Ten Common Mistakes of Entrepreneurs

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The Question of Failure

What if I fail? That is undoubtedly the biggest question on your mind as you establish your own business. As an entrepreneur, you are excited about your new business venture. You also know the possibility of failure looms. Given the time, money and effort that it takes to start a business, not to mention the high rates of small business failure, it is a wonder that anyone ventures out on their own. It is monumentally challenging to convince prospective investors and lenders that your idea is worthy of the risk they will take while you have your own questions about the business' viability. Despite these obstacles, you, like most entrepreneurs, will have no problem developing your business, getting excited about its prospects, and sharing your excitement with others.

Like many entrepreneurs you may establish your company with the best of all worlds in mind and fail to consider what will happen when the worst of all worlds happens. An old maxim warns: when you fail to plan, you plan to fail. The remedy? Spend adequate time thinking through the business in advance.

The risks attendant to starting your own business can be minimized by analyzing mistakes made by other entrepreneurs and avoiding them. The more time you spend minimizing risk, the happier you and your investors will be.

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Avoiding ten mistakes made by budding and seasoned entrepreneurs alike will put you far ahead in the game. At the root of most of these mistakes is a lack of planning and a failure to check with reality. When you start out, you may operate in a state of euphoria. Nothing can possibly go wrong and no one else could possibly have your idea. While the latter may be true for the time being, the former is a delusion. In every new venture, something is bound to go wrong at some point.

Rarely will everything happen just as you've envisioned. An event may be catastrophic or seem hardly noticeable; in either case there will be some effect on the business. So why should you even try to plan ahead? Because most events are foreseeable, at least as to the probability of occurrence. When they are foreseeable, they are preventable, or, at least, their effects can be mitigated. Another well-known maxim: success comes about when preparation meets opportunity. A business caught without a plan or options is a business that will soon be gone.

The Ten Mistakes

1. Failure to Take the Money

Do not get caught short of money when it is available to you. Generously estimate your costs, recognizing that hidden costs always arise. Just be realistic about the costs associated with the business. You will be happier because you will have the funds you need to both run and grow the business. Your lenders and investors will be happier to lend or invest their money because they will feel that you are not hiding anything.

Problems in the acquisition of financing arise when there is a distrustful relationship between the entrepreneur and the lender or investor. When raising capital for your idea, don't let your optimism for the venture overshadow your sense of reality and common sense.

Why would you ever refuse funding? You might, if you are one of those entrepreneurs who believes that "bootstrapping" is a virtue.[1] In today's market, interest rates are as low as they have been for many years; the economy has slowed while technology is moving at a light-speed pace. That makes this the time to borrow, grow, and invest to

[1] Interview with Ruthann Quindlen (Joseph Rosenbloom), *I Used to Love Bootstrapped Companies*, Inc., July 1, 2000, at 104.

prepare for when the market turns around. Insist on bootstrapping and you could put yourself and your business in the position of being unprepared for the future if cash flow and profits fail to materialize as projected.

Other less direct ways you can refuse to take the money include failure to agree to loan requirements and unwillingness to give up any control of your business to lenders or investors. These factors are within your control. Plan ahead, accurately assess the needs of your business, and take enough money when it is offered.

2. Unrealistic Valuation Expectations

As a member of a group of some of the world's most optimistic people, you may think you have more than you actually do. Indeed, belief in the success of your business is one of the key ingredients in a successful business venture –- if you don't have total faith in your idea, no lender or investor will, either. Optimism about your business is crucial to the your ability to raise sufficient capital from investors and lenders.

Recognize that lenders and investors are not naive. They know that entrepreneurs put as positive a spin on the business as possible. While you explain your project viewed through your rose-colored lenses, creditors and lenders will clarify that view with a healthy dose of reality. In October 1990, the Los Angeles Times reported that lenders and investors are becoming increasingly wary of businesses with the "fail-proof" idea.[2] They are more interested in finding real incentives for investment. If a business has been sitting around for some time with no serious potential buyers, the asking price is probably excessive.

When you seek early funding from lenders and investors, the problem can be much the same –- the valuation is too high. The theory behind valuation closely resembles that of pricing –- in the end you need to come up with the largest number possible based on valid and measurable factors. In pricing, this number has to be high enough to cover costs and allow for a profit, but low enough to keep customers coming back.[3] It is the same for valuation –- the result has to be high enough to cover anticipated costs and allow for adequate cash flow. It also must be low and realistic enough to cause lenders and investors to

[2] Tom Petruno, *Market Beat: Wary Venture Capitalists Looking for an Incentive*, L.A. Times, Oct. 12, 1990.
[3] Bo Burlingham, *The Downsizer's Dilemma*, Inc., Dec. 1, 2001.

trust your numbers and be more willing to assist your business in the future.

In his article on the "Dos and Don'ts" of financial projection, Paul A. Broni gives some good advice on how you can avoid the common mistakes made by entrepreneurs who attempt to acquire funding.[4] He recommends keeping the numbers realistic and demonstrable. When your projections and valuations are reasonable, funding – present and future – will become easier to acquire.

3. The "If You Build It, They Will Come" Syndrome

Failing to recognize that a good idea may not translate into a viable business can mean the death of a business before it has even begun. In the film "Field of Dreams" (Universal Studios 1989), the main character, played by Kevin Costner, hears a voice that whispers, "If you build it, they will come," and tills over his prime corn-growing acreage in Iowa to build a beautiful baseball diamond in the middle of nowhere. Costner's character is vindicated in the end, but the same is not always true of entrepreneurs.

Your optimism may include your unwavering belief that your idea is the newest, hottest thing out there; you know exactly who needs it and how to sell it. You may not enjoy the same outcome as Kevin Costner in "Field of Dreams" if you risk building it and they do not come. This trap looms in product development, a business start-up, or a simple marketing strategy. You need to ask some important questions. "Who really can or will use this?" "Why?" More importantly, "What if they don't like, use, buy, need, or want it?" Recognizing that potential current failure may necessitate setting an idea aside for the time being may not mean giving up on the idea altogether. Perhaps it just needs some adjustments. Internet retail companies are infamous for making the wrong assumptions initially. For that market, success requires that changes be made as quickly as possible.

One common mistake is selection of the wrong target market. In an interview in Inc. in 1996, Peter Drucker, author of Innovation and Entrepreneurship (Harper & Row, 1985), attributed the inability of many entrepreneurs to adapt to new circumstances and opportunities to their close, personal attachment to their original idea. "[T]hey insist that they

[4] Paul A. Broni, *Business 101 – Predicting the Future is Never Easy*, Inc., Apr. 1, 2000, at 163.

know better than the market . . . [and reject] success."[5] A suggestion that they may be mistaken is an insult. They would rather go out of business than change.

Drucker cites the example of John Wesley Hyatt, who developed the roller bearing. Hyatt was sure that it was perfect for use on the axels of railroad freight cars. No one accepted the idea. Failing to recognize when he needed to change his focus, he continued to try to convince people that he was right. The company ended up in bankruptcy. A few years later, Alfred Sloan, another entrepreneur who later founded General Motors, bought the company at a minimal price and changed the target market to automobiles. The company enjoyed great success for years. When you are able to recognize that your good idea may not translate into a viable business in the market you've identified and you make adjustments accordingly, your business will likely be better off in the long run.

4. Failure to Strike When the Iron is Hot

Much is said about the importance of perfecting a product or business plan before actually introducing the product to the market. The value of having a plan and a marketable product should not be overlooked, but neither should it be overemphasized. Your company may risk failure because you spent too much time and money on these preparations while the market passed you by.

You may misread your intended market and waste time and money perfecting a product or plan that is not a good fit with the market. Because the potential to misread a market is great, your business plan and product must be adaptable to the circumstances encountered after entrance into the market.

Spending too much time preparing a product for market risks failure of your enterprise. Rapidly changing consumer interest, such as in the rapidly evolving entertainment industry or vast improvements in technology, can make your product obsolete. For example, delay in the computer market can cause an entrepreneur to miss the short period of time in which the product is considered "cutting edge." Delay in preparation may give your competitors an opportunity to secure

[5] George Gendron, *Flashes of Genius: Peter Drucker on Entrepreneurial Complacency and Delusions*, Inc., May 15, 1996, at 30.

additional market share, ruining your chance to grab a sufficient share of the market.

Missing an opportunity is not the only negative outcome of over-preparation. You also risk misreading the market and wasting time and money. A good illustration of misreading a potential market can be seen in the story of iVillage.com. Co-founder Robert Levitan and his team spent months preparing the launch of iVillage.com's parenting channel, ParentSoup. Mr. Levitan's product was an online magazine for parents. To prepare for the launch of the channel, Mr. Levitan and iVillage.com had over 2,000 articles on parenting written at a substantial cost. Focus groups loved the idea. When Mr. Levitan launched the product, consumers ignored the articles, while the ParentSoup chat-room was a hit. Mr. Levitan pointed out that "You could spend six months planning a product or service, but sometimes it's better to just launch it and adapt to feedback." [6] Although over-preparation was not the direct cause of a failure, lack of working capital to absorb the losses from misreading the market can cause a start-up to fail before it begins. While a good plan and product is essential, an entrepreneur must balance these needs with the need to get into the market rapidly and adapt to unforeseen circumstances.

5. Not Understanding Your Strengths and Weaknesses.

It is essential that you fully appreciate your own strengths and weakness. First, an understanding of your weaknesses will enable you to hire employees whose strengths and weaknesses complement your own. Second, understanding yourself allows you to specialize and focus on your core competence. Finally, an understanding your strengths and weaknesses allows you to understand how potential customers may view you and your business so you can work to enhance the customer's perception.

Do not underemphasize the value of hiring appropriate initial employees. Imagine you are a sole proprietor producing a product for sale to retailers. You have the energy and skill to perfect and produce your innovative product, do the accounting, and be a skilled manager. Your weakness is a lack of enthusiasm for outside sales. Without a thorough understanding of this weak spot, you hire an employee to help you – a friend much like yourself. After a couple of years of struggle, you

[6] Lauricella, Tom, *If I knew then . . . Valuable lessons learned the hard way by four successful entrepreneurs*, SmartMoney Magazine (December 19, 2000).

fail, mainly because there was no one to generate sales and growth on a daily basis. A hire with the desire and ability to achieve success in outside sales can create a very different outcome in the ultimate success of the enterprise.

Understanding your strengths as an entrepreneur will help you to develop a core competence.[7] The theory of core competence is that in a competitive market the entrepreneur must concentrate on being the best in some area of its business in order to attract those customers who prize this particular attribute over others. Consider the retail clothing market. To compete for customers each of the leading retailers focuses on a particular attribute. Marshall Fields focuses on perceived quality. Wal-Mart focuses on price. Others, such as Target, may fall between these concepts but offer more products and convenience. To develop your core competence, you must understand your strengths and weaknesses and analyze the competition. This is the most effective way to specialize and gain market share.

6. Unsuitable Legal Structure

Utilizing the appropriate legal structure is essential to limit potential liability. Most new businesses fail. Yet most entrepreneurs begin taking business development steps before they even consider a legal structure.

There are many different legal structures you can adopt to protect yourself. The form of business you choose should be based on the particular facts of your enterprise. If your company's operations will create the potential for lawsuits, you need a legal structure that offers protection from lawsuits. If you fail to create a protective legal structure, you may find yourself in personal bankruptcy. Personal bankruptcy will create additional problems for your next attempt at starting a business, not to mention the personal and family chaos it can produce.

According to the United States Small Business Administration, four out of five new businesses start out as sole proprietorships. [8] The sole proprietorship offers no liability shield to the owner. If your sole proprietorship fails, creditors can go after your personal assets as well as

[7] C.K Prahalad and G. Hamel, The Core Competence of the Corporation, Harvard Business Review, May-June *1990*.

[8] Small Business Administration – Office of Advocacy, The State of Small Businesses, A Report of the President, Economic Statistics and Research (1998).

the assets of the business. As an optimistic entrepreneur, you may fail to see that potential liability is everywhere. Merely driving a company car or inviting customers onto business property can create the potential for enormous liability. Given the risks, it makes little sense to operate as a sole proprietorship in most businesses, because there are relatively few costs or drawbacks to forming an entity that limits personal liability.

One alternative to the sole proprietorship is the wholly owned C corporation. Although taxed as a separate entity, the C corporation provides the structure necessary to protect your personal assets. An S corporation, where business income is passed through to the owner, does not carry the double tax liability of the C corporation, but does provide some protection from liability. For partnerships, there is the option of limited liability designation, which can be acquired by filing a one-page form with the appropriate state agency. Each of these is a simple way to achieve liability protection. Beginning with the appropriate legal structure is essential to your success.

7. Failure to Protect Intellectual Property.

When entrepreneurs think about intellectual property when starting a new business, most recognize the need for patents on new inventions. The most apparent danger for many start-ups is the loss of the right to market and sell the product that is the cornerstone of the business. Consider the Minnesota corporation Wakat Design Systems, Inc. (Wakat). The corporation was formed in 1997 to create and market an innovative indoor paint product. Investors were found and in under a year the company was fully operational and had sold over a million dollars worth of product. Unfortunately, prior to the incorporation of Wakat, the inventor had formed a partnership with another investor that had fallen apart. The patent was not adequately secured and the former partner was granted the patent. Wakat was immediately out of business because of the exorbitant liability created by the loss of the right to sell the product.

New products are not the only protectable intellectual property. Amazon.com patented a "One-Click" shopping system for Internet purchases, enabling a repeat Amazon customer to place orders without re-entering personal information such as a credit card number or address. While it is now questionable whether Amazon originally invented this process, it owns the patent and has made progress in enforcing it.[9]

A more aggressive reason for protecting a patent is that patents can create revenue and garner market share. By patenting a product or process, an entrepreneur like Amazon can enforce royalties or receive other compensation from companies that attempt to use or who are already using the innovation. Some businesseses have, as a primary activity, inventing business processes, patenting them, and selling them to other businesses. Whether you are merely protecting your business or trying to create alternate streams of income, failing to adequately protect your intellectual property can result in business failure. Patents are not the only potentially valuable or vulnerable intellectual property. Unique and attractive logos, trademarks, or presentation vehicles are all intellectual property deserving of protection. Failure to protect any of this material can have disastrous consequences for your business.

8. Not Listening

One of your shining qualities as an entrepreneur is your indomitable spirit and perseverance in the face of adversity, even when you are surrounded by others offering little but discouragement. Block out most of the negative voices around you. One successful merchandising entrepreneur who built his store from a $1,000 start-up to two locations with 15 employees in seven years attributed his success to not listening to people who told him to "grow up and get a real job." [10]

At age 29, Troy Williams is CEO and founder of Questia Media, Inc. He raised $151 million for his enterprise, which he calls the world's largest online library of books.[11] During his exhaustive search for financial backers, Williams had to ignore experts who told him his idea would never work. They said publishers wouldn't give him the rights and users wouldn't pay for the Internet service. Even though the advice of experts often seems reasonable, successful entrepreneurs often recommend ignoring the advice when it doesn't feel right in their gut. On the other hand, even when entrepreneurs are shutting out the negative outside voices and listening to their inner gut, they still may

[9] Amazon.com, Inc. v. Barnesandnoble.com, Inc., 73 F.Supp.2d 1228 (W.D.Wash. 1999).

[10] Daniel Kost, *This is No Mall Store, for Sure*, Democrat & Chronicle (Rochester, NY), Sep. 24, 2001, at F6.

[11] Jay Mathews, *Doing Good, Doing Well; Dot-com: An Online Library Offers Deep Resources to its Subscribers*, Newsweek, Oct. 29, 2001.

integrate the negative comments productively. Williams notes that he used the negative feedback to rewrite a business plan which was eventually accepted by an investor group.

Once you get your business off the ground, it is still important to listen to your investment backers, attorneys and accountants. Incorporating their advice will help you avoid unforeseen pitfalls. Ignoring professional advice can risk alienating your advisors. You may need them when their help is essential to the survival of the business.

Adequately compensating professionals for their advice is also important. It sets the tone for the relationship, which may be crucial when the business is least able to compensate the professionals. This may mean giving up a certain amount of ownership in order to have them firmly on board. Better to be an entrepreneur with a percentage of something than an entrepreneur with 100 percent of nothing.

9. Avoiding Champagne Tastes with Your Beer Budget

Few of us ever will have the beer budget of August A. Busch III, chairman and president of the world's largest brewery, whose recent salary was reported at $1,152,600 and included an additional $3 million bonus.[12] So it is driven into most of us from childhood to live within our means. This message is driven even more strongly into the minds of those who lived through or had parents who lived through the Great Depression. Notwithstanding the message, many of us have a propensity to live beyond our beer-budget means, with champagne tastes.

You risk spending yourself into financial difficulty because you unrealistically compare your business needs to those of a Fortune 100 company. You can keep your spending in check and still realize some Fortune 100 tastes by thinking creatively and recognizing your realistic needs. For example, a business can realize champagne networking and software solutions on a beer budget by retaining outside help rather than hiring additional inside IT personnel.[13] One such contractor, Zero Effort Networking, Inc., bills itself as being able to provide instant virtual private networks and monthly software rentals to small to medium-sized businesses. They create complete IT solutions for network

[12] Al Stamborski, *Busch III Collects Over $4 Million in Bonus, Salary Still, That Pales in Comparison to Extra Bump of $87 Million Awaiting Coke's Daft*, St. Louis Post-Dispatch, Mar. 14, 2001, at Bus. Sec. C1.

[13] *Champagne Networking and Software Solutions on a Beer Budget*, Technology Marketing Corporation, vol. 20, issue 2, <http://www.tmcnet.com/>.

managers while eliminating upfront investments in hardware, software, and other costs associated with the in-house network management of larger businesses. According to Zero Effort's CEO Michael Day, "Small companies and individual users can benefit from the same kind of technology and applications used by Fortune 100 companies."

10. Not Recognizing We Are Always Selling

The greatest sales challenge you will have as an entrepreneur will be when you secure one or more rounds of venture financing. "Exude confidence and be straightforward about what you're doing and why it's an attractive deal to an investor," advises Crysteel Manufacturing Sales Vice President Bob Miller.[14]

As in any sale, it is important to target carefully whom you will approach. Investors tend to specialize by industry and investment levels. Even an unsuccessful call will have some value, as you lay the groundwork and build the level of trust essential to secure financing.

Being a strong sales person is vital for you at other levels. Even CEO's of major corporations such as Wendy's and Chrysler tout their own products. Particularly in an uncertain economy, it is important to sell customers on the fact that your business will be around for the long run. Pehong Chen, CEO of BroadVision Inc., has noted that in today's economy customers are in a state of uncertainty. He spends a considerable amount of his time emphasizing the fact that his company has been around eight years and they "will continue to be there to help . . . through this very tough time."[15]

Avoid the Mistakes -- Avoid the "Unlucky Seat."

It is axiomatic that smart people learn from their mistakes. It is equally true that smart people learn from the mistakes of others. This list of Ten Common Mistakes, while not exhaustive, addresses the mistakes most frequently cited in studies of entrepreneurs. Learn these mistakes and determine how to avoid them.

Nike has the catchy slogan, "Just Do It." Don't do it, however, without proper forethought. Perhaps no one said it better than Former

[14] Rick Weber, *A Primer on Picking the Best Type of Steel*, Trailer/Body Builders, Vol. 42, Num.6, Apr. 1, 2001.

[15] John Evan Frook, *One CEO Tells How He Sells*, B to B, Vol. 86, Num.12, Jun. 11, 2001.

Brooklyn Dodgers Manager Branch Rickey when he spoke about the need to properly combine action and thought for success:

> Things worthwhile generally don't just happen. Luck is a fact, but should not be a factor. Good luck is what is left over after intelligence and effort have combined at their best. Negligence or indifference is usually viewed from the unlucky seat. The law of cause and effect and causality both work the same with inexorable exactitudes.[16]

[16] Robert D. Behn, Branch Rickey as a Public Manager: Fulfilling the Eight Responsibilities of Public Management, Journal of Public Administration Research and Theory, J-PART 7 (1997) Vol. 1 at 9.

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