

## THE MYTHS OF ENTREPRENEURSHIP

A fun new shoe store just opened its second location. 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. In other words, it can evolve into a successful small business or it can make the leap to an entrepreneurial growth company.

According to a new report from the National Commission on Entrepreneurship, entrepreneurial growth companies are indistinguishable from small businesses until they enter a "growth" phase during which they are transformed into something almost entirely different.

Small companies that are able to "morph" into growth companies have a proposed product, service or distribution scheme that boosts productivity. And while most small-business owners would be satisfied if the business prospers and provides a steady stream of income and employment, most successful high-growth entrepreneurs aim to create a large, national or multinational company and intend to do whatever is required to achieve that objective.

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 contrast to the most popular small-business sectors, such as construction, retailing and cleaning services.

"Many fast-growing startups, in their earliest stages, often are indistinguishable from small businesses. Once these startups take off in their growth stage, that's where all similarities end. The challenge is to educate lawmakers about this key difference, and fashion policies to better support these high-growth companies," NCOE Executive Director Patrick Von Bargen said.

The NCOE report, "Five Myths about Entrepreneurs: Understanding How Businesses Start and Grow," says initiatives intended to aid entrepreneurs can be misdirected due to confusion about the true nature of entrepreneurial growth companies.

### **The five myths:**

**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. 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.

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

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.

There are exceptions, like 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. But far more common are entrepreneurial growth companies like Jiffy Lube, which brought moderate change and certainly marketable distinctions -- but not "revolution" -- to the way we change our oil.

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

While founders of successful companies may become knowledgeable and prominent in their field later on, 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 NCOE research.

For example, Jann Wenner started *Rolling Stone* magazine when he was just 21 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 when he founded the Princeton Review, a test-preparation and tutoring company.

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

Strategic planning and research are in fact hallmarks of the later stages of development, rather than a necessary initial ingredient. For many startups, extensive research and planning are often both unnecessary and financially impossible. At this early stage, adaptiveness is much more important than a thorough, rationalized decisionmaking process.

**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."

Venture capital is dominant in some industry sectors -- biotech, some high-tech startups, Internet -- where capital requirements force companies to skip the early growth stages. But it -- or any other type of formal financial support -- is surprisingly uncommon among most successful entrepreneurial growth companies 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 1 percent of all new businesses were backed by venture capital.

Even Bill Gates and Paul Allen, founders of Microsoft, failed to secure venture capital when they started their company in 1975. And networking giant Cisco Systems was initially financed from the personal savings and borrowings of its two founders.

## Guy Kawasaki: Top Ten Myths of Entrepreneurship

Many entrepreneurs believe a bunch of myths about entrepreneurship, so here are ten of the most common and the realities that bust them:

1. It takes a lot of **money to finance a new business**. Not true. The typical start-up only requires about \$25,000 to get going. The successful entrepreneurs who don't believe the myth design their businesses to work with little cash. They borrow instead of paying for things. They rent instead of buy. And they turn fixed costs into variable costs by, say, paying people commissions instead of salaries.
2. **Venture capitalists are a good place to go for start-up money**. Not unless you start a computer or biotech company. Computer hardware and software, semiconductors, communication, and biotechnology account for 81 percent of all venture capital dollars, and seventy-two percent of the companies that got VC money over the past fifteen or so years. VCs only fund about 3,000 companies per year and only about one quarter of those companies are in the seed or start-up stage. In fact, the odds that a start-up company will get VC money are about one in 4,000. That's worse than the odds that you will die from a fall in the shower.
3. **Most business angels are rich**. If rich means being an accredited investor – a person with a net worth of more than \$1 million or an annual income of \$200,000 per year if single and \$300,000 if married – then the answer is “no.” Almost three quarters of the people who provide capital to fund the start-ups of other people who are not friends, neighbors, co-workers, or family don't meet SEC accreditation requirements. In fact, thirty-two percent have a household income of \$40,000 per year or less and seventeen percent have a negative net worth.
4. **Start-ups can't be financed with debt**. Actually, debt is more common than equity. According to the Federal Reserve's Survey of Small Business Finances, fifty-three percent of the financing of companies that are two years old or younger comes from debt and only forty-seven percent comes from equity. So a lot of entrepreneurs out there are using debt rather than equity to fund their companies.
5. **Banks don't lend money to start-ups**. This is another myth. Again, the Federal Reserve data shows that banks account for sixteen percent of all the financing provided to companies that are two years old or younger. While sixteen percent might not seem that high, it is three percent higher than the amount of money provided by the next highest source – trade creditors – and is higher than a bunch of other sources that everyone talks about going to: friends and family, business angels, venture capitalists, strategic investors, and government agencies.
6. **Most entrepreneurs start businesses in attractive industries**. Sadly, the opposite is true. Most entrepreneurs head right for the worst industries for start-ups. The correlation between the number of entrepreneurs starting businesses in an industry and the number of companies failing in the industry is 0.77. That means that most entrepreneurs are picking industries in which they are most likely to fail.
7. **The growth of a start-up depends more on an entrepreneur's talent than on the business he chooses**. Sorry to deflate some egos here, but the industry you choose to start your company has a huge effect on the odds that it will grow. Over the past twenty years or so, about 4.2 percent of all start-ups in the

computer and office equipment industry made the Inc 500 list of the fastest growing private companies in the U.S. 0.005 percent of start-ups in the hotel and motel industry and 0.007 percent of start-up eating and drinking establishments made the Inc. 500. That means the odds that you will make the Inc 500 are 840 times higher if you start a computer company than if you start a hotel or motel. There is nothing anyone has discovered about the effects of entrepreneurial talent that has a similar magnitude effect on the growth of new businesses.

8. **Most entrepreneurs are successful financially.** Sorry, this is another myth. Entrepreneurship creates a lot of wealth, but it is very unevenly distributed. The typical profit of an owner-managed business is \$39,000 per year. Only the top ten percent of entrepreneurs earn more money than employees. And the typical entrepreneur earns less money than he otherwise would have earned working for someone else.
9. **Many start-ups achieve the sales growth projections that equity investors are looking for.** Not even close. Of the 590,000 or so new businesses with at least one employee founded in this country every year, data from the U.S. Census shows that less than 200 reach the \$100 million in sales in six years that venture capitalists talk about looking for. About 500 firms reach the \$50 million in sales that the sophisticated angels, like the ones at Tech Coast Angels and the Band of Angels talk about. In fact, only about 9,500 companies reach \$5 million in sales in that amount of time.
10. **Starting a business is easy.** Actually it isn't, and most people who begin the process of starting a company fail to get one up and running. Seven years after beginning the process of starting a business, only one-third of people have a new company with positive cash flow greater than the salary and expenses of the owner for more than three consecutive months.