Entrepreneurial Bootstrapping:

How Businesses Are Really Started Most of the Time (and How to Help Students Prepare)

By:

Dr. Robert J. Lahm, Jr.

Assistant Professor of Entrepreneurship

Jones College of Business

Middle Tennessee State University

What is Bootstrapping?

- Bootstrapping refers to the use of creative techniques and workarounds to address a lack of access to traditional forms of financing.
- Bootstrappers utilize methods such as bartering, sharing, negotiation, drop shipping, locating in low-cost facilities, and do-it-yourself (DIY).

Reasons for Bootstrapping

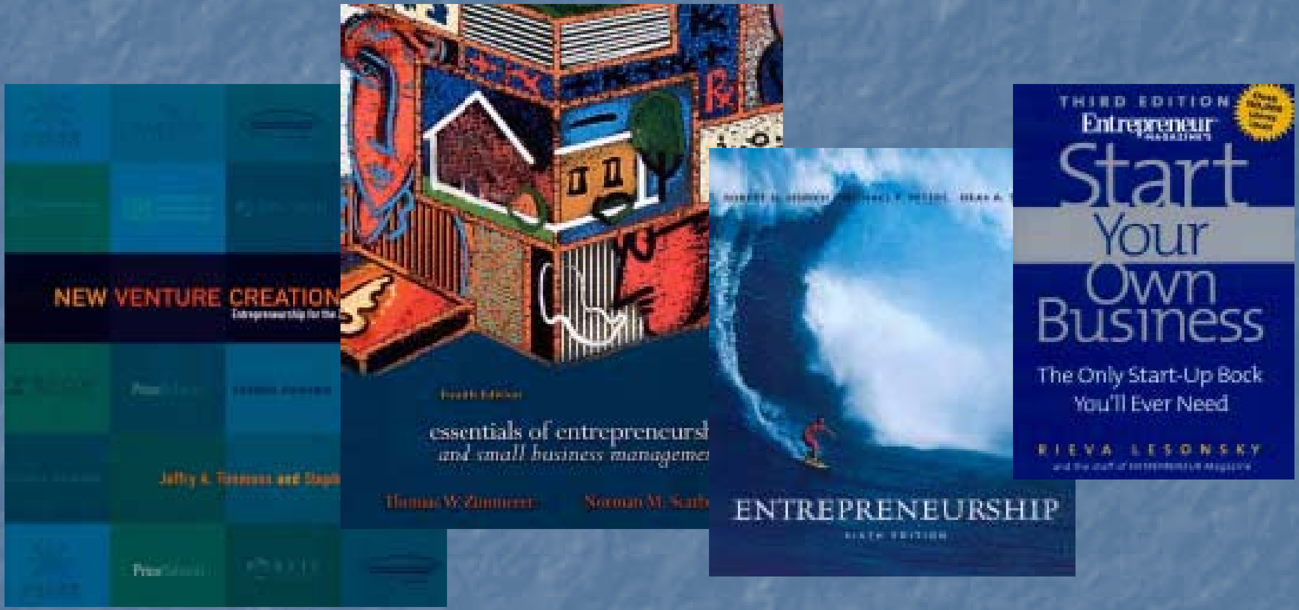
- Entrepreneur may lack the credit needed to acquire traditional loans.

- Bootstrappers may use know-how, imagination, and effort as a substitute for capital (Mamis, 1992; Levinson, 2005).

Self-Sufficiency as Personal Value

- When one accepts capital, he or she must legally and ethically accept that there are certain strings attached.
- “Strings attached” may include giving up decision authority and control.
- Some individuals may prefer self-sufficiency so as to avoid social, legal, or ethical obligations.

Traditional Sources of New Venture Financing Tend to be Emphasized in Popular Entrepreneurship Textbooks.



In Practice, Bootstrapping is the Norm.

Widespread Use of Bootstrapping

- One estimate suggested that 75 to 85 percent of startup businesses use some form of bootstrapping (McCune, 1999, p. 1).
- Bootstrapping is the method most entrepreneurs really use to start the vast majority of businesses (Worrell, 2002).

Start

Small

Think **Big**

- Pick the right type of business.
- Understand off-the-beaten track strategies.

Bartering

- Exchanging one product or service for another in lieu of cash.
- Acquiring a product or service now, in exchange for a promise to provide a product or service in the future.

Bartering

- Trade services for advertising space (very common: known as an “Advertising Trade Agreement”).
- Trade services for rental consideration.
- Provide a product that will be used as a “give away,” so long as you are reaching a desired audience and properly acknowledged.
- Trade services for services, e.g., if you are an accountant, trade with a marketing agency.

Bartering

Three-way trades:

- Party one trades with party two; thus, party one is owed something of value (by party two).
- Party two trades with party three; thus, party two is owed something of value (by party three).
- Party two pays party one with the item or service received from party three.

Locating in Low-Cost Facilities

- Locate in unused portions of facilities for low cost rent or even use your home.
- Eliminate the high cost of rent, lease or mortgage payments; this leaves more money for your business.
- Create a business using “virtual space.” For example, connect several people who are working together in their own home offices by using Internet and telecommunications technologies.

Locating in Low-Cost Facilities

- Use self-storage facilities for extra things that would otherwise be stored in higher cost finished office space.
- Store items with the help of friends and family members.

Note: Caution with these strategies. In the long-run, it may be better to avoid being a "lifelong renter," and having a clearly defined business space may have tax benefits; consult a professional advisor.

Hoarding Assets

Prior to launching a business, acquire and hoard items of value:

- Items should be non-perishable.
- Examples: Office supplies, blank stationery (classic styles), furniture, décor and furnishings, certain types of equipment (technology is typically perishable).

Develop Marketing Campaigns in Advance of Business Launch Date

In the “heat of battle,” during the start-up phase of a business, it can be hard to develop effective marketing campaigns:

- Develop print advertisements, in advance (including the acquisition of necessary art, typesetting and production materials: “A.B.P. – all before press”).
- Buy a used, portable trade show booth, customize when ready.

Develop Marketing Campaigns in Advance of Business Launch Date

- Develop other “mini-marketing” materials, in advance, such as post-cards, door hangars, newsletter templates.
- Pre-print certain marketing pieces with static content; over-print dynamic content.
- Collect stock art and photography, stock music, and other production resources.
- Pre-write press releases (especially standard announcements).

Develop a Customer Base Prior to Business Launch Date

- Develop customer history and references in advance. For example, handle several projects as a freelancer, then “officially” launch the business.
- Create a portfolio and/or work samples as an independent contractor, then launch the business. Examples: decks, decorating projects, photography portfolios.

Be a “Matchmaker”

- Somebody already has a product, but they need customers.
- A start-up bootstrapper knows how to promote and find customers, but doesn’t have a product.

It’s time to play: Matchmaker! You’re in the middle.

Hybrid example: Private label products made by someone else.

Bootstrap Capital Resources

- Bootstrappers use a wide range of resources including credit cards, home equity lines, retirement funds, severance packages, negotiated supplier repayment terms, internally generated cash flow, and money from friends, relatives, or personal savings (Pliagas, 2005; Roberts, 2003; Mamis, 1992).

Credit Cards as a Source of Start-up Capital

- A large percentage of the smallest firms are forced to use personal credit cards because of limited availability of loans.
- The use of owners’ loans and personal credit cards typically levels off or diminished as firm size increases.

- 57% of Small Business Owners Use Personal Credit Cards For Their Small Business (Industry Research Sponsored by MasterCard).

- Personal Credit Cards are “Fast, Cheap, and Easy” (Inc. Magazine).

- Business Founders May Leverage Multiple Cards, “Possibly 14 or 15!” (Wall Street Journal).

- “Good Old-Fashioned Plastic” remains “Plentiful Even in Tough Times” (Entrepreneur Magazine).

Other Credit Card Facts

- Over 80% of small businesses surveyed used some kind of credit and had outstanding debt on their books at the end of 1998.
- 55% of small firms had some kind of traditional loan, while 71% obtained credit from non-traditional sources, mainly owners' loans and credit cards.

“46% of small businesses used credit cards in connection with their start-up or ongoing operational costs” (findings similar to those of the MasterCard sponsored research—Federal Reserve Board, Report to the Congress, 2002).

However, numerous observers contend, the practice is risky.

Discouraged Borrowers

- Entrepreneurs who do not apply for a loan because of fear they will be rejected.
- These borrowers may or may not have been successful (if they had applied).

Speed and Convenience

- Bootstrapping, in its various forms, is faster and easier than suffering through a “chilly reception” from bankers (Rosenfeld, 1999, p.1).
- By leveraging credit cards (Deceglie, 1998; McCune1999) business founders can gain access to relatively large amounts of capital in comparison to the size of a business startup loan.

Speed Bump Ahead: If You Must Use Credit Cards, Think Like a Banker

- Bankers only lend to those who have the wherewithal to pay back. Hence, if you do use credit cards, make sure that you have the liquid assets to repay them, upon demand.
- Credit cards are sold with images of prosperity and economic freedom. But, they are repaid under terms of economic servitude, and through punitive, adversarial relationships.

Speed Bump Ahead: If You Must Use Credit Cards, Think Like a Banker

- The credit card industry is predatory and constantly regulated as a result. In between those times, it abuses its customer base.
- Interest rates have been at all-time lows; credit card rates have been at all-time highs (especially so called non-preferred or default rate classes).

Speed Bump Ahead: If You Must Use Credit Cards, Think Like a Banker

- The credit card industry is constantly sued and regulated for what amounts to trickery. Payment due dates have been set on holidays or weekends, and regular monthly due dates are changed, so as to ensure that some customers will be late.
- According to a PBS report, the credit card industry receives more complaints than any other industry.

Conclusion

- Bootstrapping is the way entrepreneurs really start and operate businesses.
- Most businesses are founded by bootstrappers.
- Creative techniques, avoiding risky behaviors, and working far in advance, can maximize the chances of success.

Questions