

THE TWELVE (ALMOST) * SURE-FIRE SECRETS TO ENTREPRENEURIAL SUCCESS (Venture Capital Institute)

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Venture capitalists are not known for their humility, so take note of the following confession:

Venture capitalists are chickens. Compared to entrepreneurs they're spectators in the great game of small business hardball. They would no sooner personally guarantee a corporate bank loan than they would jump off the cliffs of Acapulco. Contrary to popular opinion, however, they are not totally worthless - they work long hours, sift through more garbage than a trash collector, and have to get used to disappointing 99 entrepreneurs for every one they please. They are veteran roller coaster riders, but never get used to those big drops. They are, above all else, risk reducers - they prospect in the land of the commercially unfinanceable, and try to differentiate the superstars from the merely enthusiastic. Most of them are pretty good at it, a result of lessons learned, mistakes made, and successes observed.

Over the past 29 years as a venture capitalist, I've screened thousands of entrepreneurs who were certain of their future success. Most were literally kidding themselves. I've backed about 100 of them. I've sat on several dozen boards of directors, and been part of public offerings, mergers, bail-outs and liquidations. My learning curve is still steep, but I do know what I'm looking for, and it's not magic and it's not luck. What it is is people with an extraordinarily rare set of characteristics, views and practices.

While there is a popular image of a successful entrepreneur as a supremely optimistic person who is inclined to high risk, little could be further from the truth. In the world of small business, optimism is truly cheap and high risk takers die early deaths. What characteristics do then set the exceptional apart from the masses? In my opinion there are about a dozen of them.

Here, in no particular order, are the dozen entrepreneurial characteristics I seek.

1. They have a sound knowledge of their marketplace. The literal majority of entrepreneurs do no (or next to no) market research. Instead they try one of the following two approaches:

* "The market is there!" I guess that means "take our word for it." We won't.

* "We're part of the \$220 billion electronics industry. If we get just 1/100% of it, we'll be a \$22 million company." While the arithmetic is sound, this is so intellectually offensive that it leads to the immediate conclusion that the team's whole fabric is shallow and rhetorical. Scientific market research is almost never easy, but almost always possible. When I meet a team which has segmented the overall market to isolate their specific opportunity, when their claims are anchored to solid, third party observations, when I can taste the particular flavor of their objective, I know that they have a dead aim on their target.

2. They have a sound knowledge of their competition. A cavalier dismissal of this threat, manifested in the oft-heard phrase "We have no competition," is a near certain predictor of performance shellshock later on. We insist that the business plans we seriously review feature a competitive matrix, i.e., a comparison by relevant features of their product vs. all other logical purchase alternatives. If it isn't as clear as a bell that any fully informed prospective purchaser

would be crazy not to seriously consider purchasing the product in question, one knows, at least, that he is looking at a me-too offering with all of the risks that that entails.

3. They have a sound knowledge of the financial dynamics of their companies. By this I most decidedly do not mean that entrepreneurs need an accounting degree, or even an intimate knowledge of financial analysis. What I do mean is that they focus on key results areas, such as: gross margins, monthly fixed costs, sales/employee, sales to budget, dollar production/day - whatever factors drive cash flow and profitability in that particular type of business. Entrepreneurs exhibiting this characteristic can tell you (without looking it up) what the trend in gross margins has been over the past few months, or what the cash flow impact of a 20% shortfall in revenues would be next month.

The most memorable lesson I ever received in this regard was during the negotiation of an investment in a high volume hog feedlot. A hog feedlot operator buys 40-pound feeder pigs (a commodity), feeds them corn (a commodity) for four months and sends them off as "top hogs" (a commodity) to the slaughterhouse. When I proposed a traditional earnings/loss test as a default trigger (i.e., cause to accelerate our convertible loan to him), the entrepreneur objected, noting "There are times in this business when the state of the commodities markets literally and arithmetically prevents a profit. And then there are times when even you could make money!" I asked for his suggestion for an alternative measure of performance quality, to which he replied, "Hog/feed ratio" (how efficiently an operator converts pounds of corn to pounds of hog) "and herd death ratio" (what percentage of the herd dies before it gets to market). While I am undoubtedly the only venture capitalist who ever signed an investment agreement with "hog/feed ratio" and "herd death ratio" as the default triggers, I can tell you that this man truly understood the financial dynamics of his challenge!

4. They have a true understanding of the importance of cash flow. Ask any gathering of entrepreneurs whether they understand that cash is life and there will be nods all around. Then ask them whether they also understand that lack of cash is DEATH and the blood drains out of their faces. A fellow venture capitalist I know describes a start-up venture as "a race against insolvency," and he is right. The best entrepreneurs equate cash with blood, and part with it only when it stands to directly further their objectives.

5. They have internal loci of control. True entrepreneurs take things personally. When they succeed, they know that they deserved to. When they fail, they know that it was their fault. They don't make excuses for past shortcomings. They describe them as lessons learned. They don't look for places to pin blame. When they first smell failure, they fight like alley cats to turn things around, because they see their performance, however good or bad, as a reflection of themselves.

6. They have inner confidence. I noted earlier that optimism is cheap and it is. Optimism based on reason, however, what might be called "inner" confidence, is rare indeed. It's the difference between "knowing" you'll succeed because you're part of the \$220 billion electronics industry, and knowing you'll succeed because your new product has nailed the competition right through the heart. It is, quite simply, confidence based on a knowledge of outstanding preparedness.

7. They plan and they execute their plans. It has been said that if you don't know where you're going, any road will get you there. Entrepreneurs don't love planning. Nobody loves planning! Planning is a powerful tool, however, and the best entrepreneurs reduce their pursuit of their strategic objectives down to action plans with detailed budgets, people responsibilities and deadlines, and they monitor the assault on a real-time basis.

8. They inject reality into their attacks. Truly sound entrepreneurs not only recognize that there are risks associated with their endeavors, they have actually thought about them! They'll even admit that there are forces hostile to their success out there! And they have taken every possible

step to minimize their impact or potential impact. They have fallback plans, they have fallback cash, and even when everything is going as hoped, they run lean and mean. They rent space, buy used furniture and equipment, and draw a pittance of a salary. They are quite content to delay civilized living and celebrations until they can be paid for out of earnings.

9. They hire smart. They are not intimidated by partners smarter than they. They recruit charismatically, with equity participation as bait. They can charm industry superstars out of Fortune 500 trees onto dusty trails leading to small business wars. When I can look three to five people deep into a young venture and find nothing but talent and adrenaline, I know that I'm probably looking at a winner. When the CEO seems dynamite but the lieutenants are quaking yes men, I steer clear.

10. They hit it hard. One of my favorite motivational speakers says that "It's a dog-eat-dog world out there...for forty hours a week. But when you get out to fifty, there aren't as many dogs. And when you get out to sixty or more, it's downright lonely!" There is no attack more likely to succeed than one executed when the enemy is asleep, or having his second martini. Almost everything is stacked against entrepreneurs. They even the odds with, among other things, sustained, superior effort.

11. They make it fun! There is something special though indefinable in the air at companies run by great entrepreneurs. The pursuit of their dream is punctuated by experiences which produce natural highs. It's clear that everybody there is having a ball. And they work at making it that way. The Friday afternoon beer bashes at Apple Computer in its early years are legendary. I once had an investment in a company that would pit one production line against the other during the short Christmas week, with each allowed off for the holidays as soon as they met normal production for the period. You have never seen people move at such a pace!

12. Maybe most important, They've got fires in their bellies. True entrepreneurs have such a strong achievement orientation that winning each marketplace battle, and ultimately the war, become compulsive needs.

The most graphic example of this that I have ever personally witnessed occurred when I was in Kentucky, and the state, led by then-Governor John Y. (Kentucky Fried Chicken) Brown and his wife, former Miss America Phyllis George, hosted a one-day seminar followed by a black tie dinner-dance for the CEO's of "Inc." Magazine's 500 Fastest-Growing, Privately-Held Companies. I attended the business program during the day, which ended at 5:00 P.M., and my wife came up to the Lexington Hyatt to join me for this gala affair, which started at seven o'clock. We were waiting at the elevator when a fellow rounded the corner wearing a tuxedo and scuffed brown shoes. I recognized him from the day program as the CEO of the fastest-growing privately-held company in the country during the previous five years, and introduced myself and my wife to him. As we continued waiting for the elevator (almost a thousand people in the hotel were all trying to get to this function at the same time), he suddenly blurted out as he pointed at my cummerbund, "So that's what that is!

It's a belt!" He went on to explain that the state had procured the tux for him and that he had held the "thing" up (demonstrating for us as if he were holding a skunk by the tail) and wondered to himself, "Now whatinthehell do I do with this!"

He then decided not to go back to his room for it since if he kept his jacket buttoned you couldn't tell that he wasn't wearing it, and changing the subject, volunteered, "This is a very nice section of town. Yes we replied, it was the most prosperous retail section in Lexington. "That confirms my experience," he countered, "I sold two of my company's systems after the program." He then tired of waiting for the elevator (demonstrating classical entrepreneurial impatience), bid us good-bye and disappeared down the stairs.

I explained to my wife that subsequent to the end of the five-year period in question, this gentleman's very successful company had gone public, making him personally worth tens of millions of dollars. He was on top of the mountain - yet he had taken advantage of 1-1/2 hours of free time in a strange town to make cold calls on customer prospects! And nailed two of them!

I trust that the moral of this story is obvious. You can evaluate entrepreneurial prospects against the twelve, often complex criteria I have covered...or you can look for guys in tuxedos with brown scuffed shoes and no cummerbund.