PREPARING FOR ENTREPRENEURSHIP

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Introduction

People become entrepreneurs for a variety of reasons. Some have an ardent desire to control their own destinies. Others want to enjoy a certain lifestyle that can be supported by their businesses. Many go into business for themselves after losing their job or they are tired of corporate life and are seeking independence. A few have created AN innovative product or service THAT they believe offers THEM an attractive business opportunity.

The idea of making a ton of money or OF being your own boss and conquering the world may be very enticing, but the fact remains that only a few succeed in building a successful business. Half of the businesses fail within three years. Up to ninety percent of businesses cease to exist beyond ten years. This dismal fact is true not only OF the U.S. and Canada but also of Australia, India, the U.K. and other countries.

Main Causes of Business Failure

Among several factors contributing to business failure, two are most common: One, money problems and two, weak management.

Frequently, entrepreneurs plunge into business relying on their over-optimistic estimates of revenues streams. They have not created a strong enough base to provide for inevitable fluctuations in cash flows. The resulting inventory build-up and ballooning accounts receivables quickly drain cash reserves. At this juncture, entrepreneurs who don't have any additional sources of funds are left with no option but to fold up.

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The second major cause of failure – weak management – could be attributed to lack of competent managers and leaders. Most entrepreneurs go into business on the strength of either their previous sales experience or technical knowledge of the industry. They have ignored the importance of building a strong team that complements their individual strengths and minimizes weaknesses.

Every business must have a management structure that is appropriate for its size and complexity. When the company is small, the entrepreneur is required to wear many hats and is responsible for more than one function. But as the company grows, more employees have to be added and responsibilities delegated and shared. In turn, that will require new procedures and controls. The company will also come under close scrutiny of competitors. The biggest challenge, however, would be new entrants and competitors who may not want to play by the old market rules. A company's outside environment that is always out of the entrepreneurs' control will continue to constantly change. Entrepreneurs can't afford to rest on their laurels. In line with Andrew Grove, co-founder of Intel Corporation who said: "Only the paranoid survive," entrepreneurs must always be vigilant.

That being said, how does one create a "failure-proof" new business, or at least one that has a high probability of sustained success under varying conditions?

To make it easy to read, I have presented the material in the form of advice to a single entrepreneur.

Starting Entrepreneurial Journey

You've taken the very important first step by deciding to go into business for yourself. What you do next depends on what kind of business you want to create or buy.

If you are currently employed and earning a satisfactory income, a part-time business could be one choice. You could run your business in the evenings after work and during the weekends. Many companies offer such an opportunity. They include Amway, Avon, Tupperware and others. These are essentially a kind of sales jobs where you're responsible to carry inventory on your own account and for collecting sales receipts. You are restricted to selling one company's products. Often, you are required to limit your sales efforts within a set boundary. I call them mini businesses. They are good for a supplemental income and fun. Some are known to create large teams of agents who provide additional income in the form of commission over-rides. But most of them remain tiny and do not provide sufficient income for livelihood.

You may want to go into a business that supports a lifestyle that gives you the freedom you want as well as the income. Such businesses will depend on your own efforts and thus will offer little opportunity for growth. Once you stop working, the business will cease.

Or you may want to create a business with many employees selling its products or services not only in your own town or city but all over the country and perhaps globally. If that is the case read on.

Are You Entrepreneur Material?

A strong desire to become an entrepreneur does not necessarily ensure a successful venture. You must possess certain traits and qualities. To find out what your total make-up looks like, make a written list of all your major and minor accomplishments from childhood, through elementary and high school, through college and university and through your work experience to date.

These could include all activities where you excelled, whether studies, sports or work. You want to identify particular traits or actions that contributed to your success. In turn, examine whether any of these traits indicate whether you have any of the following characteristics essential for business success:

Leadership In business, you will be constantly required to lead your management team and employees to achieve the company's short-term and strategic goals. Are you a take charge type of a person? Leadership calls for strong character, ethics and determination. From your list of accomplishments, identify instances where you provided meaningful leadership that accounted for the final outcome. Your list will enable you to give actual examples of your leadership. You need tangible evidence.

Perseverance Look for an example where you did not allow setbacks or failures to give up your efforts. You redoubled your efforts to reach the set goal and finally succeeded in face of adversity and challenges. In business, you'll face several hurdles, some easily crossed and others seemingly insurmountable. You'll need the courage and determination to succeed.

Focus Do you have the ability to remain focused on a particular task until completion? How did that particular ability to reach your goal in a shorter time and with fewer resources? Your business will demand that you constantly keep your objectives in mind.

Frugal Money is the life-blood of every business. You must demonstrate you spend money wisely at appropriate times. That, of course, does not mean that you are stingy. Only that you have the discipline to spend money when you have to and get good value in return. Your business will require that you never run out of money. That has been the fate of many ambitious entrepreneurs who were unable to manage the company's cash flows.

Methodical Show instances where you completed the given task in a systematic manner. You have to be very organized.

Communication Are you a good communicator with an ability to effectively convey your message both orally and in writing? You'll be required to have one-to-one conversations with your management team members and employees. There will be instances where you'll have to speak before larger groups. You have to demonstrate you have strong inter-personal skills.

Financial Literacy Even though you may have an accountant or chief financial officer in your company, you must have sufficient knowledge to read and understand financial statements. It's not enough for you to read an income statement and say whether the company has made a profit or loss. You must possess the knowledge to understand the dynamics behind the balance sheet, the income statement and the statement of cash flow, the three important documents for any company. You delegate that responsibility at your own peril.

Confidence You must have full confidence in your own abilities and in the venture.

This list is by no means comprehensive. It is meant to show you the few critical traits that every entrepreneur must have. There are other skill sets needed in a business but they can be supplied by other members of the management team. Of course, in the beginning when the company is just starting up you might not have people with the required skills on your staff. But they can be easily acquired as needed without adding to your payroll.

First Clearance

Even after you have determined that you have what it takes to be a successful entrepreneur, you'll be foolhardy to take any action for launching your business without first obtaining unequivocal endorsement of your family.

Discuss with your spouse and other family members implications of your starting the business. It's very likely you will have to live on a reduced income for some time. You would hope that the period is very brief but be prepared for a long stretch – up to three years – before your business starts generating sales that can allow you to draw a good monthly salary.

You will spend long hours on business. This will mean extra burden on your spouse – if you have one – to manage home and look after your children's needs. That will mean a big sacrifice.

If there is only a lukewarm support from the family, the best thing is to forget all about business. That would prove to be a very prudent decision.

Critical Resources

Before you launch your venture, take care to secure the important resources. These are:

- Accountant
- Attorney
- Banking relationship
- Tax Advisor
- Financial planner

Your accountant is essentially a score keeper. She will record your financial transactions and prepare the balance sheet, income statement as well as statement of cash flows for a period of time, usually one year. She may also complete the income tax returns required by the government.

However, your chosen accountant might not have full knowledge or experience of tax laws and principles of financial planning for business as well as individuals. If she has, that's fine too.. That way you don't have to deal with multiple people for money matters.

In the initial stages, when the company is small you could have your accountant assume those responsibilities but as growth occurs and operations become larger and more complicated, hiring specialists could be justified..

You'll need competent legal advice throughout the life of your enterprise. Don't make the mistake of obtaining cheap legal advice or relying on your own knowledge and experience to sign a variety of legal documents. Unless you are a trained lawyer, make sure to hire an experienced and reputed lawyer or a legal firm to handle all legal matters. Your money will be well spent.

The most critical resource, in my mind, is your banking relationship. You'll have to find a banker who understands your business and is willing to extend credit and make loans to meet your initial capital and working capital needs as well as future needs to support growth.

Of course, your friendly banker is not likely to provide funding simply because you have been a bank customer for a long time. He will evaluate your loan request using the so-called four "C's" of credit:

- Character
- Credit
- Capacity
- Cash flow

I would add another "C" for competence. Are you able to show that you and your management team have the required management skills and knowledge to produce the results shown in documents or business plan to support you loan request?

You must be able to explain and justify the figures in the business plan. Often, entrepreneurs make the mistake of getting a consultant to prepare a business plan. But that is not your document. You have played a minor role in its preparation. You must own it. In fact, a business plan should provide a road map for your company's operations for a period of time. It can't be just a well written document for the sole purpose of securing a loan.

Determine Viability

Next, you'll conduct a thorough and painstaking feasibility study to determine the viability of your project. For that, you need to address three main questions:

1. Market viability. Is there a market for your product or service?
2. Economic viability. Will it generate sufficient return on investment?
3. Management viability. Do you have the required management competence?

First, you have to determine that a sufficiently large market exists for your products or service. Unless, you have an innovative offering, there will be numerous competitors. Some will have established a position of leadership. You will have to devise a marketing strategy to take on the players already active in the market place.

Next, examine whether you can generate revenues sufficient to meet all operating expenses, including your own salary. Part of your salary could be deferred until the company is on a solid footing. The question is for how long you can forgo your full salary.

Lastly, show that you together with other founders have the required management competence to efficiently and effectively manage the business Your own experience and that of your management in the industry or related business experience could play a critical role in the success of your venture.

Only after you have determined that your venture is viable on all three fronts should you undertake the task of preparing a detailed business plan containing forecasts for the first five years of income, expenses and cash flows.

It is not uncommon for entrepreneurs to make serious mistakes about their assumptions. They usually want to validate their assumptions. Instead, what they should be doing is to challenge their assumption and try to prove them wrong. This exercise will prove invaluable when you are soliciting equity investment and loans. You will have been fully prepared to answer their questions and objections.

Raising Money

As is common in many countries, you will secure investment from the following sources:

- Close family members 40%
- Other relative 11%
- Work colleague 10%
- Friend/neighbor 28%.
- Stranger 9%
- Other 2%

You may want to visit the website of Global Entrepreneurship Monitor at www.gemconsortium.org to obtain more recent data. Data presented hear are for 2002.

Banks generally are reluctant to extend loans to companies unless they have been in business for at least three years and can show they are earning a profit. You must be able to show that your business is generating cash flows sufficient to service its debt obligations after meeting all operating expenses.

If you approach a bank for loans when you are starting out, you will be able to secure a loan on your personal guarantee and collateral of your own assets. That is a huge risk many entrepreneurs take because they have utter confidence in their venture and themselves.

At the same time you have to understand the bank's position. It wants to make loans to credit worthy customers who are able to make repayments punctually on time without repeated reminders. After all, the bank is only renting you money and expects you to return it in full together with interest. So, do not approach a bank for a loan unless you can show that you are credit worthy and your business will have the capacity to make all payments.

Venture capital firms are another source of equity capital. That means you will have to share the company's ownership with them. Venture capital firms usually invest in firms with potential for rapid growth so that they can sell their shares in the company at a big profit. The firms are known to be very stingy with company valuations.

The following table will give you an idea of returns (IRR) that venture capital firms expect at different stages in a company's life.

Seed	80%
Start-up	60%
First stage	50%
Second stage	40%
Third stage/mezzanine	30%
Bridge	25%

This illustration is mostly for information technology companies that require infusion of substantial capital resources generally beyond an individual entrepreneur's means.

Seed stage is when the company founders just have an idea for the venture. A start-up company is one that is already in business and is developing a prototype but has not sold it in significant qualities. A first-stage company has developed and market-tested a product and needs capital to initiate full-scale production. Second-stage, third-stage and mezzanine financing fuels growing companies. Bridge financing may be needed to support a company while it is between rounds of financing, often while it is waiting to the public.

For more detailed description and formula for calculating internal rate of return (IRR) see Chapter 7, Equity Financing: Informal Investment Venture Capital, and Harvesting by William D. Bygrave in Portable MBA in Entrepreneurship.

Management Team and Employees

You will need to assemble a team of competent managers to share the burden of running the day to day operations. As well, you will have to hire a few employees. Take care not to hire family members and friends solely with the objective of reducing cash expenses. By all means, hire them if they have the skills to do the job. It is always useful to keep personal affairs separate from business.

Your management team should be made up of people who can provide expertise in various functional areas like accounting and control, operations, human resources, strategic planning. In other words, you'll need a range of skill sets to complement your own.

In building your management team, you should pay close attention to the need for every member to be there for the long-term, at least until the company is put on a sure footing. You may have to offer a number of incentives, including share options.

As for employees, you will need to have a detailed plan for hiring, developing, compensating, retaining and motivating. In selecting new employees, place emphasis on the skills that your company needs. Right talent might not be available at low costs. Be prepared to pay for performance. Remember cheap is always expensive in the end.

Operations

Keep the following guidelines in mind when you formulate your standard operating procedures and employee manuals.

1. Design your work processes ranging from the simple task of answering telephone calls to designing new products or services in a way that errors are eliminated or at least minimized. Error prevention should receive high priority.
2. Eliminate waste.
3. Achieve fast cycle times. Ensure jobs are completed in the shortest time possible. That will have significant impact on your operating costs.
4. Pay close attention to continuous improvement. What is done well today is done better. As a result quality of your products and services as well as performance of employees will continue to improve over the long-term.

Measurement

During your preparation, one important management tool you will have to develop is a set of measurements to assess management performance of the whole company. Generally, entrepreneurs believe that the financial measure provided by the balance sheet, income statement and statement of cash flows is sufficient to manage their company.

If you are determined to own and manage a company that maintains sustained growth and delivers progressively higher profit, you will do well to develop and use metrics to measure performance in all functional areas and not only money management. With such a system, you will be able to create a recorded history of the company's performance. This would be valuable in monitoring progress from year to year.

Technology

In the last three decades we have seen the increasing impact of technology on business. Together with optimum utilization of your machinery and equipment, you have to invest in available technological tools available to your chosen industry. You might be required to develop your own proprietary information technology tools.

Ethics

This will perhaps pose the biggest challenge. If you have to face rampant corruption so common in many countries, choosing ethics over expediency can be very problematic. Still, a few companies have managed to avoid bribing. You will have to be guided by your own principles and moral values.

Conclusion

As you can see, preparing for entrepreneurship is an intensive, time consuming process. Try to avoid taking short cuts in the hope of addressing problems if and when they arise. If you take the time and trouble to plan for all eventualities, hopefully many problems will never arise. This is simply because you have anticipated those problems and have prepared for them.

Another word of caution is in order. No matter how well you plan, things have a habit of taking more time and money than you planned. Always, allow for contingencies.

Success Story

Google Founders Larry Page and Sergey Brin bought a terabyte of disks at bargain prices and built their own computer housings in Larry's dorm room, which became Google's first data center. Unable to interest the major portal players of the day, Larry and Sergey decided to make a go of it on their own. All they needed was a little cash to move out of the dorm – and pay off credit cards they had maxed out buying a terabyte of memory. So they wrote up a business plan, put their Ph.D. plans on hold, and went looking for an angel investor. Their first visit was with a friend of a faculty member.

Andy Bechtolsheim, one of the founders of Sun Microsystems, was used to taking the long view. One look at their demo and he knew Google had a potential – a lot of potential. But though his interest had been piqued, he was pressed for time. As Sergey tells it, "We met him very early one morning on the porch of a Stanford faculty member's home in Palo Alto. We gave him a quick demo. He had to run off somewhere, so he said, 'Instead of us discussing all the details, why don't I just write you a cheque?' It was made out to Google, Inc. and was for $100,000."

The investment created a small dilemma. Since there was no legal entity known as "Google Inc.," there was no way to deposit the cheque. It sat in Larry's desk drawer for a couple of weeks while he and Sergey scrambled to set up a corporation and locate other funders among family, friends and acquaintances. Ultimately, they brought in a total initial investment of almost $1 million.

On September 7, 1998, more than two years after they began work on their search engine, Google Inc. opened its door in Menlo Park, California. The door came with a remote control as it was attached to the garage of a friend who sublet the space to the new corporation's staff of three. The office offered several big advantages, including a washer and dryer and a hot tub. It also provided a parking space for the first employee company hired by the new company: Craig Silverstein, now Google's director of technology.

Source: Excerpted from "Google History." http:// www.google.com/corporation/history.html

Consequences of Launching Businesses Without Full Preparation

A recent report in the magazine Businessworld describes the pain suffered by mall owners in Mumbai and New Delhi, India. Over three quarter of retail space in the Star City Mall, in New Delhi remain unoccupied.

A short walk away from the Star City Mall is the DLF Galleria – another shell mall, sporting the same air of pathos as its neighbor. Almost 90 percent of its retail space is unoccupied.

A report says that 80 percent of 255 malls are ailing, half of them seriously.

A major reason for this situation is that most of the malls lack competent management. The builders did not have any long-term stake in the success of the malls. They built and quickly sold the space to investors.

Source: Businessworld. October 1, 2011

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