



Cautionary Tales - Plus Encouragement - from Three Veteran Entrepreneurs

Published : January 26, 2005 in [Knowledge@Wharton](#)

While a bold idea, unflagging determination and patient financial backers are all crucial to successful start-ups, entrepreneurs must also focus on less dramatic aspects of running a company, according to seasoned entrepreneurs who spoke at the 8th Annual Wharton Entrepreneurship Conference.

This means paying attention to investment relationships, exit strategies and the mechanics of building a business, including hiring and firing, marketing and distribution, said Jeffrey A. Citron, co-founder and chief executive of Vonage Holdings, David Morgan, founder of Real Media and currently chief executive of TACODA, and Josh Kopelman, founder of Infonautics and Half.com.

Citron, whose Vonage Holdings is an Internet-based telecommunications firm, led off the conference with a call to go bold. When looking for start-up opportunities, Citron said he targets businesses that revolve around disruptive technologies that will shake up big, preferably global, markets with huge entrenched players. He looks for businesses with products that make a major change in a large number of lives.

"If it's not going to improve peoples' lives significantly, we are going down the wrong path," said Citron, who founded the computerized trading system, The Island ECN, and online brokerage Datek Online Holdings before turning his attention in 1999 to Vonage.

Citron said he is not concerned about bringing a new technology to markets dominated by big, established competitors. "They are stodgy, slow-moving players who are asleep at the helm. Even if they see it coming, they don't know [how to react]. All they can do is steer straight ahead." Citron stressed that he also looks for businesses with a strong revenue stream that will transform the current value proposition in a business for customers, and fundamentally change an industry's cost structure.

Innovation, he added, is crucial. "You can change the value proposition, but the day you talk about it, or the day you release it, is the day your competitor copies it," he said. Broad distribution is also important because it is the link to revenue and broad distribution can mitigate other risks. "The really hard stuff, the stuff that makes and breaks companies, is distribution. It's absolutely, fundamentally critical."

From the start, entrepreneurs should be thinking about their approach to partnering, according to Citron. At Vonage the original strategy was to form strategic partnerships, but because the process was taking too long Citron decided to create his own distribution channels. He teamed up with companies such as Earthlink and Armstrong Cable and is now reaching consumers through more than 8,000 retail outlets. As a result, Vonage has established a multi-channel distribution system under its own brand name. "Building a brand sounds scary, but it's possible," Citron said.

He likes to fund new ventures internally to preserve equity, but also likes to take on partners who can provide expertise or new networks. He cautioned, however, against signing on the wrong partners, such as strategic ones rather than financial ones. The terms may be cheaper, but strategic partners could have other interests that might ultimately conflict with the entrepreneur. "Don't take dumb money," he advised.



This is a single/personal use copy of Knowledge@Wharton. For multiple copies, custom reprints, e-prints, posters or plaques, please contact PARS International: reprints@parsiintl.com P. (212) 221-9595 x407.

When building a company Citron does not pay attention to nay-sayers, hype, or the competitive landscape. He focuses on customers and managing growth. Entrepreneurs must know their competition, but not obsess over it. "[Competitors] can be big, but that's okay. Deep pockets don't buy great ideas." Large companies are focused on productivity and reducing costs, not growth.

To build an organization he recommends hiring a first-rate human resources director and using professional recruiters. "You can't do everything yourself. Outsourcing is okay."

"Hire Slowly; Fire Fast"

David Morgan -- founder of the interactive marketing company Real Media which he ran from 1995 until 2001, and now CEO of TACODA, a firm that develops targeted marketing technologies -- never intended to become an entrepreneur. "I grew up with absolutely no commercial bones in my body. I came in last every single time Little League or Cub Scouts were selling peanut butter cups."

He started his career as a lawyer in a Philadelphia firm. He loved the law, but didn't like to listen to bosses. "I found out I made a terrible employee." Eventually he left the firm and worked briefly in politics before becoming an in-house lawyer for a newspaper trade association in Pennsylvania. It was there that he saw a mismatch between the resources held by traditional media companies and the new capabilities for information on the Internet.

Morgan said he met a venture capitalist in the elevator at a conference who invited him to submit a business plan. He came up with one calling for \$1 million in financing. The venture capitalist told him his group did not finance projects for less than \$10 million. Morgan, who couldn't imagine how he would have spent \$10 million, said that he probably would have burned through it and been left without a company. "Don't write your business plan just because money is available. One thing I'm thankful for is I didn't go back" and ask for the \$10 million, he said.

He did struggle, however, finding out early on which banks would allow him to float payroll checks the longest. He "bootstrapped" both Real Media and TACODA, and along the way created environments similar to those of the Spanish conquistadors who burned their oars on the beach when they arrived in the Americas. It was a message to the soldiers with them that there was no turning back. "It takes that level of commitment to be successful," he said. "You will never understand how tough it is going to be."

Real Media survived the Internet shakeout, but Morgan was still faced with firing 275 employees. "Until you have fired someone for your own mistakes you don't know how to hire very well. You learn to hire slowly and fire fast." Most of the employees Morgan dismissed were fired because of business conditions, but about 50 to 75 were problem people. In nearly every case, Morgan said, there were red flags early on. "I learned as I went along that you are not going to get any benefit or do yourself a favor by trying to make it work," he said. "Every time the red-flag person was taken out, the productivity and the culture picked up."

Morgan stressed that it is important for entrepreneurs to pay attention to details of investors' terms, such as dilution and ratchet provisions, not just the overall amount of financing. "If you are going to take money from investors, make sure it's a two-way street." Finally, he said, entrepreneurs should be prepared to face unethical behavior. "The thing that has surprised me the most in my last 10 years is the absolute lack of ethics that occurs in business -- including small business -- out of a sense of getting it done at any costs."

"Getting Your Message Heard"

A simple idea is essential to entrepreneurial success, according to Josh Kopelman, who was an

undergraduate at Wharton in 1991 when he co-founded his first start-up, Infonautics, an Internet information company. In 1999, he founded Half.com, the online market for used books, movies and music.

Kopelman said his idea for Half-com was simple: To unlock the value of books that would never be reread by their original owners. "Entrepreneurs think the way to have a defensible idea is to have a confusing idea. The first thing any entrepreneur should think about is, what is your simple idea? How do you boil it down to a simple essence? The simplest ideas are the most powerful ideas."

He rejects the notion that entrepreneurs should go after untapped markets. He prefers to follow a crowd. "The market is so competitive. There are hundreds of thousands of entrepreneurs and personally I believe if a market need is untapped, there's probably a good reason why. Dozens of entrepreneurs have probably tried it and failed."

Of all the risks entrepreneurs face - technological risk, financial risk, execution risk - the greatest is market acceptance, he noted. At the time Kopelman was developing Half.com, Amazon.com was pioneering Internet retailing with book sales. That acceptance led Kopelman to target Half.com at used books.

He likes to attack an "urgent, pervasive problem" in a large market with a unique solution. As an example, he pointed to his most recent business start-up, TurnTide, aimed at reducing spam. Recently he has become interested in search technology. "I think there are too many people who try to change consumer behavior. That's really expensive. When an entrepreneur tells me he or she wants to educate the market, I run the other way."

In the years since he first set out as an entrepreneur, the costs of starting a business have declined, said Kopelman, adding that new technology now allows companies to easily and cheaply outsource needs such as software, web hosting, and e-mail. He estimates that companies that once needed to raise \$3 million to \$5 million to get up and running can now manage with \$500,000 to \$1 million. If an entrepreneur can get started at those prices, peeling off equity to venture investors may not even be necessary, he said. TurnTide, for example, had no outside venture capital.

He also stressed the importance of an exit strategy. "There's an unwritten term on every term sheet and that's the term of exit," he said, adding that the unwritten rule for venture capitalists is that until they can return a specific amount there is no exit. "What's happening now is because the costs are lower, the VCs are able to exit at lower prices that are more profitable for the founders and their angel investors. I think that's a powerful and empowering trend for entrepreneurs."

While technology costs are coming down, marketing costs remain high, Kopelman added. Too many entrepreneurs are overly focused on their marketing message. "The more fundamental problem is not what your message is; the problem is getting your message heard."

Since consumers are exposed to up to 3,000 marketing messages a day, he encouraged entrepreneurs to find creative ways to build marketing buzz. He told how Half.com convinced the town of Halfway, Ore. to change its name to Half.com in return for a snowplow and some computers. Kopelman got coverage on *The Today Show* and in *The Wall Street Journal* and other media outlets, which he said would have cost \$10 million to buy. The company followed up with other novel ideas, including Half.com screens placed in urinals at trade shows, and ads on the backs of fortunes in Chinese fortune cookies. "I would encourage people, especially under-funded people, to think of creative ways to get your message out there."

Entrepreneurs must play off the weakness of big corporate competition, which usually rewards safe behavior, Kopelman added, going on to make a basketball analogy. A player who fouls out in the first 15 minutes is probably too aggressive. A player who never comes close to fouling out is playing it too safe.

"The culture we tried to build at Half.com is that you encourage people to get their fouts, to take the chances. The way to do that as a leader is to make sure your culture is tolerant of mistakes." He said the urinal screens were probably a bad move, but the tolerance for risk at Half.com gave the company's marketing director the confidence to dream up the successful fortune-cookie idea a month later.

Flexibility is also crucial to success as an entrepreneur, Kopelman told his audience. "I have seen thousands of business plans and the one similarity they have is that they are always wrong. The world changes, market conditions change, there are so many changes happening that by definition your business plan is wrong." Entrepreneurs need a business plan, he said, but it must be one that takes into account the potential for change. "It should be an organic living document and have the discipline to stay flexible and adjust to market conditions."

This is a single/personal use copy of Knowledge@Wharton. For multiple copies, custom reprints, e-prints, posters or plaques, please contact PARS International: reprints@parsintl.com P. (212) 221-9595 x407.