Six Tips for Allocating Startup and Seed Capital

Arthur F. Rothberg, Managing Director, CFO Edge, LLC

Raising capital is a big challenge for many Southern California business owners and executives, especially those seeking startup and early-stage financing and seed funds. But getting the money is often just the start of things — owners and entrepreneurs often find it just as challenging to determine how to best *spend* the capital they raise.

During the go-go days of the dot.com boom, many new Internet and technology firms were notoriously loose with how they spent their startup capital. In order to attract and retain the young, talented, tech-savvy employees they needed to grow, many spent big bucks on lavish employee perks like indoor basketball and racquetball courts, game rooms with pool and foosball tables, and practically unlimited free food for staffers.

Some of these companies survived and thrived — think Google, eBay and Amazon, for example — but many more failed. The reasons for these failures were varied, not the least of which was often a flawed business plan that treated profitability as optional. But there's little question that poor decisions with regard to the allocation of startup and early-stage capital was high on the list of causes of these business failures.

Narrowing Down Priorities

Despite the very public failures of many of these dot.com startups, misallocation of capital continues to be a common mistake among many startup firms today. This includes not only Internet and technology firms, but businesses in virtually every industry across the board.

One of the most important responsibilities of startup entrepreneurs is to make smart decisions when it comes to allocating capital. There are literally dozens of "priorities" staring you in the face, but it's your job to narrow these down and decide which ones will benefit the most from the limited capital at your disposal. Here are six suggestions to help:

1. Don't spend capital you don't have yet. This should go without saying, but we'll say it anyway: Don't start spending money that isn't actually in your bank account yet. Sometimes, ambitious startup entrepreneurs get ahead of themselves when it comes to raising capital. A pledge of capital to your business isn't the same thing as a signed check. You shouldn't commit to spending any capital until the check is cashed and the money is in your bank account.

2. Establish financial discipline right from the start. When they receive a large lump sum of capital from one or more investors, it can be easy for startup entrepreneurs to get a little careless with it. The key is to commit to sound financial discipline and accountability from day one. Capital allocation decisions should be made by a team of managers and executives, not by any one individual (including the founder himself or herself).

3. Create a spending plan/budget. The first thing this executive team should do (even before the money is in the bank) is draft a plan or budget that spells out in detail how raised capital will be allocated. The plan doesn't have to be cast in stone — it can be adapted as time goes on to reflect changes in the business, industry or competitive environment. But having a spending plan in place before even the first dollar is raised will provide an overall vision for capital allocation and emphasize to everyone that the company takes spending seriously and does not intend to waste precious capital resources.

4. Don't scrimp in areas where you need to spend. Sometimes, startup entrepreneurs go to the opposite extreme and pinch pennies in areas where they should be willing to spend freely. The spending priorities for every company will be different, but it often makes sense to allocate capital during the startup phase toward initiatives that help you hire the best employees you can afford, better understand your customers and build a solid corporate infrastructure that will last over the long haul.

5. Be honest with your stakeholders. Startup entrepreneurs tend to be optimistic and passionate by nature — if they weren't, they would never be able to take on the risks and demands that accompany what they do. But this natural tendency toward optimism should not temp you to try attract employees, vendors and other stakeholders by representing your company's capital position and intentions with anything less than full disclosure and honesty.

6. Remain objective about your company's financial condition. This dovetails with the previous point. Your natural optimism and passion about your business and its products and services could cloud your judgment when it comes to allocating capital. Be willing to take off the blinders and see your company's financial condition for what it really is — whether this is good, bad or somewhere in between. Then make capital allocation decisions based on this objective viewpoint.

Concluding Thoughts

For Los Angeles and Southern California executives seeking startup and early-stage capital, getting the money is often just the start of their challenges — determining how to best *spend* the capital they raise can be just as difficult. Despite the very public failures of many of dot.com startups due to misallocation of capital, this continues to be a common mistake among many startup firms today. One of the most important responsibilities of startup entrepreneurs is to make smart decisions when it comes to allocating capital. An outsourced CFO services provider can help you narrow down the dozens of priorities that are screaming for attention and decide which ones will benefit the most from the limited capital at your disposal.

About CFO Edge

CFO Edge, LLC delivers enterprise-class financial and operational performance solutions to executives at small and mid-sized companies in Southern California. Based in Los Angeles, our formerly-seated chief financial officers engage on demand as part-time CFOs, single-project CFOs, and interim CFOs to help business leaders successfully resolve pressing challenges and realize their financial and operational goals. At CFO Edge, we're passionate about helping our clients create, grow and sustain value. For more information, visit www.cfoedge.com or call 800.276.1750 Ext 101.