

BOOTSTRAPPING BUSINESS START-UPS: A REVIEW OF CURRENT BUSINESS PRACTICES

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Abstract

Existing scholarly research on bootstrapping is limited, despite the widespread use of bootstrapping strategies in actual practice among start-up entrepreneurs. This paper discusses bootstrapping as a creative financing strategy. Bootstrapping has been advocated in, and documented by, the popular business press. Two methods that broadly address bootstrapping are identified and discussed. These two methods include the acquisition and control of resources (both tangible and intangible), and the efficient uses of those resources to finance the enterprise for growth. Examples of bootstrapping activities are presented to illustrate each method. The paper also provides a short-list of practical suggestions for bootstrapping start-up businesses.

Introduction

Bootstrapping is entrepreneurship in its purest form. It is the transformation of human capital into financial capital. The overwhelming majority of entrepreneurial companies are financed through this “highly creative” process, which involves the use personal savings, credit-card debt, loans from friends and family, and formal sources of private equity (Freear, Sohl, and Wetzel, 1995).

The entrepreneurship academic community has not fully recognized the effect of bootstrapping on entrepreneurial behavior and organizational success through formal research. Bhide (1992) suggested that the success of an enterprise hinges on the ability of its owner(s) to create and leverage financial resources. There appears to be a dearth of studies in the entrepreneurship literature that focus on the use of resources that characterize the bootstrapping process, such as obtaining start-up working capital from personal credit cards or home mortgaging (Cole, Lahm, Little, & Seipel 2005).

This paper discusses two methods which broadly address the four types of bootstrapping options (i.e., bootstrapping product development, bootstrapping business development, bootstrapping to minimize the need for (outside) capital financing, and bootstrapping to minimize the need for capital) identified by Freear, Sohl, and Wetzel (1995) and Winborg and Landstrom (1997). The first method involves the acquisition and control of resources (both tangible and intangible). The second method involves the efficient uses of those resources to finance the enterprise for growth. Examples of bootstrapping activities are presented to illustrate each method.

Bootstrapping in textbooks and on the Internet

Academic textbooks used primarily in college and university entrepreneurship courses seldom provide in-depth coverage of bootstrapping. Bootstrapping is often characterized as a means to an end when other choices (i.e., formal venture capitalists, banks, and angel investors) do not exist. While bootstrapping techniques are widely used by entrepreneurs of all types, little more than a passing mention is made in many of today’s textbooks. Many devote just a few paragraphs or pages to the subject.

A series of Internet searches of the academic literature revealed that rigorous study of bootstrapping, as a serious variable in entrepreneurial success has been minimal. The searches conducted on databases used by *Proquest* revealed the scarcity of scholarly research on bootstrapping. While parameters for the searches were set to select only scholarly journal articles with full-text availability, the low number of articles selected from *Proquest* databases suggests an opportunity for future studies of bootstrapping as an antecedent to entrepreneurial success.

The results of a broader Internet search encompassing the business press, practitioner journals, and magazines revealed the term, bootstrapping, has different meanings to different contexts. A *Google* search on the term “bootstrapping” returned 650,000 hits. A brief review of the 650,000 hits showed that an indeterminably large number of these hits pertained to homonymic variations, which apply to computing, statistical method, and meanings other than that which pertains to business start-ups. An advanced search algorithm using the words “bootstrapping” and “business” together produced 129,000 hits.

Bootstrapping as a Start-Up Financing Strategy

While numerous articles appearing in periodicals such as *Entrepreneur* and *Inc.* tend to suggest bootstrapping can be risky, they nevertheless also emphasize that the vast number of start-up businesses utilize bootstrapping techniques. Interestingly, academic research has suggested that bootstrapping techniques can minimize risk because of the absence of outside venture capital investors (Carter, et. al., 2002). Although the percentage of start-ups that actually use bootstrapping quoted by Worrell (2002) in *Entrepreneur* magazine might be disputed as a figure of speech, he wrote:

Despite the dream of some entrepreneurs to meet a VC with deep pockets, the fact is that 99.9 percent of business owners will struggle alone, pulling themselves up by their bootstraps. That is not necessarily a bad thing. With a little luck and a lot of pluck, bootstrapping a business can be both financially and emotionally rewarding. (p. 1)

McCune (1999) quoted Tom S. Gail's, executive professor at the University of Houston's Center for Entrepreneurship and Innovation, who estimated that "between 75 percent and 85 percent of startups use some form of bootstrapping to help finance themselves" (p. 1). Although the number of start-up businesses that rely on bootstrapping may be difficult to determine exactly (and may fluctuate based on economic conditions and other factors), it is evident that a substantial number, constituting a majority, engage in the practice. Previous scholars have studied the use of bootstrapping (Van Auken, 2004), as well as differences among firms and consequences of various start-up financing strategies (Van Auken & Neely, 1996). Van Auken observed a "serious gap in the literature" (in apparent concurrence with the authors of this paper) and stated that "research on the use of bootstrap financing is limited" (Van Auken, 2005, p.95), even though "bootstrap financing is a common source of financing" (p. 146). Hamilton (2001) has written about the culture of self-funded e-commerce firms. He identified self-funded entrepreneurs as "classic 'bootstrapping' types, often using credit cards, second mortgages, or retirement funds to bring a dream alive" (p.279).

In the months prior to 911, the handwriting was on the wall and what had been popularly known as the "dot-com frenzy," was coming, or did come, to an end. In a July 21, 2001 article published in the *Fedgazette* (a publication of the Federal Reserve Bank of Minneapolis), Wirtz reported "nervousness" (p. 1) about the new economy and observed efforts to expand the availability of venture capital. The exact moment in time when the so-called "bubble" burst may be the subject of some debate among economists. However, what has transpired post-911, is a radical tightening of venture capital availability, and hence, even more bootstrapping efforts on the part of entrepreneurs. Roberts (2003), in an article titled "*Bootstrapping is back: Entrepreneurs dig deep and make personal sacrifices for their businesses,*" observed: "Entrepreneurs were spoiled during the dot-com era, often receiving funding before they had a business model or a customer, in the past two years, however, venture backers have become much stingier, especially with seed money" (p. 44). Whatever the state of the economy is, has been, or will become, the use of bootstrapping among nascent entrepreneurs can be logically predicted, or observed through formal study. In other words, when there are no other sources of capital to be found, bootstrapping becomes the method of choice (Freear, Sohl, and Wetzel, 1995).

Cole, Lahm, Little, & Seipel (2005) observed the scarcity of academic research on the use of credit cards by entrepreneurs and small business owners, despite the widespread use of credit card financing in actual practice. The Federal Reserve Board has estimated that 46% of small businesses include credit cards as a source of start-up capital and provider of cash for ongoing operations (Report to the Congress, 2002). Some entrepreneurs parlay multiple cards to amass significant funds, such as a Los Angeles entrepreneur and his partner, who used 10 Visa and MasterCard accounts and accumulated \$40,000 in debt (Deceglie, 1998). The entrepreneurs subsequently reported having a thriving business (that was also paying high interest credit card debt). An online article from *morebusiness.com* (Charge wisely, 2004) admonished that reliance on credit cards could be "dangerous," but then offered "nine rules" for using credit cards to finance a start-up business (p. 1). Besides leveraging credit cards, self-funded entrepreneurs tend to utilize personal resources (Longnecker, Moore, and Petty, 2002) and whatever additional creative strategies may be at their disposal.

Bootstrapping Methods

However one might approach a discussion of bootstrapping, simply put, there are only two basic methods employed by nascent entrepreneurs: 1) gaining control of resources, and 2) efficiently utilizing resources (e.g., minimizing expenses). Taken together, these two methods form the basis for an overall strategy. A bootstrapping entrepreneur's very survival may well depend on his or her ability to be highly adaptable and operate on a shoestring budget (Goodman, 1996; Pliagas, 2005; Willcocks, 2002).

Bootstrapping Risks and Advantages

“When everybody says ‘no’--from the banker to the private investor--the tough small business owners turn to themselves....they raise money from within by bootstrapping” (McCune, 1999, p.1). Because bootstrappers have no choice except to be resourceful, they may have an ironic advantage over other individuals who hail from more resource-rich environments in terms of developing their managerial and entrepreneurial skill-sets. To a certain extent, being deprived of resources forces (Bhide, 1992) the entrepreneur to find other inventive ways to make-do (or do without). For instance, a traditionally funded organization with more assets is in a better position to offer open credit terms to its customers. Bootstrappers, not being in the same position to bankroll the operations of customers, may conversely be compelled to negotiate for payments (or a portion thereof) in advance (McCune, 1999). For anyone who has experienced the not so pleasant situation of having to collect on a past due account, the sound of “ching-ching” in advance is most reassuring.

Bootstrappers may also consciously consider strategies that can actually reduce risks associated with their entrepreneurial pursuits. By purposely opting to create a business that provides services and requires little or no inventory, the entrepreneur, who does not have access to traditional (i.e., external) funding sources can make the business more “bootstrappable” than others (Mamis, 1992). However, bootstrapping entrepreneurs may tend to cut corners too close in areas such as property insurance (Sekula, 2005) and by foregoing health insurance. Another pitfall of being in a constant “do-it-yourself” mode is that the entrepreneur may spend too much time learning to perform or performing tasks that are worth less than other tasks. For instance, if meeting with a prospective customer could possibly generate a \$5000 sale, and yet the entrepreneur is too busy performing a more menial task such as bookkeeping or copying documents (tasks that could easily be farmed out), then the business may not ever realize its full revenue potential.

There are manifestations of bootstrapping that are not high risk at all; indeed, these methods—properly envisioned and executed—may actually reduce risk to a bare minimum. Publishers’ of *Who’s Who*-type directories have employed this tactic successfully. The scenario works as follows: (1) identify a special interest group or category; (2) solicit individuals for inclusion in an upcoming directory; (3) congratulate or otherwise flatter the individual for his or her achievements (and thus, eligibility for inclusion); (4) offer a pre-publication discount for ordering an advance copy of the directory; (5) collect the money for the purchase(s); (6) pay the printing bill (supposing 5,000 advance copy sales at \$125.00 each, paying the printing bill is easily attainable); (6) ship the printed book; (7) repeat the process with more prestigious or alternate books. According to book industry consultant John Kremer (1998), other directories “come in at least 57 varieties” (p. 53) and can “form the foundation for an entire line of related books” (p. 52); these books may also require annual updating, and thus create a perennial sales cycle. Accordingly, risk is reduced as a result of a business model under which money is collected in advance of the service being provided.

Methods for Gaining Control of Resources

A hybrid of selling a product or service up-front is to pre-sell a promise of performance, and a specific example would be the sale of gift certificates, prior to providing (or even having the capacity to do so) a product or service. Detamore-Rodman (2003) chronicled the instance of entrepreneur and founder of The Chocolate Gecko, Lissa D’Aquanni, who employed the tactic:

In 1999, the cash-strapped chocolatier needed molds and a temperer for the Christmas rush. Recalling a strategy she had seen in a magazine, she sold discounted gift certificates to raise capital. D’Aquanni offered customers \$25 in free chocolates for every \$100 in gift certificates purchased. Within two weeks, she had \$5,000 for the equipment purchase. ‘A lot of folks mailed them as gifts to friends, family and co-

workers,' D'Aquanni says. 'And most of those people ordered chocolates. My customer base exploded'....D'Aquanni routinely barter to pay for professional services for her business; both her accountant and Web site designer accept chocolates in exchange for their services.

Another method that bootstrappers can utilize is to identify those individuals or organizations that stand to gain, and enlist them as participants in the enterprise. Small businesses, especially those started from a home-based location, often suffer from an image problem. Mamis (1992), writing for *Inc. Magazine*, wrote about an entrepreneur who satisfied this problem in a unique way, by trading office space in exchange for potential gain that the host business might incur:

'One thing I realized very quickly is that people want to see fancy offices, fancy letterhead, fancy everything,' says founder Michael Kempner of MWW/Strategic Communications Inc., in River Edge, N.J. He did not have fancy anything, but he had a friend in advertising who did. Kempner moved into the friend's office at no expense, on the quid pro quo understanding that his public-relations firm would steer advertising in the friend's direction. He even moved in on the ad company's name: 'I put a slash on it, added "Strategic Communications," and looked like I was part of a big company. It was all a mirage at the beginning. As far as my clients knew, here I was with a fancy name in a fancy office. Those were important, or people would not hire me. This way, they came upstairs and saw 40 employees, and thought they were working for me. I never told clients those people didn't work for me, and they never asked.'"(p.7)

Bootstrappers do not just concentrate on ways to raise cash through leveraging financial resourcefulness (such as by using credit cards, home equity loans, and so forth), they often think of clever ways to bring a plethora of resources into their businesses. Mamis (1992) identified these practices as "the distinction between capital-dependent and wit-dependent commerce" (p. 1). Manifestations might mean gaining access to people and their talents, inventory (e.g., on consignment), shared office space, and just about anything else through bartering. Local media are accustomed to bartering advertising with small and large companies, and many do it so often that they have standard contracts and are ready to trade on a moment's notice—they also trade with one another.

Bootstrappers may find help in the form of labor by trading on skills (the combinations are virtually endless) or banding together to form larger teams. For example, small advertising agencies frequently employ this technique by hiring out video production, design, market research, and numerous other services. Even three-way trades are possible: a magazine may provide advertising for a resort property or restaurant on trade; after accumulating trade credits, that magazine might in-turn satisfy one of its payment obligations by offering a stay at the property or dinner in lieu of cash payment. (Some crossover between gaining control of resources and minimizing expenses as discussed in this paper is unavoidable.)

Methods for Minimizing Expenses

Arora (2002) suggested, "Dedicate yourself to becoming a frugal minimalist, and you'll be well on your way." The popular author of the "Guerilla" series of books (seminars and ancillary products) Jay Conrad Levinson observed:

By understanding that economizing does not mean saving money, but investing it wisely, guerrillas test their investments on a small scale before plunging headlong into any kind of marketing. They have no fear of failure, providing the failures are small ones and knowing that even one success in ten tries means discovering a path to wealth and profitability. They know in their hearts that money is not the key to happiness or success, but that enough of it enables them to have a key made. Real frugality is more about priorities and results than just saving money. (p. 1)

As Levinson suggests, bootstrapping companies can reduce risk and minimize expenses (by taking smaller chances and making better decisions) in the same ways that large organizations ensure their successes, through research--before charging headlong into anything, not just marketing. Montana State University has created a program administered through its Center for Entrepreneurship for the New West that assigns student interns to technology businesses at the incubation stage of their development. The executive director of TechRanch, an associated organization that implements the incubation program stated: "If you are a young company in a heavy bootstrapping mode, getting pro-bono research is a big deal....the student interns get credit and real world

experience. Our clients get free research. It is a good match” (Schmidt, 2004). An initial reaction to the dictum to save money is to pay a lower price for purchases. While buying cheaper may have its benefits, spending wisely and purchasing with scalability and longevity in mind can be another way of economizing. Regarding the preparation of marketing communications materials, Levinson advised: “When you say in a brochure that you’ve been in business five years, you must update that brochure next year. When you say you’ve been in business since 1995, that’s always going to be the truth” (p. 1).

On the spending side of the equation, nascent entrepreneurs may minimize expenses by being taught to think differently about various business models. On the Internet, there are single-person businesses using technologies such as auto-responders, fully automated shopping carts with merchant processing, automated affiliate programs, drop shipping of tangible goods or digital delivery of intangible goods, and additional outsourced services (e.g., Web hosting). Some of these individuals are generating significant incomes, often by selling or reselling information products “twenty-four hours a day without any intervention on ...[their] part” (Kremer, 1998, p. 338). Entrepreneurship courses (and the stories told by entrepreneurs) may tend to portray a one-size-fits-all, life-consuming image of entrepreneurship relative to business models, business plans, and notions of bigness and growth; it might be argued that micro, self-sufficient, virtual, part-time (or non-labor intensive), and automated are desirable characteristics of a business model.

Bootstrappers should probably avoid capital investment in virtually any item that can be outsourced. Common advice is to lease, not buy (Arora, 2002). However, advice that is more practical may be to minimize any long-term obligation if external production resources are available. Any kind of hardware is notorious for depreciation, yet entrepreneurs often buy or lease expensive copy machines, computers, phone systems, and other capital items that might be outsourced through a copy center, secretarial service, and answering service, respectively. A perfect example is Web hosting, which is available for less than five dollars per month, thereby making the purchase, or lease, of a server costing in excess of \$2,000 hard to justify.

A Short-List of Practical Suggestions for Bootstrapping Business Start-Ups

The authors of this paper offer the following suggestions (in no particular order):

- 1) Start-up entrepreneurs with little capital should be advised to strongly consider a business model that entails compensation prior to the delivery of a product or service (e.g., consulting, mail order, or niche oriented Internet businesses that do not require a glitzy Web site).
- 2) An emphasis on pre-launch preparations, perhaps several years in advance may be wise.
- 3) More education and training are needed for would-be entrepreneurs such that they are more familiar with traditional sources of capital and non-traditional sources. Bootstrapping should be a course unto itself in university level entrepreneurship programs.
- 4) Stockpile non-perishable business assets over a long period of time. Businesses that have resulted from a hobby often start out with many of the necessary tools, contacts, sources, and skills on the part of the owner to be well equipped from their inception.
- 5) Conduct enormous amounts of research: library research, bookstore research, Internet research, and especially field research (the non-scholarly translation of field research: network, network, network, with prospective suppliers, customers, advisory board members, and other potential friends of the business).
- 6) Consider an agency or brokerage-type business: connect a party who needs to sell, with a party who needs to buy.
- 7) Get quotes. Provide a vendor with a general idea of a needed end result for a manufactured product (or a service) and ask for design specifications, pricing, projected delivery schedules and terms (be sincere as a prospective customer).

- 8) Negotiate terms carefully. Negotiate terms for purchases from vendors and sales to customers. When possible, arrange the purchase-sales sequence in a way, that customers finance the purchase of inventory through prepayment terms.
- 9) Choose a location wisely. Consider the “image” needs of the business, but also seek economic development dollars (or stakeholders) and co-location opportunities in neighbors with synergistic potential. Do not choose a location because it is close to home and convenient for the owner. It must be convenient for the customer, for the logistical needs of the business, and in a nurturing environment.
- 10) Advertise a product that could be produced, if response to the ad justifies its production.
- 11) Develop business communications and media skills. Be worthy of media attention (i.e., be newsworthy) due to a unique product, company history, team, or even aspiration.
- 12) Be generous. People are willing to follow a leader who understands their needs, and fulfills those needs.
- 13) Sell in volume at wholesale, rather than one unit at a time (Mamis, 1992).
- 14) DIY (Do-It-Yourself).
- 15) Read.

Conclusion

Mamis (1992) observed, “there’s no course book of bootstrapping techniques, but there ought to be....the approach has much to teach--and even companies that have progressed beyond their bootstrap days would do well to relearn some of the proven tactics” (p. 2). Van Auken (2005) has suggested that small business owners lack familiarity with sources of capital, and this influences their capital structure. However, it is also evident that raising capital from banks, venture capitalists, and other traditional sources for initial capitalization can at the very least, be difficult in the absence of a substantial inducement to join the entrepreneur’s cause in the form of investors’ potential for gain, collateral, or both. Conversely, it does not seem adequate to send would-be entrepreneurs an abstinence message with respect to some of the more risk-prone methods that they might employ, or simply admonish that bootstrapping is fly-by-night as compared to conventional wisdom (e.g., write a business plan, impress a banker). The authors of this paper offer the following suggestions (in no particular order):

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