

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
- D**
- 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

- G.A. Smart & Company (Chicago), 61
- General Motors, 88
- “Golden parachutes,” 80

I

- “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

M

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

R

- 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

S

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

W

- 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