stockholders, 72
personnel records, 84
employee books/manuals, 85
employee litigation, 86
health insurance, 88
hiring procedures, 85–86
internal records, 84
management records, 86
motivation techniques, 86
other employee benefits, 87–88
payroll records, 84–85
personnel consultants, 87
personnel reports, 85
regulatory agencies, 86–87
ratio analysis, 89
average salary, 89
average sales per employee by division, 89
benefits as percentage of payroll, 90
employee turnover, 90
sales per employee, 90
total payroll as percentage of sales, 90
required information/management area, 327–329
key questions, 320–327
required information/personnel area, 329, 335–337
key questions, 330–335
strengths and weaknesses, 89–90
workforce structure, 82
morale, 83
training program, 83
unions, 82–83
work stoppage, 83

see also Financial analysis/personnel; Production investigation/production employees
“Constructive deceit,” 37–38

Deal exit, 9, 275–276
going public, 276
brokerage house selection, 278–279
timing, 276–277
underwriter’s fees, 277–278
liquidation, 292–293
reorganization, 291–292
sale (another investor), 290
corporate partner, 290–291
new venture capital partner, 291
sale (back to company), 284–285
employee stock ownership trust, 285–286
put or call exit, 286–289
sale (strategic or financial buyer), 279–280, 283
assets sale for cash, 281–282
assets sale for notes, 282
assets sale for stock, 282–283
stock sale for cash, 280
stock sale for notes, 280–281
stock sale for stock, 281

see also Workout situations
Deal structuring, 181
commitment letters, 190–191, 212–213
collateral and security, 195
collateral and security/case example, 195–198
conditions (commitment letter), 208
conditions of the loan, 198
conditions of the loan/case example, 198–204
conditions/case example, 208–209
example, 418–424
representations, 204
representations/case example, 204–208
terms of investment, 191
terms of investment/case example, 191–195
investment memorandum, 209–210
collateral and security, 211
conditions of commitment, 211
conditions of investment, 211
other issues, 211–212
representations, 211
terms of investment, 210–211
pricing, 181
internal rate of return, 187, 189
net present value, 189
present value, 188–189
and return on investment, 183–184, 188
and risk/reward, 181–182
probabilities, 185–187
return analysis techniques, 187–188, 190
and risk reduction, 182–183
types, 184–185
Due diligence process, 1, 319–320
see also Company personnel/compensation review; Evaluation process components (first stage); Financial analysis; Marketing and sales analysis; Production investigation; Purchasing process; Reference information; Written summary

E
Eagle Scouts, 6
EBITDA (earnings before interest, taxes, depreciation, amortization), 9
in case example, 17
EEOC (Equal Employment Opportunity Commission), 126
Entrepreneur, 27–28
analytical evaluations of, 42–43, 67
like/dislike lists, 57
strengths/weaknesses list, 66–67
see also Entrepreneur background information; Entrepreneur interview
characteristics, 30
ambiguity (tolerance for), 32
communications skills, 36–37
competitiveness, 30–31
determination, 33
energetic, 35
fair play attitude, 39–40
independence/autonomy, 31
integrity, 37–39
mental stamina, 36
moderate risk takers, 32–33
partnership goal, 39
reality orientation, 34–35
resourcefulness, 33
self-confidence, 32
sense of urgency, 34
knowledge of financials, 2–3
perceptions about
judgements and intuition, 41–42
“trait tags,” 40–41
vs. small business manager, 55–56
studies of, 28–29
see also Assessment of entrepreneurs
Entrepreneur background information, 57–58, 326–327
Entrepreneur background information, continued
  business references, 58–59
  credit reports, 60
  customers, 64–65
  decision making process, 66, 324–325
  documentation, 66
  employees, 65
  entrepreneur as source, 63–64
  investors, 65
  local people, 64
  management team, 65–66
  personal references, 58
  private investigations, 60–61
  psychological assessment tests, 61
  public information, 64
  written information, 61–63
Entrepreneur interview, 43–44
  clarity, 44
  distraction-free environment, 44–45
  documentation, 46–47
  effective listening, 45
  individual interview, 46
  panel interview, 46
  preparation, 44
  rational and intuitive approach, 45–46
Entrepreneurs/potential problem issues, 258
  financial control problem, 258–259
  people problems, 259–260
    poor development program, 261
    poor incentives to management, 260
    poor job definition, 260
    poor review program, 261
    poor selection process, 260
  undercapitalization problem, 259
ERISA (Employee Retired Income Security Act), 76
ESOP (Employee Stock Ownership Plan), 285–286

Evaluation process components (first stage)
  deal exit, 9
  high projection of earnings/value, 3–4
  management, 4–5
    achievement, 6
    experience, 5–6
    high energy level, 6
    honesty/integrity, 5
    key questions, 320–327
    motivation, 7
    required information, 327–329
  market-oriented product, 8
  numbers presentation, 2–3
  accountant, 3
  unique situation, 7–8
see also Due diligence process;
  Quick evaluation process components

F
FCC (Federal Communications Commission), 126
Financial analysis, 141, 158, 327
  balance sheet analysis, 146–147
  fixed assets, 147
  inventory, 147
  liabilities, 147
  budgeting and control, 148
  cash flow analysis, 145–146
  entrepreneur’s investment, 150–151
  entrepreneur’s ownership, 151
  other investors, 151–152
  past financings, 148–149
    bank financings, 149–150
    personnel, 141–142
    proceeds/financings usage, 152
  projections, 153–155
  ratio analysis, 155
    cash ratios, 157–158
    leverage ratios, 156–157
liquidity ratios, 156
profitability ratios, 155–156
reports, 158
required information, 380, 405–407
key questions, 380–405
verification of qualitative data, 142
historical financial statements
review, 142
income statement analysis,
143–144
loss leaders, 144
operational audit, 142–143
percentage of completion, 144
research and development, 144
standard cost, 145
Ford, Henry, 8
Franchising, 22
concept, 22
franchisor’s money making
strategy, 22–23
franchisor’s financial statement, 22
relationships, 23
G.A. Smart & Company (Chicago), 61
General Motors, 88
“Golden parachutes,” 80

“Intellectual honesty,” 38
Interview see Entrepreneur interview
Investment, vs. partnership, 9–10
Investment bankers, 1
Investment discovery, 299, 317–318
objective, 299
activity level, 304–305
exit timing, 302–303
geographic preference, 303–304
liquidity preference, 304
purpose, 300
return (timing of), 305
risk profile, 304
size of investment, 303
specialty investing, 302
stage of company development
preferred, 301–302
type of money for investment,
300–301
opportunity handling, 312–313
originating opportunities, 305–306
accountants, 307
advertising/direct mail, 311
attorneys, 307
banks, 306–307
business brokers/financial
brokers, 308
chambers of commerce (local),
310
cold calls, 310–311
consultants, 308–309
conventions, 309
economic development
organizations, 309
friends/associates, 310
industrial/professional trade
organizations, 309
investment bankers/
stockbrokers, 307–308
other groups, 311–312
suppliers, 311
venture capital companies/LBO
funds, 310
proactivity, 312
see also Brokers
Investment monitoring, 239
board/investor meetings, 243–244
external warning signs, 254
general industry decline, 254
government changes, 255
technical change, 254
involvement, 239–240
monthly financial reports, 240–241
monthly written reports, 242
case example, 242–243
other discussion items, 244–245
policy decisions (major), 240
Investment monitoring, continued
ratio analysis as warning indicator, 255
record maintenance, 245
board meeting file, 247
correspondence file, 246
financial recording file, 246–247
legal records, 245–246
tracking file, 247–248
tips, 255–257, 270–272
pitfalls, 272–273
warning signs, 248
  accounting methods changes, 253
customer/supplier/lender (major) loss, 253
entrepreneur unavailability, 250
figures readjustments, 251
labor problems, 253
late balance sheet item changes, 250
late financial reports, 249
late payments, 248–249
loss of profits, 249
management changes (major), 251
planning deficiencies, 252–253
price/market share changes, 254
reports showing poor preparation, 249–250
sales/order backlogs changes, 251–252
thefts (large), 250–251
see also Entrepreneurs/potential problem issues; Investor involvement; Workout situations
Investor involvement
factors, 268
  amount invested, 268
distress issues, 269
expertise, 268–269
lead investor status, 269
need for assistance, 268
receptivity to assistance, 268
relationship with entrepreneur, 269
time availability, 269–270
objectives, 273–274
in operating problems, 261–262
bankruptcy, 265–266
fix the problem, 263–264
foreclose on assets, 264–265
liquidation, 266
sell the business, 264
and partnership issues, 266–267
IRR (internal rate of return), 187, 189

L
Lawyers, 237–238
  experienced, 230
  as investors or business owners, 229
and legal fees, 231–232
  arguments, 233–234
  legal points disagreements, 232
  legal style, 233
  research on points of law, 233
  rewrites, 233
  syndications and lawyers, 234–235
LBOs, 302, 310
Legal closing, 215–216, 235
  documents
  and commitment letter, 215
  exhibits to stock purchase agreement example, 462–463
  loan agreement example, 424–441
  promissory note example, 441–446
  review procedures, 230–231
  simplicity benefits, 225–226
stock purchase example, 453–461
stock purchase warrants example, 446–453
and fees, 231
closing fees, 236–237
last minute changes, 236
loan with options type, 216–217
loan agreement, 217–223
note, 223
other documents/exhibits, 224–225
stock purchase option, 223–224
purchase of stock type, 226
stock purchase agreement, 226–229
see also Lawyers
LIQUIDITY EVENT, 9

MARKETING AND SALES ANALYSIS, 91, 116
customer communications, 102
advertising, 102
advertising budget, 103
advertising questions, 103–104
formal advertising program, 103
public relations, 102
customer identification, 96–97
customer complaints, 99–100
customer credit approval/credit terms, 101
customers, 97
disputed invoices, 101–102
loss of customers, 98–99
order backlog, 100–101
special-arrangement contracts, 97–98
customers
customer service, 134–135
reference questions, 176–178
external information, 113
industry associations, 113
trade publications, 114
trade shows, 113–114
internal reports, 111
marketing reports, 111–112
procedure manuals, 112–113
sales projections, 112
marketing direction
decision-makers, 91–92
employee terminations, 94
motivation, 93–94
outside representatives, 93
personnel, 92
salesperson analysis, 92–93
marketplace analysis, 104–105
competitors, 105–106
market growth, 106
market information, 106
market size, 105
objectives, 107
strategies, 107
price determination, 108
price changes, 110
pricing policies, 108–109
pricing process, 109–110
product warranty, 110–111
ratio analysis, 114
discounts as percentage of sales, 115
gross profit per salesperson, 115
marketing expense as percentage of sales, 115
returns as percentage of sales, 115
salaries and commissions as percentage of sales, 114–115
sales per salesperson, 114
selling expenses as percentage of sales, 114
required information, 337–338, 356–358
key questions, 338–356
Marketing and sales analysis, continued
  sales focus (what is being sold), 94
  product descriptions, 95
  product development, 96
  product literature, 96
  product seasonality, 95
  products, 94–95
  strengths/weaknesses, 115–116
  MBO (management by objective), 5

  N
  NPV (net present value), 189

  O
  OSHA (Occupational Safety and Health Administration), 126

  P
  Partnership, 9–10
  and trust, 266–267
  see also Deal exit
  “Phantom stock option plans,” 78
  Production investigation, 117, 137, 139–140
capacity, 130
capital expenditures, 122–123
equipment, 119–120
  new requirements, 120–122
  surplus, 122
  facility research, 118–119
  plant moves, 119
  inventory, 128–129
  production capacity, 123
  production costs, 129–130
  production employees, 123–124
  motivating mechanisms, 124–125
  retirement plans, 125
  staff meetings, 126
  unions, 125
  production levels, 130
  quality control, 129
  ratio analysis, 137
direct labor hours percentage
  of total factory hours, 138
  idle time percentage, 138
  labor costs as percentage of
  production cost, 138
  machine utilization, 139
  manufacturing overhead to
  total production cost, 138
  material cost to total
  production cost, 138
  overtime as percentage of total
  hours, 138–139
  scrap rate, 139
  unit production hours, 137
  regulatory agencies, 126–127
  required information, 358, 373–376
  key questions, 358–370
  and shipping, 133–134
  strengths/weaknesses, 130–131
  subcontracting work, 127–128
  see also Customer service;
  Research and development
  Purchasing process, 131–132
  and receiving, 132–133
  required information; key
  questions, 370–373
  suppliers, 132
  Put or call exit formulas, 286
  appraised value, 289
  book value, 286–287
  multiple of cash flow, 288
  multiple of sales, 288
  percentage of sales, 287–288
  prearranged cash amount, 289
  price-earnings ratio (PE), 286

  Q
  Quick evaluation process components
  four keys to success, 24
  quick screening, 23
Reference information, 161, 179–180
advertising/public relations agency, 175–176
competitors, 178
corporate identification, 161–162
corporate structure, 162–163
credit information, 179
customers, 176–178
insurance agents, 172–173
landlords, 173–174
lawyer (current and past), 171
management questions, 163–164
stock questions, 164–167
manufacturers’ representatives, 174–175
professional references, 167
accounting firm, 169–171
bankers, 167–168
other institutional lenders, 168–169
required information, 408
key questions, 408–416
subcontractors, 178–179
suit settlement, 172
suppliers, 176
Research and development, 135–137,
139–140
in financial analysis, 144
required information, 379–380
key questions, 376–378
strengths/weaknesses, 137
Revolutionary vs. evolutionary products, 8
ROI (return on investment), 183–184,
187

Second liens, 13
Small business manager vs.
entrepreneur, 55–56
Smart, Goff, 61

Washington, George, expense account, 87
Workout situations, 294–295, 296–297
business plan, 295–296
damage estimate, 295
liquidation analysis, 296
turnaround experts, 296
Written summary, 10, 20–21
format, 15, 21
case example one, 15–18
case example two, 18–20
questions to answer
amount of investment, 12–13
business situation summary, 11–12
cash-in plan, 14
collateral security, 13
contact at the business, 11
investment entity, 11
investment use, 13
management team, 12
past financial performance, 13–14
product/services being sold, 12
projected profit, 14–15
reasons not to invest, 15
reasons to invest, 15
uses, 21–22