NATIONAL COMISSION ON ENTREPRENEURSHIP

FIVE MYTHS ABOUT ENTREPRENEURS:

Understanding How Businesses Start and Grow

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Prepared by the

National Commission on Entrepreneurship

The National Commission on Entrepreneurship *was established to provide local, state, and national leaders with a roadmap for sustaining and expanding a flourishing entrepreneurial economy. Entrepreneurship is the critical force behind innovation and new wealth creation–the key drivers of our country's economic growth. Through research, publishing, conferences and other events, the Commission promotes an agenda that helps grow a successful entrepreneurial economy into the 21st Century.*

Table of Contents

Overview 2
Part One: Unique Characteristics and Roles of Entrepreneurial Growth Companies 3
Growing Prominence 3
Economic Impact 3
Celebrated but Unexamined 4
Common Origins: Small Businesses and EGCs 5
Potential Productivity Gains: The First Departure Point 6
The Growth Period........ 6
Common Origins: Big Businesses and EGCs........ 8
Part Two: Myths and Misconceptions About Entrepreneurial Growth Companies........ 9
1. The Risk-Taking Myth: Most successful entrepreneurs take wild, uncalculated risks in starting their companies........ 10
2. The High-Tech Invention Myth: Most successful entrepreneurs start their companies with a break-through invention – usually technological in nature. 11
3. The Expert Myth: Most successful entrepreneurs have strong track records and years of experience in their industries........ 14
4. The Strategic Vision Myth: Most successful entrepreneurs have a well-considered business plan and have researched and developed their ideas before taking action. 15
5. The Venture Capital Myth: Most successful entrepreneurs start their companies with millions in venture capital to develop their idea, buy supplies, and hire employees. 17
Part Three: What Does Public Policy Have to Do With Entrepreneurial Growth?........ 19
A Precarious Transition........ 19
Facilitating Conditions and Policy Implications 20
1. Shared Risks and Rewards........ 20
2. Fostering and Protecting Innovation........ 21
3. Expertise........ 22
4. Planning and Strategy 22
5. Capital........ 23
Part Four: Conclusion........ 24
Endnotes 25

Overview

Entrepreneurial growth companies make up only a minute portion of all companies in the United States, and just a small percentage of the new businesses started each year, yet they play a surprisingly large role in terms of creating jobs and fueling the economy. In fact, these entrepreneurial growth companies (EGC) were a major contributor to the economic boom of the 1990s and are an important complement to the success of both large businesses and traditional small businesses that are their close cousins.

Despite the growing prominence of entrepreneurship, understanding of its key features and developmental stages lags far behind. Mainstream media coverage frequently emphasizes the most unusual successes, creating misconceptions about the nature and evolution of most successful growth companies. There is relatively little academic research focusing on the distinctive features of growth companies. And in many respects, EGCs are indistinguishable from small businesses until they enter a “growth” phase during which they are transformed into something almost entirely different.

All too often, confusion about fast-growing businesses results in diffuse or misdirected efforts to support this key economic sector. This confusion creates tremendous problems for policymakers who are interested in helping promote entrepreneurship. For these reasons, a description of some of the key features of successful EGCs, both in their earliest stages and during their transition to established companies, is needed.

To address this need, the National Commission on Entrepreneurship conducted its own series of nationwide focus groups with entrepreneurs and turned to Amar Bhidé's invaluable study, The Origin and Evolution of New Businesses[1] (2000). An economist and business professor formerly at Harvard Business School and now with Columbia University, Bhidé has researched entrepreneurship for more than 10 years, including in-depth analysis of leading business figures and interviews with scores of the most successful entrepreneurs in the nation.

The following sections describe the key features of entrepreneurship, dispel common myths about what makes EGCs successful, and explore broad policy considerations that may be important to supporting the continued growth of entrepreneurship in the United States.

Part One: Unique Characteristics and Roles of Entrepreneurial Growth Companies

Growing Prominence

The past decade has marked a period of tremendous growth for EGCs and the founders who make them thrive. Not since the days of Edison, Ford, and the railroad barons have entrepreneurs, inventors, and innovators captured the public imagination or dominated the business news so completely. Steve Jobs and Bill Gates are household names. Entrepreneur-oriented magazines such as *Fast Company, Red Herring, Wired, Fortune Small Business, Entrepreneur, Success,* and *Inc*. proliferate.

The change is especially noticeable in the choices made by those entering the business world and the institutions that educate them. Top college graduates now often choose promising startups over the choices of an earlier generation: elite graduate programs, prestigious consulting firms like McKinsey & Company, and famous Wall Street firms like Goldman Sachs. From fewer than 25 business schools with courses in entrepreneurship in the early 1990s, there were more than 125 schools with full-blown majors in entrepreneurship at the close of the decade. And in 2000, Harvard Business School replaced its decades-old core curriculum course in "General Management," with a new course required for all HBS students in "Entrepreneurial Management."

Economic Impact

The economic and societal reasons for the prominence of entrepreneurship are clear. Each year, at least 700,000 new businesses are started in the United States, and a small portion turn out to be the fast-growth companies that propel the economy forward. Each year, this small set of businesses creates a disproportionate share of the new jobs and fuels the economy in numerous other ways. According to one 1988-1992 study, EGCs or "gazelles" made up just 4 percent of all companies but generated 60 percent of the net new jobs. Some economists suggest that EGCs account for roughly 50 percent of the difference in economic growth rates among industrial nations.

In addition to creating new jobs and improving our position in the global economy, entrepreneurship improves our quality of life and helps lift all parts of the American economy. We all benefit from entrepreneurship, not only in large-scale economic benefits and transforming inventions but also in the form of improved products and services: Helicopters. Low-fee brokerages. Contact lenses. Next-day mail. Air conditioning. Superstores. Heart valves. These are all examples of innovations and services that were developed through entrepreneurship. Small entrepreneurs account for more than two out of three innovations since World War II, according to one estimate.

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Celebrated but Unexamined

Despite the many benefits of this entrepreneur-fueled economic boom and its growing prominence, entrepreneurship remains celebrated but largely unexamined. In the absence of rigorous and systematic academic study, the past and present success of entrepreneurship in the United States is often attributed to ill-defined virtues such as the American "spirit of adventure." Just as often, the characteristics and behavior of entrepreneurial growth companies are conflated with those of small businesses, which are closely related but differ significantly.

Fueled by simplistic profiles of entrepreneurs in the news, public understanding is understandably focused on the least common – and usually most successful – entrepreneurial efforts. Often when the popular press focuses on an EGC, they portray it as brand new. In fact, most of the companies they write about are beyond start-up and are in the later stages of entrepreneurial growth. What Bhidé and others find is that both the public and policymakers are familiar with these later stages of entrepreneurial growth, but fairly unschooled about the early stages.

This gap in understanding stems partly from the fact that EGCs are markedly different as they evolve over time. Their development is so dramatic and in some cases so quick that few observers have been able to document and distinguish the early stages. As a result, the characteristics of early-stage entrepreneurship are often missed entirely, according to Bhidé – a critical gap in our understanding. While understandable, this knowledge gap creates predictable problems when it comes to developing and maintaining support for entrepreneurs.

EGCs each develop at different rates, and within each EGC there are periods during which certain elements develop at a faster rate while others lag behind. While not all entrepreneurial endeavors fit each and every one of the descriptions and generalizations included here, Bhidé's research provides a useful overview of common features and evolutionary stages of most successful EGCs, as well as dispelling several of the most common myths and misconceptions about entrepreneurship.

Common Origins: Small Businesses and EGCs

While conventional wisdom about entrepreneurship may be misleading in some regards, it's not entirely wrong about the close resemblance of small business and growth companies. There are numerous similarities between most small businesses and entrepreneurial efforts. They both start small and require tremendous energy and adventurousness on the part of their founders. They both serve important economic functions, stimulating the economy and creating new jobs to replace those lost by downsizing in other areas. And most entrepreneurs start with "the same limited means as the typical lawn care or painting business," according to Bhidé. Small businesses are also an important breeding ground for growth companies and often serve as a key supplier to entrepreneurial endeavors.

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In fact, small businesses and EGCs can be indistinguishable at the start. Who is to say whether the fun new shoe store that just opened its second location is destined to become a successful small business or a national chain of stores? The store could continue to do well with just a few locations, or it could develop a new model or approach to shoe selling that propels it to national prominence. There are countless stories of businesses begun with small or uncertain scope that, somewhere down the line, were transformed into entrepreneurial efforts.

Potential Productivity Gains: The First Departure Point

But the key departure point that allows some small businesses to "morph" into EGCs lies in the productivity gains latent in their company's proposed product, service, or distribution scheme.

While calculations of productivity gains can get very technical, essentially they involve evaluations of the entire production and distribution process, as well as the quality of products and services produced, per person or per other resources used. An entrepreneur who can produce a product or service of superior quality, compared with competitors with the same resources, offers a productivity gain. An entrepreneur who produces the same quality product with fewer resources offers a productivity gain. And entrepreneurs who can produce both higher quality and consume fewer resources offer an even greater increase in productivity.

It is this latent productivity improvement in the entrepreneur's product, service, or distribution scheme that makes fast growth possible, and thus distinguishes potential EGCs from small businesses that cannot offer productivity gains. But while higher productivity potential makes it possible for an entrepreneur to build a fast-growth company, it certainly does not make it inevitable. Much more is involved.

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The Growth Period

Most businesses "start small and stay small," according to Bhidé. On the one hand, the business may not offer any productivity improvement and therefore may have no significant potential for entrepreneurial growth. On the other, even with this potential, the business owner may have limited aspirations. Searching for independence and economic support for family and children, the typical small business founder is not working daily towards the goal of growing the business at a speed that may transform his or her industry sector. If the business prospers and provides a relatively steady stream of income and employment, most small business owners would be satisfied. Limited growth and continued profitability are cause for celebration.

Massive growth may not be the foremost goal of most small business founders, but for the entrepreneurs in EGCs, audacious goals are at the heart of what they are doing. Right from the start, most successful entrepreneurs aim to create a large, national or multi-national company and intend to do whatever is required to achieve that objective. Whether they eventually succeed or not, this difference marks an entrepreneurial growth company as different from most small businesses, and shapes a whole series of decisions about the type of businesses entrepreneurs tend to start, and how they are run.

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What distinguishes an EGC from a small business is this distinctive period of growth. In most cases, the growth period comes right from the start and is part of the initial vision for the company. But in some cases the growth period can come later, or even arrive from out of the blue. Each year, a certain number of small businesses "morph" into entrepreneurial growth companies along the way. A successful pharmaceutical salesman with five years of growing revenues decides to turn his model into a national company. Three years out of college, buddies with a thriving coffee shop business realize that they could go national with their idea. It makes no difference when the growth period happens, but a business becomes dramatically different during and after the growth period.

In that sense, "EGC" is not just a fancy word (or an annoying acronym) for a successful small business. Though the term is often used loosely, being "entrepreneurial" in this case means much more than putting in long hours. Appreciating the difference between a small business before its growth period and once it has become entrepreneurial is perhaps the most important step towards creating effective support for the growth companies.

The productivity gain latent in EGCs and the entrepreneurial desire to create large, high-growth businesses lead to several other key differences. In contrast to most small businesses, growth companies are often clustered around newly deregulated and emerging industry sectors such as telecommunications, financial services, and, most obviously, information technology – where potential productivity gains are enormous. This is in stark contrast to the most popular small business sectors, such as construction, retailing, and cleaning services.

More so than most small businesses, entrepreneurial ventures are particularly uncertain – extremely vulnerable to falling flat. In many cases, entrepreneurial efforts are created in industries where there is no proven business model, and no established network of support. What entrepreneurial efforts do have is the promise – however unlikely – of tremendous returns. Bhidé likens entrepreneurship to a small business "with a lottery ticket attached."

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Common Origins: Big Businesses and EGCs

Bhidé also explains that it is this growth without tried and traditional business models that distinguishes innovative EGCs from innovative large corporations. He argues that start-ups typically pursue small (requiring relatively little capital) and highly uncertain (new, unproven) opportunities. In contrast, the *Fortune* 500 advantage lies in taking on perhaps similarly innovative, but much larger and much less uncertain projects. For example, bootstrapped entrepreneurs help incubate new "disruptive" technologies that at first cannot compete in mainstream markets, can only be sustained in niche markets, and produce early revenue streams too small to interest bigger companies. By pursuing these new, uncertain products and markets, and sometimes employing talented people that do not fit the cultural norms of large corporations, EGCs mitigate the "inflexibility" of long-established, bigger companies. Bhidé concludes that the very different roles played by EGCs and big businesses complement each other and even "reinforce each other in the multi-faceted and protracted process of innovation" in the American economy.[2]

The growth of Cisco Systems illustrates how a single company can itself make the pilgrimage from a start-up to EGC to big business along the curve that Bhidé's analysis suggests. Sandy Lerner and Len Bosak started Cisco in 1984, persuading friends and family to invest a little money and to work for deferred compensation. They then ran up their credit cards bills to finance the early stages of the company's growth. During this time they were building and selling computer network "routers" in what was then a tiny and totally uncertain marketplace. But they started to turn a profit with the routers they did sell and thus began to prove out the technology, the market, and the business model. In 1987, needing more capital to expand their operations with a growing market, they turned to the Sequoia Funds, a major Silicon Valley venture capital fund. With that investment, they further increased revenues and profits and went public in February of 1990. As the company grew even more, they acquired smaller EGCs that had taken the chance on small, uncertain new products and services and successfully proven out their productive value. Now, 16 years after its founding, Cisco is a big business – the world's leading supplier of routing equipment that links computer networks.

This story of a successful large corporation that was once a lowly start-up, struggled through the growth pains of an EGC, and achieved public company status is of course not the exception, but the rule. In fact, another Commission publication study will document the entrepreneurial origins of virtually all of the 200 largest *Fortune 500* companies in 1997.

Part Two: Myths and Misconceptions About Entrepreneurial Growth Companies

One of the main problems facing entrepreneurship today is the limited and often-incorrect conception of what "entrepreneurship" means and what entrepreneurs do in order to succeed. In fact, both Bhidé and the Commission's own research show that few of the most common perceptions apply to the majority of EGCs during their earliest stages of development.

There are, of course, notable exceptions to this rule, where the common perceptions and reality of some EGCs actually meet. One type of exception involves new businesses in particular industry sectors where entrepreneurs are forced to skip these earliest stages and essentially start out at the later stages of development. Biotechnology, for example, has capital requirements that preclude any of the bootstrapped efforts found in most other sectors. In the "land rush" that seemed to characterize the Internet industry over the past few years, the speed of change was so fast that many technology-based companies had to skip the early stages that apply to most growth companies. In industries like this, the business adage "get big, get niche, or get out" applies from the very start.

Given the prominence of Internet start-ups in the media, the impression that this is true for all entrepreneurial growth companies is understandable. In most cases, however, perceptions about entrepreneurship describe a stage of development that only a few companies ever reach. In their earliest stages, most companies fly below the radar.

1. The Risk-Taking Myth: "Most successful entrepreneurs take wild, uncalculated risks in starting their companies."

Risk is an intrinsic part of any business venture. Starting a company of any type places tremendous strain on the founders' personal lives. The cost of the uncertainty that comes with a new venture can be staggering in terms of stress on family relationships, self-image, and personal bank accounts.

But according to Bhidé and others, the highest measurable levels of risk to the founder of the EGC – financially and professionally – come much later in the development of the business and not at the start, as is commonly thought. At this earliest stage of development, the founders of entrepreneurial growth companies do not take on the majority of the risks that are associated with the company. They find others to take on these risks.

However counterintuitive it may seem, a close look at growth companies in their earlier stages of development shows that founders do not assume all of the risks of the venture. In terms of professional risks, the founders of most successful growth companies are usually not well established in the field in which they're starting the new venture – a phenomenon described in greater detail in following sections. In terms of financial risks, most entrepreneurs starting out have little by way of financial assets or protected intellectual property to offer, and so their financial contribution – in absolute dollars – is limited. Successful entrepreneurs are surprisingly effective at spreading the risk around to others.

Given that an even greater set of risks is shouldered by those who work for an entrepreneur, sell supplies to an entrepreneur, or agree to buy whatever the entrepreneur is selling, the ability to persuade others to take on risks is key to the early success of entrepreneurs. Without it, little progress can be made.

Successful entrepreneurs rely on a range of tactics to overcome these hurdles, according to Bhidé. They learn to target resource providers who have limited alternatives, short-term needs, and a personal or psychological preference for working with new companies. They attempt to mimic the appearance of established companies. Entrepreneurs offer extra services and special deals to prospective customers – though rarely offer to cut prices to where they can't make a profit. Above all, the founders offer various forms of equity to their employees, suppliers, and even customers. Even knowing the risks involved, lawyers, accountants, landlords, and other resource providers sometimes participate, with the hope of developing a long-term client, developing new business, or winning equity in what may become a lucrative new company.

It is only later on in the development of the company, when the business has created some real value, that entrepreneurs risk losing it all if they are to continue growing. At these later stages, the risks involved are almost unimaginably high for the founder. Here, the popular conception of risk-taking entrepreneurs is right on target. During the later stages, financial and other risks that were previously shared among a broader group now fall heavily on the company founder, who now must face the potential loss of all that has been created. And at this point, there is much more to lose. The founder has invested a tremendous amount of time, developed a successful product, invested early revenues back into the company, and has responsibilities to his or her employees. For example, if the EGC fails to make its revenue projections or delays a product introduction, the entrepreneur may be forced to seek additional capital to keep going. If the new capital investment is not forthcoming, he may have to fold the company entirely; or if he gets the money, it may be on terms that could radically reduce his ownership of the company or even strip him of all control of the company.

Further growth requires increased investments – a factory, a system of warehouses, a set of Internet servers, or a research and development unit. Outside funders often require aggressive growth trends, the hiring of experienced managers, and a commitment to a high-risk strategy as a condition of their investments. As a result, this later stages of development requires tremendous drive on the part of the entrepreneur to make the business grow into something much larger, ignoring the risks and going for broke regardless of the consequences.

Grand ambition, organizational and managerial ability, and the willingness to take significant risks become much more important at the later stages. So does the ability to trust others to make key decisions about the business and relinquish personal control. "Only a very few individuals like Sam Walton will have the ambiguity tolerance needed to start an uncertain business and the risk tolerance needed to build it," writes Bhidé.

2. The High-Tech Invention Myth: "Most successful entrepreneurs start their companies with a break-through invention – usually technological in nature."

Going by mainstream media coverage, it would be easy to imagine that most successful EGCs are built around some sort of invention or breakthrough – probably technological in nature. But that is not the case. "Revolutionary ventures" are relatively rare among successful growth companies, according to Bhidé. He cites Federal Express, which was started in the 1970s on the then-unheard of idea of creating a worldwide system of transportation dedicated to providing overnight delivery of packages, as the exception that proves the rule. Far more common are EGCs like Jiffy Lube, which brought moderate change and certainly marketable distinctions – but not "revolution" – to the way we change our oil.

Certainly, innovation is important to successful businesses, and inventions, new processes, and proprietary knowledge are certainly an important part of long-term business development. The potential productivity benefit of a new product, service, or distribution system must lie at the core of the new business. And technological innovation and other forms of distinctiveness become particularly important during a growth company's transition out of its original form. Bhidé finds that few ongoing ventures thrive without developing distinctive products or services. Distinctiveness is also a key to securing outside venture funding, which usually requires that a company have the potential to become a leader in its field based on the productivity gain it offers, as a condition of investment. An idea that is easily imitated or lacks copyright or other protection is of little interest to a venture capital firm risking millions at a time.

Having a breakthrough invention, a unique product, or a radically new process is not a necessary element at the beginning of most successful growth companies.

However, having a breakthrough invention, a unique product, or a radically new process is not a necessary element at the beginning of most successful growth companies. In Bhidé's interviews, "exceptional execution of an ordinary idea" was cited by almost nine out of ten successful entrepreneurs as the key to their success and enough to create the needed "distinctiveness." Or, if there is an innovation, the innovation can be small and the company can still be very successful. In some cases – take Starbucks Coffee, for example – being first or second to dominate a new market is enough of a difference. Or there might be a minor variation, or a change in packaging that makes the endeavor appear to be unique.

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In many cases, entrepreneurial growth companies create distinctiveness and protect their advantage by moving quickly, upgrading frequently, and always keeping one step ahead of the competition. Massive marketing efforts are sometimes a key element. But quality implementation, flexibility, the ability to meet customers' needs, the successful delivery of the promised productivity benefit – are usually more important than whether a company provides a unique service, product, or business model, according to Bhidé and others.

There are several well-known examples of growth companies that have thrived without early reliance on inventions or proprietary processes: Charles Schwab and other discount brokers found a way to make money with a new pricing strategy that encouraged individual investors to bypass traditional money managers. By guaranteeing the uniformity of the eating experience through tightly controlled franchises, McDonalds and other fast-food restaurants found a powerful way to win market share. And Sam Walton improved on the idea of a discount retailing that had been developed by predecessor stores like Ann & Hope and used careful site selection and rigorous inventory control to help create the Wal-Mart empire.

In fact, only six of 100 successful entrepreneurs interviewed by Bhidé even claimed to have had a unique idea, and fewer than 10 percent of the *Inc.* 500 companies studied were based on unique ideas according to their founders. Few of these successful founders were even the first or second entrants in their markets. Instead, they based their companies on replicating existing services or products with only a marginal improvement – "slightly modifying someone else's idea," according to Bhidé.

Even in the computer industry, the companies that thrive don't often offer a unique product or service. Bhidé cites Bill Gates as an example of a wildly successful entrepreneur who pursued "small, uncertain opportunities, without ... breakthrough technology." Or take another example. WordPerfect dominated the word processing software sector for many years and was bought for $884 million by Novell in 1994. But at the time WordPerfect first started shipping software, Wang already offered software applications, and WordStar was on the shelves a full year before. It took WordPerfect another six years – into the mid-1980s – to produce a technically superior product and to overtake WordStar as the market leader. In the end, WordPerfect delivered higher productivity than its competitors.

It's not just that these growth companies do without inventions; most aren't even technology-based. These EGCs have found ways to deliver productivity benefits in non-technological ways. Interestingly enough, Bhidé's research shows that most entrepreneurs are not basing their business on technology-based services or products. While technology-based companies receive the lion's share of attention in the public and among venture capitalists, technology does not dominate entrepreneurial start-ups and growing companies. In fact, two out of three companies listed in the *Inc. 500 – Inc.* magazine's list of the 500 fastest growing companies in the U.S. – are not technology-based. As Bhidé likes to point out, "you can't get a Starbucks latte on the Internet."

3. The Expert Myth: "Most successful entrepreneurs have strong track records and years of experience in their industries."

Jann Wenner started *Rolling Stone* magazine when he was just 21 years old and just out of college. Steve Wozniak, who helped found Apple Computers, was an "undistinguished" engineer at Hewlett-Packard when he built the first Apple computer. John Katzman was a part-time tutor at Hunter College in New York City when he founded the Princeton Review, a test-preparation and tutoring company.

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While founders of successful companies may become knowledgeable and prominent in their field later on, it is surprising but true that early-stage growth companies are just as likely to be started by relative amateurs with little background experience in the field. A full 40 percent of *Inc.* 500 founders had no prior experience in the industry they were entering, according to Bhidé's research. In fact, many of them have little work experience at all. More than a third of the *Inc.* 500 founders interviewed by Bhidé were out of work when they started their companies. Many others had just a few years on the job. These entrepreneurs often have few if any contacts in the field that they are going to enter.

Given the uncertainty involved, it makes sense that established executives and experienced professionals might not be interested in leaving their jobs for such a slim chance. "The individuals who face high opportunity costs...usually do not start small, bootstrapped ventures," writes Bhidé. While entrepreneurs may be intelligent and many have impressive sales skills, what makes these companies so successful is that their founders are highly responsive and adaptable. It is their personality, adaptability, and their willingness to provide specialized products or services that wins the day, rather than the traditional industry expertise that they bring. And through this unceasing attention to the needs of customers and adapting their products and services accordingly, they gradually develop a clarity of vision to make and deliver the products or services that will win market share. They may not have "years in the industry," but they know what they are doing.

During the transition to the later stages, however, growth companies need a deep reservoir of industry expertise and specialized training in order to thrive. This process, which Bhidé calls "upgrading resources," usually includes the acquisition of highly qualified and motivated employees who do not require training and whose skills fit the needs and direction the company has taken. Bhidé cites the case of experienced Procter & Gamble executive Steve Ballmer, who joined the fledgling Microsoft company in 1980, to show how hiring can affect company growth during this stage. Shortly after Ballmer joined Microsoft, IBM approached the company to write an operating system for its personal computer. Bhidé and others credit the presence of Ballmer as a key to that transition.

While entrepreneurs may be intelligent and many have impressive sales skills, what makes these companies so successful is that their founders are highly responsive and adaptable.

Starbucks is another example of a company whose steep growth curve Bhidé attributes in large part to hiring experienced executives in order to propel the company from a small, regional player into a worldwide behemoth. Howard Schultz's hiring of Lawrence Maltz, who had 20 years of experience in business and eight years of experience as president of a profitable public beverage company, proved a turning point in Starbucks' history.

Again, the quest for outside funding often accelerates this process, pairing inexperienced founders with experienced executives as a condition of funding. As a condition of providing investment funds, a venture capital firm will often require the hiring of an established chief operating officer.

4. The Strategic Vision Myth: "Most successful entrepreneurs have a well-considered business plan and have researched and developed their ideas before taking action."

While it might be easy to assume that most successful entrepreneurs start out with a well-considered plan of action, strategic planning and research are in fact hallmarks of the later stages of development, rather than a necessary initial ingredient.

For many start-ups, extensive research and planning are often both unnecessary and financially impossible. At the early stages, Bhidé finds that successful entrepreneurs do not necessarily have grand plans or a horizon-to-horizon vision of where they want to take their businesses. Only 4 percent of the *Inc.* 500 founders interviewed by Bhidé used any sort of systematic search to develop their business ideas, and fewer than one out of three had anything more than a rudimentary business plan. Another study by Bhidé found that fewer than half of the *Inc.* 500 founders during the 1980s even consulted with a lawyer before starting their businesses.

For these reasons, the first efforts of many successful entrepreneurs are often not the product or service that eventually brings success. William Hewlett and David Packard started out selling an audio oscillator. Virgin Records founder Richard Branson's first several business ventures included a failed magazine launch.

The process of starting a new business is like jumping from rock to rock up a stream rather than constructing the Golden Gate Bridge from a detailed blueprint.

While lack of long-term planning may seem hasty or unwise, the reasons so many successful companies go without it are clear. Bhidé comments that the process of starting a new business is like jumping from rock to rock up a stream rather than constructing the Golden Gate Bridge from a detailed blueprint. “In businesses that lack differentiating technologies or concepts,” he writes, “personal traits such as open-mindedness, the willingness to make decisions quickly, the ability to cope with setbacks and rejection, and skill in face-to-face selling help differentiate the winners from the also-rans.”

At this early stage, adaptiveness is much more important than a thorough, rationalized decisionmaking process. Through this adaptive process, an Internet business originally intended to generate revenue from its articles and analysis may evolve into a web portal that generates revenue by selling magazine subscriptions or ad placement without any original content. Only later, when the business is ready to make the transition to a later, more developed stage, do planning, strategy, and research become prime considerations.

It is during the later stages of growth that extensive research and strategic planning become essential to survival and further development of an EGC. The initial success of the company cannot be sustained by a series of improvised, unrelated decisions that might lead it to pursue too many disconnected endeavors. Initiatives that do not fit within the overall strategy of the company must be discarded, however profitable. In these ways and others, spontaneity and speedy adaptation are replaced by planning, innovation within defined constraints, and carefully coordinated decisionmaking. And the need for outside investment, usually accompanied by intense scrutiny by potential investors, only reinforces the need for a sound business plan. Strong advocates of planning and research, venture capitalists usually require a business plan with set metrics and timetables as well as seats on the board and other concessions.

5. The Venture Capital Myth: "Most successful entrepreneurs start their companies with millions in venture capital to develop their idea, buy supplies, and hire employeees."

Of all the myths and misunderstandings surrounding entrepreneurship, the role of venture capital is perhaps the most exaggerated. The venture capital phenomenon has received so much attention that it often appears to those looking in from the outside that most decent business ideas would receive venture backing. The media lavishes coverage on venture-backed startups, and has highlighted the massive growth in business "incubators" around the country.

In truth, venture capital is dominant in some industry sectors where capital requirements force companies to skip the early growth stages. For example, venture capital backing is a common feature among biotechnology ventures, some high-tech startups, and the Internet industry. For example, at the height of the boom, Internet startups received roughly $17 billion out of $21 billion (80 percent) in venture capital during the first quarter of 1999. But even after the "dot-com crash" (the third quarter of 2000) Internet companies still accounted for 45 percent of all venture capital investments.

And venture capital is an important part of the transition from a fledgling company to a more developed EGC. Growth companies of all types require equity financing in order to grow. At the later stages, substantial resources are needed in order to capitalize on initial successes. Started with just $5,000 of Sam Walton's money in 1945, Wal-Mart supported its own growth until 1969, when it secured a large term loan and shortly thereafter completed a $4.6 million public offering. In many cases, the search for outside funding and the conditions imposed by venture capital firms accelerate and enforce the transformation of initially successful startups into later-stage growth companies. There are data, for example, that show that venture capital-financed companies perform better through entrepreneurial growth stages than EGCs without such investors.[3]

However, venture capital – or any other type of formal financial support – is surprisingly uncommon among most successful EGCs at their early stages of development. In 1999, for example, fewer than 4,000 of the roughly 700,000 new businesses created were venture capital-funded. That means that less than one percent of all new businesses were backed by venture capital. In recent years, no fewer than half of all initial public offerings have involved companies without venture backing, according to the National Venture Capital Association.[4]

While high-tech startups are often the exception to this rule, it is well worth noting that even Bill Gates and Paul Allen, founders of Microsoft, failed to secure venture capital when they started their company in 1975. Hotmail.com, the popular e-mail program, thrived without venture capital before it eventually received outside backing and was bought out by Microsoft for $400 million. And Cisco Systems, now one of the top providers of Internet routers and servers, was initially financed from the personal savings and borrowings of its two founders.

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In fact, most growth companies start with limited means. One reason is that the resources required to start most growth companies are remarkably small. In the world of venture capital, backing usually starts at about $3 million – far more than most early-stage growth companies need or warrant. In most cases, there is simply no need for a massive influx of cash. According to Bhidé, 26 percent of the successful businesses he studied started with less than $5,000. Two out of three on the 1996 *Inc.* 500 started with less than $50,000. The average funding required for these companies was just $25,000.

Rolling Stone magazine was started with just $7,500 in the bank. Waste Management, Inc., a NYSE-listed waste management leader operating in more than half of the states, started out with a single truck and revenues of $500 a month. Bob Reiss founded Valdawn, which makes fashionable, inexpensive watches, with just $1,000 of initial funding. By 1994, Valdawn was an *Inc.* 500 company with $7 million a year in revenue.

At these funding levels, personal savings, and money from family and friends, are usually more than enough to do the job. In some cases, individual “angel” investors become involved at this point. Angels, many of whom are former entrepreneurs with industry experience, are often the first outsiders to look critically at an EGC. Through the moderate amounts of funding they provide, angels frequently accelerate the transition between the early and later stages of entrepreneurial growth.

Moreover, venture capital is usually only awarded to initiatives that have features most EGCs lack at the start – a strong business plan, and a solid track record, experienced staff, and an innovative or proprietary idea. They may acquire some or all of these things along the way, but, lacking most of these characteristics at the outset, three out of four entrepreneurs surveyed by Bhidé didn't even attempt to secure venture capital. “More than 80 percent of the Inc. founders I studied bootstrapped their ventures with modest funds derived from personal savings, credit cards, second mortgages, and so on,” states Bhidé. “The median start-up capital was about $10,000. Only 5 percent raised their initial equity from professional venture capitalists.”

Part Three: What Does Public Policy Have to Do With Entrepreneurial Growth?

A Precarious Transition

Understanding the different stages that most successful EGCs go through is essential to developing effective public policy. Most of the popular media attention towards entrepreneurs has focused on their efforts during the later stages, when they are transitioning from one type of company into another. The early stages of development have gone virtually ignored, and any policy program intended to support entrepreneurship will have to address the needs of entrepreneurs in both stages.

None of this means that entrepreneurs who reach the later stages are out of danger and have no need for support. Having started a successful company is no guarantee of its survival, much less its prosperity. In fact, growth companies remain in a particularly precarious position even after they have enjoyed a series of early wins. And in many ways, building a company past its initial success is even harder than getting the initial business off the ground. It is for these reasons that the vast majority of new businesses fail within ten years. Most close their doors entirely or become “the walking dead” – remaining small and being quickly surpassed by others. Many of those that do survive the initial stage cease fighting for long-term viability on their own and are often bought out by larger competitors. And entrepreneurs who have decided to enter areas such as the Internet or biotechnology face tremendous hurdles within the first few months.

Because the motivations and characteristics of a successful later-stage entrepreneur are so different from those at the earliest months, growth companies are particularly vulnerable during this transition. The transition from initial entrepreneurial success to long-term growth requires “comprehensive” changes in many attributes of successful EGCs, according to Bhidé. Only the very few entrepreneurs who can reinvent themselves into ambitious, strategy- minded risk-takers will continue to grow. To make this transition successfully, growth companies have to "find new employees, customers, and sources of capital," according to Bhidé.

Given what Bhidé calls the "limited correlation" between these attributes and those initially required, it is no surprise that many founders decide to sell their firms or remain local, regional, or niche players. For many entrepreneurs with one set of highly developed skills who are facing a whole new set of challenges as they enter the later stages of development, it can make more than just financial sense to consider selling the business. "The passage from a fledgling business to a large company requires entrepreneurs to develop new skills and perfect new roles," writes Bhidé. At these later stages of development, a successful entrepreneur must do almost the opposite of what has been successful in the past in order to prevail. And here again, outside investors often play a key role in facilitating this transition by setting conditions that require entrepreneurial growth companies to adopt new behaviors.

Facilitating Conditions and Policy Implications

If anything is clear from recent and limited research on entrepreneurship, it is that many policies that have been adopted to spur entrepreneurship may be based on misunderstandings about entrepreneurship and may fail to meet the real-world needs of growth companies. Moreover, the needs of growth companies are not a uniform set of conditions, but rather a range of economic and social structures that differ, depending on the stage of development of the company.

Despite the current prominence of entrepreneurs, social pressures against risk-taking remain strong. Without an environment supporting entrepreneurship, critically needed resources – money, people, technology, and suppliers and customers – may be diverted away from risk-taking EGCs. The following is a brief description of several policy considerations that may warrant further investigation. This is by no means a comprehensive or detailed set of ideas.

1. Shared Risks and Rewards

EGCs need others to share their risk – employees, investors, suppliers, and even customers. This requires an education system that produces both employees with the basic skills (analytical, communications, and creative problem-solving skills) and employees with the right technical skills. Immigration policy is relevant if there is a shortage of technical staff. Regional policies that support networks of suppliers (lawyers, accountants, landlords, etc.) that are "entrepreneur-savvy" can also help. Bankruptcy laws that do not overburden or stigmatize entrepreneurs who take risks but fail are another critical element. Finally, regional political and community leaders can celebrate the success of EGCs and encourage a culture where working for or working with an entrepreneurial company becomes an exciting, honorable calling.

Shared rewards are also key, at both the earliest and later stages of entrepreneurial growth. Those who do take risks and succeed with entrepreneurs must be rewarded with a piece of the value created and grown by the entrepreneur. Early employees, early investors, suppliers, and even customers must have access to stock ownership or options in the EGCs they work with.

For those who succeed to the later stages, rewards for the success of the business should be maximized. First, an array of "exit" strategies – such as an initial public offering or an acquisition by another company – must be available to realize their gains. And these exit strategies require a vibrant new issue market (e.g., NASDAQ), reasonable securities regulations at federal and state levels, accounting standards that truly reflect the nature of the new business, and a reasonable anti-trust policy that sees acquisitions of EGCs as generally a good thing for the economy. Finally, tax policy should reward investment in EGCs.

2. Fostering and Protecting Innovation

Intellectual property policy is another policy issue of critical importance to entrepreneurship. However, constructing an effective approach requires a delicate balancing act. For early-stage entrepreneurial growth companies, entrepreneurs need access to ideas that can be modified and executed successfully. Intellectual property laws that over-protect certain innovations would be a problem. For later-stage businesses, the enterprise seeking institutional capital and professional management needs enforceable legal rights to an innovation as a key asset of the company.

At a regional level, universities should do more to encourage "spin-out" of commercial applications of their technologies, by their own professors or otherwise.

Entreprenuerial growth depends on sustaining levels of public investment in research and development and technology transfer laws that allow researchers and their institutions to commercialize their discoveries. At a regional level, universities should do more to encourage “spin-out” of commercial applications of their technologies, by their own professors or otherwise.

3. Expertise

Clearly, an analysis of the early stages of entrepreneurship suggests policies that better prepare individuals with the skills to be successful entrepreneurs. That probably means education that is excellent in both a general skills sense (analytical, communications, and creativity) and also some specific training in the requirements of entrepreneurship and business. On a regional level, public policy should encourage extensive networks of entrepreneurs and professionals who can advise and mentor these entrepreneurs – a support infrastructure that will help minimize the mistakes of youthful entrepreneurs.

Later-stage entrepreneurship requires policies that will encourage industry experts and managers to join EGCs. Again, the availability of stock, stock options, and favorable tax treatment is important. Making sure that personal liability for corporate actions is severely restricted is important too (securities litigation, for example). From a regional perspective, an education, transportation, communications, and lifestyle infrastructure attractive to managers is another key. And if there are a number of growth companies in the same region or area, then the risks for experienced managers who are considering relocation are lowered even further. If things don't work out with one company, there are others nearby that might be in search of skilled professionals.

4. Planning and Strategy

The “adaptiveness” that is the hallmark of early-stage entrepreneurship further emphasizes the need for education, entrepreneurship and business training, and critical support networks described above. Moreover, public policy and the agencies that implement it need to give the entrepreneur the flexibility to make decisions quickly. Overly onerous regulations and regulatory agencies (especially at the local level) that are ponderously slow and unduly delay the implementation of an entrepreneur's move are not helpful. “Entrepreneurs need more forgiveness than permission” in this phase.

The changes that EGCs face during these early stages also require the flexibility of capital and labor. Capital must be equity capital during this phase, without all the covenants, conditions, and security that accompany debt instruments. Policies that make such equity capital abundantly available are critical. Labor regulations must be flexible during this tumultuous phase too. The more that employees have access to portable health and pension benefits, the better they will be able to endure the necessary hirings and firings of the early stages.

5. Capital

Perhaps the most significant policy contribution over the last 30 years to U.S. entrepreneurship has been the creation of a vibrant capital market to finance entrepreneurial growth companies.

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Early-stage EGCs require an abundance of non-institutional equity capital. Policies that enable credit cards and second mortgages – at low interest rates – to be used to fund EGCs are important. Policy should encourage the reinvestment of earnings during the early growth stages of an EGC. Securities regulation, at the federal and state levels, must allow friends and family to invest in these companies. And regional policy should enable the formation of angel networks and seed capital funds to support entrepreneurial growth companies at the $300,000 to $3 million level. Good exit strategies for these early investors, in the form of vibrant public offering and acquisition markets, are obviously critical.

For EGCs, the policies that have supported the extraordinary development of the venture capital industry in the United States must be continued. This includes key provisions in ERISA that helped foster venture capital investments. We must also sustain the securities regulation, accounting standards, and initial public offering market regulations that have fostered robust exit strategies for these investors. Acquisitions of venture capital-backed companies must continue to be favored in anti-trust policy.

Part Four: Conclusion

Public policy has played an instrumental role in supporting entrepreneurship in the United States. While public understanding of EGCs may be incomplete, research by Bhidé and others show that different (although complementary) public policies need to address different stages of entrepreneurship. Because of these commonly held five myths of entrepreneurship, the early stages of EGCs are often missed. As a result, the needs of entrepreneurs during the early stages are sometimes ignored, or supported unintentionally rather than given serious consideration. Ensuring that public policy supports EGCs from their early start-up through maturity is no easy task. But, understanding these different stages of entrepreneurship provides policymakers with valuable tools to meet these public policy challenges.

Endnotes

[1] Bhidé, Amar (2000) . *The Origin and Evolution of New Businesses*, New York, NY: Oxford University Press

[2] Bhidé , Amar (2000) . *"Looking Back to the Next Century"*, Closing Keynote Address, TiECon 2000 at www.bhide.net

[3] See, for example, Kortman, S. and Lerner, J. (January, 2000). *"Assessing the Contribution of Venture Capital to Innovation"*, a paper prepared at Boston University, Harvard University, and the National Bureau of Economic Research

[4] Heesen, Mark G (September 6, 2000). *Exploring the Venture Capital and Entrepreneurial Relationship*, Washington, DC; National Venture Capital Association

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