

column

paul allen

Paul Allen started Infobases, MyFamily.com, and 10x Marketing. He currently runs business incubator Provo Labs. He has taught at UVSC and BYU and he blogs at www.infobaseventures.com/blog.

a dramatic way to reach positive cash flow

Several good companies presented at the recent FundingUtah.com speed-pitching event. But the one that caught my attention the most was Seatability.

This company sells very comfortable and innovative chairs.

Selling chairs is not the kind of high-tech business that I've been involved in personally. But a lot of things about this company have caught my eye as I've watched them over the last year.

I like the fact that most of the company's founders speak Mandarin. They personally visited more than 50 factories in China to explore options before deciding to manufacture in Taiwan.

But what I like most of all is that the founding team have invested nearly \$200,000 of their own savings in the company over the past 18 months and they have all been working without salaries from the beginning. Talk about commitment!

August was their first profitable month, sans salaries.

As sales continue to grow, the founders may be able to start paying themselves while keeping the company profitable.

Eventually, the value of their equity in the company may dwarf whatever take-home pay they have been sacrificing and the investment they have already made.

Can you say, "Deferred gratification?"

Entrepreneurs, especially those who are bootstrapping their companies, cannot generally pay themselves high salaries in the beginning years. If they do, they drain the company of the funds it needs to develop and market its product or service.

Two of my previous companies would not have been able to turn the corner to profitability without short-term sacrifices from the founders and management teams.

At Infobases, Dan Taggart and I paid ourselves just \$18,000 per year initially until our sales were high enough to justify higher salaries.

But as importantly, we started Infobases on the side while we both had other jobs. We quit our full-time jobs only after getting some large orders from retailers. I had developed the products and Dan had sold them before we incurred any rent or payroll costs. In effect, sweat equity was our startup capital.

At 10x Marketing, our CEO took a salary below his market value in order to get a larger equity stake in the company and to help the company get to profitability.

Some venture-backed companies pay high salaries and give stock options in order to attract top talent. But most Utah entrepreneurs are going to hit it big only if they forego high compensation in the early years.

If you run a lifestyle company, where you trade your time for pay, it may not make sense to take a low salary.

The most exciting entrepreneurial funding program in the state is Junto Partners. Created by Greg Warnock with support from Grow Utah Ventures, this program provides up to \$50,000 of startup capital to promising entrepreneurs who are willing and able to live without salaries as they launch their ventures.

Some wonder if this work-without-pay filter is a good idea, or if some of the best entrepreneurs won't be Junto winners because they may have a young family to support or don't have enough savings to work without pay for a year or more.

I'm guessing that it is a good filter and that Junto companies statistically will have a far greater chance to succeed than those formed by entrepreneurs who need a salary in the short term.

The best-selling (but now out-of-print) book, "The Entrepreneur Manual" (highly recommended) describes how to form founding teams who work part-time without pay in the startup phase of a company. The employees switch to full time and start receiving salaries once the bootstrapped startup has raised sufficient venture capital.

I have learned by sad and too recent experience (I should know better by now) the consequences of using too much startup capital for high executive wages.

It takes time for most startup companies to reach cash flow positive. It is very painful to run out of capital before a startup has reached breakeven and to force the management team and employees to make the tough decision of, "Do we shut this company down, or can we find enough people who are willing to work for free until it turns around with an equity opportunity as the sole motivator?"

The most dramatic near-death experience I have ever heard is the Ah-ha miracle story (now Enhance Interactive). CEO Paul Brockbank had to announce in a company meeting back in 2000 that the company's funds had run out and it would be shutting its doors.

After the meeting, one of the employees said he needed to get back to service some customers. Brockbank said, "You don't understand, we're out of business." But the employee ignored that fact and went back to work. So did dozens of others.

Over the next few weeks the employees worked on what Brockbank called the "It's a Wonderful Life" payment plan. He would ask each employee how much they needed to survive and then try to pay them that much.

Within a few months Ah-ha had turned the corner and received some investment capital from MyFamily.com. Within a couple more years the company was sold for tens of millions of dollars — all because a group of dedicated employees was willing to work for equity.

I love the Ah-ha story and I applaud the Seatability team for starting their company with deferred gratification in mind.

If we want more successful startups in Utah, we need more entrepreneurs and employees to join founding teams that believe in building equity value — even when it means little or no compensation in the near term. tm

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