A Test for the Fainthearted

by Walter Kuemmerle

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A Test *for the* Fainthearted

Starting a business is rarely a dignified affair. Do you have the guts – and the mind-set – to take on the challenge?

by Walter Kuemmerle

Three years ago, almost anyone could have been an entrepreneur; all you needed was a hot – or even lukewarm – idea. Billions of dollars went into ventures hatched by fresh-faced youngsters with, at most, a couple of years' experience at pricey consultancies or high-tech companies under their belts. So they had little business experience? No problem; they could always find a grown-up, like eBay CEO Meg Whitman, to handle the operations. Not surprisingly, many young people came to believe that entrepreneurship was a safe career choice. More than a few of their elders, too, underestimated the risks involved in financing start-ups and ended up pouring millions of dollars into doomed ventures.

The economic downturn has shattered those illusions. Now, as we sift through the debris of hundreds of failed Internet companies, it's a good time to ask the hard questions that many would-be entrepreneurs – and those who bankrolled them – overlooked in the heady days of the boom: What really makes an entrepreneur? What characteristics set successful entrepreneurs apart, enabling them to start ventures against all odds and keep them alive even in the worst of times? Do you have those characteristics, and if you don't, can you develop them?

The truth is, real entrepreneurship is a far cry from managing an established business and farther still from the sanitized model that became popular during the late 1990s. Over the past five years, I have studied more than 50 start-ups – some successful, some not – in 20 countries. My research has uncovered intriguing similarities in ways that successful entrepreneurs behave, similarities that hold true no matter the country or industry involved. Winning entrepreneurs feel comfortable skirting the boundaries of propriety. They are passionate enough about their ideas to assume enormous personal risks – powerful enemies, bankruptcy, even jail – to realize their dreams. However grand their visions, they are ready to start small and patiently scrabble in the mud for any deal they can swing. Profoundly opportunistic, they will do whatever it takes to win the confidence of their customers and investors, knowing that simply staying in business is the only thing that matters.

I've distilled my findings into five straightforward, if discomforting, questions that I see as a kind of litmus test for the potential entrepreneur. By posing these questions to yourself – and answering them with complete honesty – you can help yourself begin to understand if you have what it takes to be an entrepreneur.

Are You Comfortable Stretching the Rules?

All businesspeople have to be a little devious at times – it goes with the territory. But entrepreneurs are different. They're not just willing to bend the rules; they revel in it. In fact, most start-up success stories I've heard contain at least one episode of an audacious entrepreneur using some outrageous tactic to swing a crucial deal or find the resources to get an idea off the drawing board.

Consider the case of two young entrepreneurs who were trying to set up a mail-order business in the late 1990s. A venture capital company had given them seed money, and they needed to quickly recruit a team of two dozen seasoned marketers to create the first catalog. But the entrepreneurs hadn't rented an office yet. Equipped with only a cell phone and computer each, they were working out of their bedrooms. Since the labor market was tight, they knew that the best talent would not bother to show up for interviews unless they could present their company as an established concern. So the enterprising duo decided to live two white lies.

First, they published a large ad in their country's leading business newspaper describing themselves as a "fast-growing multinational company." Although this statement wasn't exactly true, it wasn't false either, since, the entrepreneurs reasoned, they *planned* to expand into other countries in the region. And the ad worked: More than 1,000 applicants responded to it. With résumés in hand, the entrepreneurs rented a plush suite for one day at the local Four Seasons and interviewed selected candidates there. Their deceptions, the entrepreneurs believe to this day, heightened the company's appeal and thereby attracted talented people. And that, in turn, increased the chances of the business's success. For the record, by 2001 the company had 600 people on staff and had indeed become a fast-growing multinational concern.

Do you have the stomach for such subterfuge? What if it puts your livelihood at risk or threatens your family's financial well-being? Since start-ups operate on shoestring budgets, entrepreneurs often have to take big chances with their finances. Many have kept their businesses afloat by juggling personal credit cards or borrowing against their homes – without worrying much about the consequences. Fred Smith, the founder of Federal Express, is celebrated for his financial inventiveness. On at least two occasions, he used creative financing to rescue his fledgling parcel delivery company from bankruptcy. In 1973, when FedEx was on the verge of going belly up, Smith's shenanigans landed him in court and almost got him sacked by his board. He was accused of knowingly making a false statement in order to obtain a $2 million loan from the Union National Bank of Little Rock in Arkansas.

Smith was acquitted, but it was a close call, and the experience taught him a salutary lesson all entrepreneurs should remember whenever they find it necessary to embellish the truth: You can bend the rules, but you can't break them.

Are You Prepared to Make Powerful Enemies?

In general, smart entrepreneurs prefer to go after market niches that incumbents have overlooked. But they are not afraid to make powerful enemies. In fact, they often enjoy playing the underdog because, unlike many people, they don't crave approval. The size of their rivals doesn't bother them much either, and I've seen a number of smart entrepreneurs win by finding cunning ways to use their enemies' own strengths against them.

Aleksandar Mandic embodies this pattern of behavior. In 1993, he started Brazil's first Internet access provider, the eponymous Mandic, and quickly built a small but growing subscriber base. The business began to boom as Brazil woke up to the Internet's potential, and by the mid-1990s, several competitors with deep pockets had entered the market. Among the new players was Universo Online (UOL), a joint venture between two of Brazil's largest communication companies, the Abril Group and the Folha Group. The latter owned *Folha de S. Paulo,* Brazil's largest-selling newspaper with a Sunday circulation of 1 million. UOL began with a splash: One Sunday morning in June 1997, every copy of *Folha* came bundled with a free CD. It was affixed to a full-page ad that extolled the virtues of using the CD to dial up and subscribe to UOL's Internet service.

Mandic could not afford to take on UOL by distributing a million free CDs of his own, even if he had the time to do so. He decided to fight back, but in an imaginative – and cost-effective – way. The following Sunday, Mandic published his own full-page ad on the same page of *Folha* that had contained UOL's ad. It didn't include a CD but provided detailed instructions on how to use the UOL CD to connect to the Internet – this time by subscribing to the Mandic service. The dueling ads became a topic of conversation, especially on the Internet, and everyone marveled at the way Mandic's company had upstaged its much larger rival.

UOL was furious, particularly since it shared a parent company with *Folha*. It complained, and the newspaper's executives agreed to never again run Mandic's ads. But this threat didn't faze the company's leader. He seized on the ban to launch a public campaign against

Folha's policies and the newspaper's tight links with UOL. For months, *Folha's* rivals were only too happy to keep the controversy alive, and Mandic won enormous popular support as the entrepreneurial David who had taken on a media Goliath.

Do You Have the Patience to Start Small?

In 1999, Tom Herman and Kaleil Isaza Tuzman, best friends since childhood, quit their comfortable jobs to start govWorks, with millions of VC dollars to back them up. Their goal was nothing if not grandiose: to use Internet payment systems to transform the way federal, regional, state, and local governments worldwide collected fees and taxes. To use the company's own phrase, govWorks was about "all payments for all governments." (The film *Startup.com* featured the company.)

Soon after Herman and Tuzman set up shop, they approached a venture capitalist for additional funding and for advice. He suggested that the company test and refine its business model by initially focusing on one payment operation, for parking tickets, in one U.S. city. The entrepreneurs almost bit off his head. "The leader in this market space is going to be a multibillion-dollar company," Tuzman declared. He believed that by winning the support of umbrella organizations that represent many municipalities, such as the U.S. Conference of Mayors, govWorks could quickly go nationwide. But it didn't work out that way. Tuzman and his partner underestimated how little the cities actually trusted the endorsements of the umbrella organizations. The big contracts did not come as quickly as the founders had expected, and in early 2001, the company was no longer in business.

GovWorks's failure is a textbook example of the perils of grandiosity. Smart entrepreneurs recognize that start-ups cannot afford to pass on any opportunity, no matter how small. They see business much like a game of PacMan – you can bag big fish only by learning to swallow small ones. The best entrepreneurs also recognize that trying out a business model on a small scale helps them find out what their industry is about and lets them make mistakes at those times when they can still afford it. Growth, when it comes, is all the more sustainable as a result.

Back in 1987, Leopoldo Fernandez Pujals, a corporate veteran with 20 years of experience at the likes of Procter & Gamble and Johnson & Johnson, decided to set himself up as Spain's first pizza magnate and founded TelePizza. He believed that customers in Spain – and, indeed, throughout Europe – would respond enthusiastically to a branded chain that offered home delivery, as Domino's does in the United States. Pujals recognized, however, that he knew little about making pizza or delivering fast food, let alone how such a business might function in the Spanish market. So he decided to start small, with a single shop in Madrid. In this way, he reasoned, he would be able to experiment with the economics and logistics of a pizza business and gain firsthand experience of his customers as well.

The outlet was an instant hit, but Pujals resisted the temptation to immediately replicate it. He waited a year before opening a second shop, and the delay paid off, because he had a much clearer idea about what would and would not work after his initial experience. During that first year, for instance, he found that Spanish customers felt more comfortable ordering takeout pizza once they had consumed one on the premises. So, in contrast to the setup at Domino's, Pujals included an eating space in his store and experimented with the dining area's size and décor. Ultimately, he discovered that a small, spartan dining room was good enough. Pujals also found it was usually the children's idea to order pizza from home. As a result, TelePizza has consistently marketed its products as family food, targeting its messages to children as well as adults.

Expanding slowly also gave Pujals the chance to work out and test his business model. He was able to determine exactly what sort of investments he could expect future franchisees to make and how large an area of geographic exclusivity he needed to offer them. On the cost front, he found that to tap cheap student labor, franchisees would have to supply delivery personnel with mopeds, because most Spanish students, unlike their American counterparts, did not own motorcycles or cars.

As a result of Pujals's initial caution, growth when it came was both fast and steady. When he sold the company in 1999 to the Spanish food conglomerate Campofrio, TelePizza spanned six countries with more than 600 outlets selling some $250 million worth of pizza a year. He had turned an equity investment of $100,000 into a fortune of more than $300 million in just 12 years.

Although many aspects of entrepreneurship favor the young, patience does not. Here, more seasoned businesspeople have the edge. The impatience and idealism of the young often lead them astray, pushing them to blindly adopt a get-big-fast philosophy – "going for scale," as the dot-commers put it. This approach makes sense in certain contexts, especially for businesses like on-line recruitment sites, because their competitive advantage lies in the size of their networks. But it does not work for most start-ups. Among the unsuccessful ventures I've studied, many simply burned up their capital by trying to expand too soon. Entrepreneurs should be greedy, but they need to be patient as well.

Are You Willing to Shift Strategies Quickly?

Many would-be entrepreneurs place their strategies on a pedestal. Once they have the plan on paper, they try not to stray from it. Sticking to their guns, they believe, sends out a positive signal to customers, investors, and employees. Changing the plan, on the other hand, undermines credibility. Sometimes this conviction runs so deep that entrepreneurs appear more interested in pursu-

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ing the original strategy than in keeping their business afloat.

The harder it has been for a company to work out its strategy, the more trouble it has abandoning it. I studied one group of entrepreneurs who had developed a touch-free, sensor-based technology that enabled the precise locating of objects in a three-dimensional space. After much debate, the group decided to customize the technology for two markets: electric motors and handheld devices. Because the founders decided to focus exclusively on those two applications – and were unwilling to abandon that strategy – they missed out on a $100 million market opportunity to bundle their technology with other companies' products. As a result of that strategic blunder, investors lost confidence in the entrepreneurs, who were forced to sell the business to a hardware manufacturer.

By contrast, smart entrepreneurs – and savvy investors – recognize that a new venture gains credibility more by simply surviving than by doggedly following its original strategy. They are quick to recognize when they have to change course, and they seldom hesitate to do so. Indeed, they often take pride in their ability to turn on a dime, painting their twists and turns in the rosiest of colors. That's not to say that a good strategy is unimportant; it's just that, in the course of day-to-day business, you don't have the luxury of standing pat. You often have to shift from one strategy to another very quickly.

Consider the story of Andy Freire and Santiago Bilinkis. In January 1997, they set up Officenet, Argentina's first catalog-based supplier of office products. By 1999, the company had grown into a profitable $20 million business. Their early success sparked big dreams, and Freire and Bilinkis began talking about turning Officenet into a multinational company – the Staples of South America. The original investors, however, were less than impressed by such bravado, believing that the proposed expansion would require more capital than the company could raise, and certainly more than they could provide.

Then, Submarino, a leading South American retailer of books, CDs, and consumer electronics – a south-of-the-border Amazon.com – proposed a merger with Officenet. Since that arrangement would provide Officenet with the level of investment it needed in order to grow, Freire and Bilinkis were happy to abandon their strategy of independence. Better yet, as they pointed out to their backers and employees, the combination could provide a gateway to markets outside Argentina. Officenet might not become the Staples of South America, conceded Freire and Bilinkis, but being a division of a Southern Hemisphere Amazon.com would do very nicely.

Ten months after the merger, however, circumstances had changed again. Submarino had become a victim of the Internet bust, forced to withdraw its application for a Nasdaq IPO. Freire and Bilinkis recognized at once that the writing was on the wall for Submarino – and for the entrepreneurs' strategy. Freire and Bilinkis pulled out of the merger and reverted to their go-it-alone approach, knocking once again on doors that had shut them out the year before. To their surprise, the experience was different this time, even though market conditions had worsened. Investors, it turned out, were unfazed by Officenet's twists and turns; they now saw Freire and Bilinkis as born survivors. Within three months, the two had raised more than $30 million in one of Latin America's largest postcrash financing rounds. Today, despite Argentina's economic woes, Officenet is a thriving independent concern.

Are You a Closer?

Successful entrepreneurs know how to seal deals. They possess an almost uncanny ability to come in, often at the last moment, and elbow their rivals aside. However tough the market or small the transaction, they know exactly what they must give up – and what they can get away with – while finalizing deals under pressure.

N.R. Narayana Murthy, the man who cofounded the Indian software company Infosys Technologies in 1981, was nothing if not a closer. His company had to break into international software markets because the local one was virtually nonexistent. To succeed, Infosys needed to build a track record, which meant closing deals quickly.

Murthy took charge of sales, landing Infosys's first contract with a U.S. company – a six-year deal to upgrade the computer system at a large, New York-based textile distribution company. The upgrade – from a 16-bit processor to a 32-bit one – was quite involved, requiring that much software be rewritten. Over the next 20 years, Murthy spent little time at home. In 1990, he lived in France for three months, closing just one deal. His efforts paid off. Today Infosys is a serious contender in the customized software market in the United States and Europe, with $400 million in revenues and a market capitalization of around $8 billion.

Being a closer involves more than a willingness to go the distance in negotiating deals. You also have to be comfortable repeatedly making life-or-death decisions in the dark. Most executives-turned-entrepreneurs don't realize how big the gap is between making decisions in established corporations and making them in start-ups. And that's one of the main reasons many first-rate executives find it hard to adjust to the entrepreneur's world. Not only are decisions in a start-up more important – even small errors can kill the business – but they are of an entirely different nature.

In a corporation, managers are usually making the same sorts of decisions every day and are surrounded by other people making similar choices. While corporate managers obviously have to operate with a degree of uncertainty – they may not have all the information required – the environment is familiar, and that fosters self-confidence. In a start-up, however, managers don't have those comfort layers. If they can't trust their gut, they'll freeze.

In one case I studied, a senior investment banker had left a prestigious Wall Street company to join a start-up established by a former colleague. Wall Street traders are not known for their indecision, and this one had been a star, staking millions of dollars on his trading instincts and closing dozens of securities deals daily. But his killer instincts deserted him once he left the familiar environment of the trading floor. He even had trouble choosing which office supply vendor to go with. As he put it: "I felt I needed more and more information every time I tried to make a decision."

Real entrepreneurs know that using their time to gather extensive information is a luxury they sometimes cannot afford. They are more concerned that a decision be made than that it be the best possible choice. One entrepreneur I studied estimated that he had had to make around 150 key decisions before he was ready to do business – from naming his company to hiring his first employee. If he hadn't been able to trust himself to make those decisions quickly, he might have never launched the company.

Learning the Ropes

What happens if you answered "no" to any of my questions? Does that mean you can never start a business? Not necessarily. It certainly helps to have an entrepreneurial personality from the get-go, but you can learn some of the traits I've described. And even if you can't master them all, you can sometimes make allowances for your deficiencies.

If you're not a natural-born entrepreneur, the worst thing you can do is to simply dive into your first venture. Rather, you should work a few years for a fast-growing company, ideally in the same industry in which you want to start your business. It's a fairly risk-free way to get exposure to entrepreneurial life, and with some close encounters already behind you, you'll feel more comfortable with the risks, twists, and turns of managing your own business.

You might also look for a mentor – perhaps someone from the fast-growing company where you learned the ropes – who can help you identify which entrepreneurial traits you most need to develop. I've found that successful entrepreneurs are usually happy to act as mentors; they see it as a way of giving back. But don't take all your mentor's advice at face value. As you become more successful as an entrepreneur, your mentor may begin to feel threatened and may even seek to undermine your confidence. As we've seen, entrepreneurs have sizable egos.

You should also look for a partner. Few people are all-round entrepreneurs, gifted with every necessary trait. Your partner should be an equal – a co-founder; an early-stage venture capitalist; or an older, experienced corporate executive hired to fill a senior position such as CFO. Sometimes the partner will act as a brake by bringing your grand visions down to earth or by reminding you of the limits of the law. At other times, though, it can be the partner who pushes you to close the deal or to challenge your assumptions.

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Being an entrepreneur isn't for everyone, and even those who have the right stuff find the path to success much rougher and, usually, much longer than they had anticipated. But if you start your journey with a clear sense of your own capabilities and the gaps in them, you'll be much more likely to succeed in your venture.

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