

From the Practitioner's Corner

Seeking God (in the details)

Joseph E. Levangie

Entrepreneurs tend to be self-styled “idea” people. They often believe they have the next “Big Concept”—one which could change the world, reaffirm their self-worth, and, of course, make them and their venture team a fortune.

In contrast, as they build a company to implement their business dream, entrepreneurs also tend to eschew or trivialize administrative details. Why should they waste their creative juices on minutia? As a result of this insensitivity to detail, these captains of capitalism often trip in their entrepreneurial journey. For example, they might:

- Forget to remit payroll taxes on schedule.
- Fail to document the justification underpinning the dismissal of a key employee.
- Allow the company's liability insurance to lapse.
- Neglect to report sales usage tax.
- Verbally grant employee incentive stock options during an informal luncheon meeting, at a yet-to-be-determined exercise price and without the board of directors' approval.

Some wag once noted that “God is in the details.” As for finding God, many entrepreneurs are stunned to find out that God is not that reflection in their mirror! To sustain this spiritual metaphor, the Church of Entrepreneurship requires that the entrepreneur seek salvation and do penance by tending to those distasteful administrative nits that otherwise might transform into future mortal sins. Such “sins” might manifest themselves as

- noncompliance with the IRS;
- noncompliance with the EEO;
- noncompliance with the SEC;
- significant (and possibly unnecessary) stock option expenses imposed by the company's audit firm;
- costly errors, accidents, or acts-of-God that are not covered by insurance; or
- operational shortcomings in areas regulated by an alphabet soup of oversight agencies (FDA, FTC, FCC, OSHA, etc.).

As a practicing entrepreneur involved with dozens of ventures for more than two decades, I confess that I am not without sin. The Church, after all, is for sinners. From listening to the many sermons over the years of those wiser than me, I have learned—by looking after administrative

housekeeping issues—how to sin less and enjoy business success more! Seeking God (in the details) can be self-fulfilling (and profitable).

In today's venture world, we are emerging from more than three years of economic recession. Most entrepreneurs have been in their foxholes simply trying to survive. Now is the time for them to reestablish a more aggressive (entrepreneurial) approach to growing business. Opportunities should be numerous. As will the potential pitfalls! What details should an entrepreneur tend to in order to avoid these pitfalls?

1. Choose, evaluate, and upgrade the company's professional advisers (legal, accounting, banking, investment banking, board of directors).

- Correlate work product with hours of work and hourly rates.
- Choose individuals with knowledge of the company's industry. Their contacts may help in sales leads and partnering opportunities.
- Irony: The closer the relationship with advisers, the greater the return, at often a lesser cost.
- Case Example: Recent tax law (JGTRRA-2003) reduces C-Corp tax rate for dividends to 15 percent from 38.6 percent. Advisers may want to increase dividends to provide lower-taxed “compensation” for inside shareholders, while reducing the cash outflow and expense to the company. An alternative decision would be for an S-Corp to consider the efficacy of converting to a C-Corp to provide the principals with a lower tax rate. This type of issue is where advisers really earn their stripes.

2. Upgrade financial reporting standards.

- The sooner private companies adopt public company (FASB-like) standards, the easier it will be to create an exit position for shareholder liquidity. An acquiring company will likely require SEC-compatible financial information. An IPO requires two years of audited financials, so there is substantial lead time involved. Many private companies are adopting Sarbanes-Oxley rules for corporate governance and documentation of transactions, large and small. The Sarbanes-Oxley Act (SOA) is perhaps the single most important piece of legislation affecting

the corporate world since the U.S. securities laws of the 1930s. The SOA includes rules on corporate governance, financial disclosure, and the practice of public accounting.

- Entrepreneurs must understand that pending FASB proposals point to the expensing of employee stock options value. This has significant implications for an important venture team incentive. The current thinking is to grant fewer options to fewer employees, exercisable at market price or higher.
- Public companies continue to be required to provide faster reporting. The time (from period end) for 10K (annual) reports has been reduced from 90 to 60 days. For 10Q (quarterly) reports, the time has been reduced from 45 to 30 days. This recent regulation change has implications for the quality and quantity of support staff to provide faster turnaround reporting.

3. Monitor the external influences on Human Resources.

- Retirement plans have experienced a sea of change over the past couple of decades. The trend is toward defined contribution plans. Recent tax laws (EGTRRA-2001) provide for a more generous contributive calculation for small business and self-employed. As a result, 401(k) plans have become more attractive options than SEP-IRAs, SIMPLE IRAs, profit sharing, or money purchase plans.
- Laws impacting eligibility for overtime pay have become more restrictive. Senior executives and professionals are generally ineligible, as are employees who earn more than \$100,000 a year.
- The HR group needs to be aware of employees who are “tax avoiders.” These potentially dangerous people falsify W-4 forms for economic or political reasons to avoid paying taxes.
- The strong trend is for employees to share, increasingly, in the cost of health care. Recently enacted laws allow for the tax-free creation of Health Savings Accounts (HSAs) to allow employees to save for medical outlays.

4. Reduce expenses.

- Eliminate certain managed costs. For example, have fewer people take fewer business trips. Instead, utilize more video- and tele-conferencing opportunities. Only the deal-closers need to hit the road for face-to-face meetings.
- Outsource those line items of expense that other firms can guarantee (contractually) to perform cheaper and better. Companies such as Google (where the entrepreneurs’ own start-up money is in the company) show high profitability using out-

sourcing.

- Make high ROI investments to save money. Example: Genzyme’s new HQ building in Cambridge, Massachusetts, is a “green” facility. While it cost 15 percent more than a comparable building, the design is expected to save 38 percent per year in energy costs and 32 percent per year in water costs.

5. Understand that the landscape for raising capital is ever-changing.

- Private funds from individuals increasingly are available through formal “angel” networks or investment clubs; some of which are now managed much like venture capital funds.
- Venture capital is still being held back, but is poised to break loose very soon. Companies need to be prepared to exploit this funding opportunity by having updated financials, business plans, and presentations.
- The going-public (IPO) option is reemerging, with a few wrinkles:
 - o Low-end investment banking firms were largely eliminated in the most recent recession. The \$10 to \$25 million IPOs will now be rare. The larger investment banking firms seek larger deals to generate larger fees.
 - o Performance standards for IPO candidate companies have been eased. Two years ago, revenues of \$60 to \$80 million, with two profitable quarters were required; now, \$35 million in revenue and no profits seem to satisfy underwriters.
 - o Two new forms of IPOs have emerged. The Dutch Auction, employed by Google for example, is an option for well-publicized companies to achieve market-based valuations, while avoiding hefty investment banking fees. A Canadian format—Income Deposit Securities (IDSs)—is designed for low-growth, cash-flow dependable companies. IDSs combine, in one unit, both equity and debt.

6. Personal fortune: Know how to cash-in.

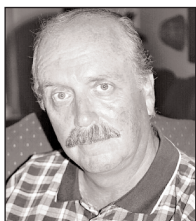
- Exit options for the entrepreneur and the venture team include:
 - o private sale of shares,
 - o private sale of company, and
 - o sale of publicly traded shares.
- Recent changes in tax laws make dividends more attractive (15% tax rate).
- Sale of publicly traded shares by insiders is subject to complex and restrictive SEC regulations.
- Recent changes in estate laws impact inheritance

economics. While the federal government is gradually eliminating the “death tax,” certain states (wanting to maintain a revenue stream) are aggressively restructuring their estate laws, creating separate inheritance taxes that are imposed on heirs rather than the estates. This obviously raises issues for where the entrepreneur wants to establish permanent residence.

In conclusion, entrepreneurs have enlightened self-interest to do the “dirty work” of getting enmeshed in the details of their business, monitoring the external business environment, and grappling with the overall growing complexity of their financial empire.

God is indeed in the details. Regrettably, many entrepreneurs (myself included) tend to be ungodly messy. We are not saintly. We tend to be Oscar Madison-like, as

opposed to Felix Unger-like (the neat one of *The Odd Couple*). Personally, I find administrative housekeeping chores to be distasteful. To a large degree, I have survived by relying on a business partner (the saintly and capable Cindy) who has worked with me for more than 20 years and who reviews every piece of paper that flows through my office. Reliance on another person requires extreme trust and faith. It is all part of the Entrepreneurial Creed. You need not walk the road to salvation alone. Along the way, keep current with both the general business and industry-specific periodicals. If necessary, get an administrative helper/partner/Guardian Angel. Do an organizational audit of all administrative, legal, financial, and accounting activities. In any case, “Just do it!” May God bless all entrepreneurs (and keep the sinful details under control)!



About the Author

JOSEPH LEVANGIE is a Boston-area investor, adviser, and entrepreneur. Over the last quarter century, he has helped launch several dozen new business enterprises from first a large company platform, then from a not-for-profit incubator, and later as a venture adviser, independent entrepreneur, active investor, and passive “angel.”

His companies have competed in a wide array of industries: financial services; renewable energy; uninterruptible power sources; biotech; computer hardware, flex circuits and software; medical lasers; electronic retail color-matching systems; radioactive medical implants; food technology; modular housing; semiconductor equipment; specialty materials; and waste tire recycling. The number of Levangie’s ventures successfully completing an IPO has now reached double figures. He has served on the board of directors of dozens of private and public companies, and has been a guest reviewer at Business Plan contests at MIT and Harvard Business School. Levangie is an active alumnus of both institutions. He currently is vice chairman of Ardour Capital, a NYC investment banking firm.