So YOU WANT TO START A BUSINESS?

8 Steps to Take Before Making the Leap

Edward D. Hess and Charles F. Goetz

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Publishing as FT Press
Upper Saddle River, New Jersey 07458

Printed in the United States of America

First Printing August 2008

ISBN-10: 0-13-712667-0
ISBN-13: 978-0-13-712667-5

Pearson Education LTD.
Pearson Education Australia PTY, Limited.
Pearson Education Singapore, Pte. Ltd.
Pearson Education North Asia, Ltd.
Pearson Education Canada, Ltd.
Pearson Educatión de Mexico, S.A. de C.V.
Pearson Education—Japan
Pearson Education Malaysia, Pte. Ltd.

Library of Congress Cataloging-in-Publication Data

Hess, Edward D.

So, you want to start a business? : 8 steps to take before making the leap / Edward D. Hess, Charles F. Goetz.

p. cm.

Includes bibliographical references.

ISBN 0-13-712667-0 (pbk. : alk. paper) 1. New business enterprises. 2. Entrepreneurship. 3. Business planning. I. Goetz, Charles F., 1956- II. Title.

HD62.5.H475 2009

658.1'1—dc22

2008014682

Introduction

Welcome to our book! In this introduction, we want to answer a few questions that many of you may have:

- Should you buy this book?
- Why is this book important?
- What topics are covered?
- Why are the authors qualified to write this book?

Who Should Buy This Book?

This book was written to help anyone starting a business—whether he or she is a business person or not. This book also should be helpful for anyone who has started a business and is not making enough money. Lastly, this book should help anyone investing in a start-up because most start-ups face the same challenges.

Why Is This Book Important?

Over 5,000,000 new businesses are started each year, but millions will fail, and most new businesses fail for the same sets of reasons. Our experience has taught us that there are 8 common reasons why start-ups fail, and with our combined 50 years building, financing, and teaching others how to build successful businesses behind us, in this book we offer ways to avoid making those 8 common mistakes.

What Topics Are Covered?

Our goal is simple and focused: to teach you how to avoid the 8 common mistakes many start-ups make.

Ask ten people why so many new business ventures fail, and many will answer, "Because the new business was undercapitalized." Undercapitalized means the business runs out of money before it makes enough profit to survive. We disagree with that conclusion. Running out of money is the result or consequence of more fundamental, underlying failures—the 8 common mistakes—which we teach you how to avoid.

People run out of money because they make one or more of the following 8 common mistakes:

1. Choosing a bad business opportunity (Chapter 3)
2. Choosing the wrong customers (Chapter 4)
3. Trying to sell the wrong product (Chapter 5)
4. Selling for the wrong price (Chapter 6)
5. Overestimating the number of and the speed of customer purchases (Chapter 7)
6. Mismanaging the business (Chapter 8)
7. Failing to hire and retain the right people (Chapter 9)
8. Being unable to grow or scale the business to accommodate growth (Chapter 10)

This book will direct your focus to the 3 Ws:

1. **W**hat will you sell?
2. **W**ho will buy?
3. **W**hy will they buy?

Why Are We Qualified to Write This Book?

Ed Hess lives in Charlottesville, Virginia, and spent most of his business life advising entrepreneurs and financing their business ventures. He went to college at the University of Florida and to law school at the University of Virginia and graduate law school at New York University. Ed's professional career was spent with firms like Atlantic Richfield Company, Warburg Paribus Becker, Boettcher and Company, The Robert M. Bass Group, and Andersen Corporate Finance, and he has built three service businesses.

In 1999, Ed began teaching business students part-time at Goizueta Business School, Emory University, during which time he created and taught the entrepreneurship course. In 2002, Ed joined the faculty at Goizueta full-time as an Adjunct Professor where he became the Founder and Executive Director of both the Center for Entrepreneurship and Corporate Growth and the Values-Based Leadership Institute.

Ed has written five other books:

- Hess, Edward D. *Make It Happen! 6 Tools for Success* (EDHLTD, 2001).
- Hess, Edward. *The Successful Family Business: Proactively Managing Both the Family and the Business* (Praeger: Westport, Connecticut, 2005).
- Hess and Kazanjian, eds. *The Search for Organic Growth* (Cambridge University Press: New York, 2006).
- Hess and Cameron, eds. *Leading with Values: Positivity, Virtue and High Performance* (Cambridge University Press: New York, 2006).
- Hess, Edward. *The Road to Organic Growth: How Great Companies Consistently Grow Marketshare from Within* (McGraw-Hill: New York, 2007).

In July 2007, Ed joined the Faculty of the Darden School of Business at the University of Virginia as a Professor of Business Administration and Batten Executive-in-Residence where he teaches courses on building small businesses and organic growth.

Charlie Goetz earned his college degree at Emory University and holds an MBA from the University of Texas. Charlie is a successful serial entrepreneur. He built several successful businesses, which in total employed over 1,500 people. He sold most of his businesses and made substantial amounts of money their sales. Charlie then began teaching entrepreneurship at Emory University in the Goizueta Business School where he was again successful. His courses are always oversubscribed, and he has earned multiple teaching awards.

Today, Charlie lives in Atlanta, Georgia, and is an investor in several new businesses and consults with people starting businesses. His specialties are marketing, customer acquisition, and product development.

How to Use This Book

There are two ways to use this book:

1. Read it from start to finish. It was written in a specific order—tracing a business idea from the idea stage through the steps of building a business.

2. If you want to focus on a specific question, issue, or problem, go to that chapter. Each chapter will stand by itself.

This book will not guarantee that you will be successful, but it should help you avoid the 8 common mistakes made by start-up businesses.

Basic Rules of Business Success

Chapter Topics

- *The 8 common start-up mistakes*
    1. *Choosing a bad business opportunity*
    2. *Choosing the wrong customers*
    3. *Choosing the wrong products or services*
    4. *Pricing products or services improperly*
    5. *Not selling to enough customers fast enough*
    6. *Not executing well*
    7. *People problems*
    8. *Mismanaging growth*
- *Basic rules of business success*
- *The 7 Ws*

The 8 Common Start-Up Mistakes

In the following sections, we discuss the 8 common mistakes start-up companies make and use them as a teaching tool to set forth the basic rules of business that successful entrepreneurs use.

Common Mistake #1: Choosing a Bad Business Opportunity

There is a BIG difference between a good *business idea* and a good *business opportunity*.

Ideas are as plentiful as sand on a beach. The entrepreneurial trash cans are full of good ideas—ones for products that work and that make sense. The problem is that customers did not need them badly enough to pay for them.

The difference between a business idea and a business opportunity is two-fold:

1. Good business opportunities satisfy existing customer needs.
2. Customers are willing to now pay for satisfying those needs.

Customers might consider an idea "nice-to-have" but do not see it as necessary.

The second big difference between a good idea and a good business opportunity is that a good idea may not "pencil"—that is, the economics might not work. By that we mean it is unlikely that enough product will sell at a profit large enough for you to earn a living. A good business opportunity pencils—you should be able to make a good profit.

Another reason your good idea may be a bad business opportunity is execution. It may be something hard for you to do or to produce for any number of reasons, or it may be outside your skill level. Or the product may be too complex to be made in bulk with consistent high quality by employees.

Your business idea may not be a good opportunity because you cannot find customers or because there is good competition that you cannot beat either because of cost or quality level issues. Good business opportunities are ones that meet customer "must-haves." There is a specific customer need or "pain" that is met or reduced because of your product or service.

We meet many hopeful entrepreneurs who tell us they have created a new product or they have developed something that is completely new.

Unlikely.

Trust us, in the year 2008, there are very, very few things that you can think of that someone somewhere has not already thought of and tried. That is okay. Uniqueness is not necessary.

Business Rule #4:
You are looking for a good business opportunity—*not* a good idea.

So what is a good business opportunity? A good business opportunity

1. Has many potential customers with real needs (a large market).
2. Has customers who you can find (customer access).
3. Has customers who have money to buy your product (qualified prospects).
4. Allows you to make and sell your product at a profit (good profit margin).
5. Can result in enough sales to enough customers fast enough (conversion rate).
6. Allows you to earn your needed income level.
7. Is something you are qualified to do.
8. Requires that you do something that someone else is not doing well enough (beatable competition).

Another way to describe a good business opportunity is

- A large potential market, with…
- …Customer access with…
- …Many qualified prospects, with…
- …The potential for a good profit margin, with…
- …The potential for fast enough customer adoption; so…
- …You can earn enough money by…
- …Doing something that you are qualified to do by…
- …Beating the competition.

In Chapter 3, "What Is a Good Business Opportunity?" we will use an approach that is adapted from the brilliant work Discovery Driven Planning did in 1995 by Professors Ian MacMillan of Wharton Business School and Rita McGrath of Columbia University Business School. We can use it to evaluate business ideas and test whether a given idea is a good business opportunity.

Success in the business world is measured by positive cash flow. Positive cash flow results from customers paying you enough for your product that you can cover all your costs plus make a large enough profit that you can make a living.

Common Mistake #2: Choosing the Wrong Customers

To be successful in starting a business, you have to have a match; that is, you have to align the right customers with the right products or services, which then results in the customers' needs being met—which is a large part of the foundation of a successful business. Mistakes can occur by trying to force a "fit" between who you might see as a customer and your product as you produce it. Customers know what they need, and not all potential customers will be real customers. You have to find those customers. *Customer segmentation*, which is discussed in subsequent chapters, is a good tool to use in choosing which customers to go after. *Qualified prospects* will be your goal—those high-priority prospects who have the specific needs you can fulfill and the money to pay you for meeting their needs.

Mismatches occur when you try to sell a potential customer something he or she truly does not need resulting in you having chosen the wrong customer.

Common Mistake #3: The Wrong Product

What is the right product? The right product is that product which gives the customer what he or she needs, no more, at a price they can afford and which allows you to make a fair profit.

Delivery channels will be the means through which you reach and get the most attention from the largest number of qualified potential customers. It could be a retail store, the newspaper, the Internet, a wholesaler, or radio advertising. You will also learn on what basis to make your sales pitch: your *Product Differentiation Story*. How will your product or service be better? Will you compete on price, features, reliability, service, or quality?

Creating a sales pitch as to how your product is different and better requires you to understand your competitors' products. This book shows you how to use a competitor product analysis template, looking at the features, performance, cost, reliability, desirability, style, quality, ease of service, ease of repair, and ease of use of your competitors' product(s).

You will also learn how to choose your "battlefield"—the basis on which you can beat your competition. This entails deciding what your differentiators will be.

Selling the right product is giving the customer enough of what he or she needs but not too much, cost-wise. Customers are willing to pay for what they need—not for what they do not need.

Many entrepreneurs fail the product test because

- They love their product more than they love the customer.
- They want to make the world's best product with all the bells and whistles.
- The customer either does not need or is not willing to pay for all the bells or whistles.

Common Mistake #4: Pricing Products or Services Improperly

- How much will someone pay for your product?
- What price do you need to charge to make a profit?
- How do you determine your costs before you start the business?
- How do customers view pricing?
- What are the two best ways to set your price as a start-up?

Pricing is simple: If you get it wrong, two things can happen, and they both are bad. First, no one will buy your product, or second, you make sales but lose money because your costs exceed your price.

There are three key parts involved in determining your price:

1. Figuring out your product cost—fully loaded. Remember:

Price – Cost = Positive Cash Flow

2. Knowing what your competitor's price is and knowing your potential customers' buying choices.
3. Value-pricing, which is truly understanding what your potential customer is willing to pay for.

In reading about Common Mistake #4, you will learn when your price has to be lower than the competition's, when it is okay to be on par or the same as your competitor, and when you can charge a higher price than your competition.

Common Mistake #5: Not Selling to Enough Customers Fast Enough

Chapter 7, "How Can You Overcome Customer Inertia?" deals with the customer buying process, overcoming customer inertia, and the velocity (speed) of purchase and volume (number) of purchases you need to make to be successful.

We are going to make a bold statement, a true one, but for you probably a shocking one:

> **Business Rule #5:**
> Every entrepreneur overestimates the number of customers that will buy and the speed at which they will buy.

Why? Because entrepreneurs love their products, and they think everyone will love them as much as they do.

Wrong.

Customer inertia is strong, and people do not like to change their behavior, including their buying habits. Why should your customer change? Why should he or she do something new like buy from you? Chapter 7 discusses how you overcome customer inertia and how you create a sense of urgency to buy.

The second issue we discuss in both Chapters 2 and 7 is the concept of Customer Conversion Rates. You need to accept the fact that all customer prospects will *not* buy your product. How many prospects must you have to convince just *one* of them to buy?

$$\text{Number of Buyers} \div \text{Number of Prospects} = \text{Customer Conversion Rate}$$

The next variable is how long of a time is the buyer decision process? How long will it take for your prospective buyer to make his decision?

10 minutes?

1 day?

1 week?

1 month?

3 months?

6 months?

1 year?

Wow—big differences.

You will learn that the time to make a sale depends on the magnitude of the price and whether your product has a short lifespan or will last for years. Selling someone a bagel that will last a day is very different from selling someone a car, which will last years. This also impacts the number of customers you will need to be successful—and it impacts the length of time it will take to make a sale.

All of this will teach you a big difference between a high-volume business and low-volume business, which impacts the number of sales you need to make. And you will also learn the difference between low-profit products and high-profit products.

Simply put, you have to sell a lot of low-price, low-margin products to succeed.

Remember: *You will overestimate you number of buyers, AND you will underestimate the length of the buying time.* This combination means that you will not earn as much money as fast as you think.

Common Mistake #6: Not Executing Well

Great—you have customers. Now you have to deliver a quality product on time, every time, defect-free at a profit.

You have to *execute* and *operate* a business, and you probably have never done so.

Chapter 8, "How to Manage Your Business," teaches you some basic management principles—how to understand your *value chain*; how to create *processes;* how to *prioritize* daily tasks and *manage by objectives*; and how to *manage by exceptions* or variances. You will also learn about the *power of simplicity*, the rule of 3s, and the rule of 7s.

Do not be overwhelmed. Most businesses are not rocket science. Running a business is a lot like baking a cake—you need the right ingredients. You need to do steps in the right order. You have to use measured amounts—and you do it the same way every time.

Running a business is "sweating the details" and loving the everyday challenge. But businesses are also composed of people, and people make mistakes. It's is the job of a manager to make good stuff, limit the bad stuff, and fix the mistakes.

Common Mistake #7: People Problems

Business is about *people*. You do business with people: customers, and you do your business in most cases through people: your employees. Your success depends on how your employees treat customers and how your employees do their jobs.

Without good employees doing good work, you will fail—pure and simple.

In Chapter 9, "How Do You Find and Keep Good Employees?" we focus on how to hire, train, and retain good employees and the best practices on how to manage people based on the work done by researchers at the University of Michigan, Harvard, Stanford, Case Western, and at Gallup.

Business Rule #6:
Happy employees create happy customers, which creates profits for you!

And who creates happy employees? You! As the owner, manager, or boss, *you* create happy employees by the way you treat them.

Do you treat your employees fairly, with respect, give them a sense of doing something important and meaningful, praise them, teach them, help them accomplish their dreams while they help you accomplish yours?

We discuss two fundamental management rules in the People Problems topic:

1. Employees will do what you measure.
2. They will do it even better if you reward what you measure.

Our goal in Chapters 8 and 9 is to teach you how to create a *high performance business*—how to create an environment that promotes high performance. This will help direct your focus on the "why" of your business—so employees can find meaning and pride in being on your team.

And last, we introduce the concept of creating a "family" at work. The second part of the chapter will focus on you—your people skills and how you need to manage not only your employees but also yourself.

Common Mistake #8: Mismanaging Growth

Congratulations—you have customers. Congratulations—you have more customers than you expected.

Success creates challenges. How do you manage your growth so that you do not implode? Success is good. But too much success too fast can overcome the best new business. By overcoming, we mean that big mistakes happen. Common big mistakes are

- Poor quality products
- Missing customer delivery times
- Poor financial controls
- Employee theft
- Employee defection to a competitor
- Employee illegality or misrepresentations
- Hiring too many new employees too fast
- Improper training of employees due to time pressure
- Promoting people before they are ready for the next job

How do you simultaneously, on a daily basis, service existing customers; produce more products and services on a high quality basis for new customers; hire, train, and motivate new employees; all the while managing cash flow? How do you expand when there is a limit to what you can personally do? Do you need to put into place processes, quality controls, financial controls, and technology? How and in what order? Do you need to make investments in computers, people, and software? And yes, we discuss the unthinkable: Are you the right person to manage the business as it grows?

Basic Rules of Business Success

Let us review some of the key business rules that are the foundation of building a successful business.

Business Rule #1:
The Jerry McGuire Rule: Follow the Money—Cash is King.

Business Rule #2:
The Peter Drucker Rule: "The sole purpose of business is to serve customers."

Business Rule #3:
Customers know best what they need.

Business Rule #4:
You are looking for a good business opportunity—*not* a good idea.

Business Rule #5:
Every entrepreneur overestimates the number of customers that will buy and the speed at which they will buy.

Business Rule #6:
Happy employees create happy customers, which creates profits for you!

Business Rule #7: The 7 Ws

A good business opportunity should answer the 7 Ws.

1. **W**hat can I sell?
2. To **W**hom can I sell?
3. **W**hy will customers buy from me?
4. At **W**hat price?
5. **W**hat are my costs?
6. **W**hen will customers buy?
7. **W**hat will the competition do?

Chapter Two: Lessons Learned

Businesses generally fail for 8 fundamental reasons:

1. People choose a bad business opportunity.
2. People try to sell to the wrong customers.
3. People try to sell the wrong products or services.
4. People price their products improperly.
5. People overestimate the number and the speed at which people will buy.
6. People cannot manage the business so as to consistently produce high quality products on time at a profit.
7. Employee problems.
8. People cannot scale their businesses to accommodate customer demand.

Let's move on to Chapter 3, and learn some techniques to evaluate business ideas.

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