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Book Review

Startups That Work

By Joel Kurtzman and Glen Rifkin

Penguin Group: New York, 2005

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Startups That Work (Penguin Group: New York, 2005) by Joel Kurtzman and Glen Rifkin offers a thorough and instructive analysis of 350 startup companies that were tracked from 2001 to 2003. Specifically, the authors analyze “the ten critical factors that will make or break a new company.” They are, in brief: planning, management, the board, cash flow, the market, competition, the business model, the product, customers, and alliances. This is a pretty straightforward list and it is easy to see how excellence in each area would lead a company to success.

The title of Chapter 2 is “To Get Where You’re Going You’ve Got to Have a Map.” One of the key findings is that for a company to create value, it must have (and follow) a plan. To create this plan, the authors determined that, first, everyone in the company must be a marketer and, second, the plan, or map if you will, should be built on nine drivers: market size, competitive position, business model, cash flow, investor value contributed, strength of the management team, product development, channel/alliances, and customer acquisition. For a startup to progress, there needs to be growth along all of these axes simultaneously. The authors point out that what typically happens is that some areas are focused on for a time then, other areas

receive emphasis later. In startups, the squeaky wheel gets the oil, just as in life.

The next topic covered is management. Great people are the key to funding and eventually success. The authors state that the first rule for business might be summed up as “It’s the people, stupid.” This is the conventional wisdom as well. Kurtzman and Rifkin depart from the conventional wisdom, however, by warning against putting together a high powered and, thus, highly compensated team too early. In the early stages, the benefit of having all the pieces of a great management team in place is far outweighed by the increase in the burn rate necessitated by paying for all that talent. That talent will be needed later on to develop the company and to bolster the chances of obtaining additional financing. So entrepreneurs should have the talent identified but not necessarily hired in the earliest stages.

What is most important, both early on and later is to have a team. It is suggested that the best teams work well together and have successfully worked well together before, perhaps at a previous employer. Teams should have a leader, the members should have diverse skill sets, and all should understand the marketing function.

Two observations about the management team seemed particularly instructive. First,

being smart does nothing other than open the door. The management team must have value adding skills in addition to intelligence or they are wasting their time and money.

Second, the decision about when to bring in a professional management team is one of the most critical decisions a company can make. Too early and the company wastes money; too late and the company wastes opportunity.

The management team consists of the entrepreneurs, the financiers, the eventual professional management staff, and the board. In addition to their traditional role as watchdogs, the authors suggest that, if a person doesn't bring something of value to the company other than oversight, they have no reason to be on the board. The author's research indicates that the role of the board in startups is evolving towards being part of the value creation equation. A good board can provide strategic assistance, customer introduction, help in forming strategic alliances, and (whether it is desired by the founding entrepreneurs or not) hands-on assistance. Kurtzman and Rifkin also found that companies that had angel investors on their boards had more-developed strategies than those that did not, or those that had venture capitalists on their boards. However, the 'VC-backed companies had slightly better management teams[.]' This expanded role for boards blurs the line between oversight and management, which could cause friction. The opportunity for friction increase as a company moves from the seed stage into the growth stage. At this point, the goals of the company's management and the goals of the board, especially VC's and other investors, may be in conflict.

Managing cash flow is one of the most difficult things that startups have to contend with. The idea for a typical startup is to borrow some money and use that money to create products and services and, then to begin to sell. If necessary, the process of borrowing is repeated as sales increase,

driving up the value of the company until the company no longer needs to borrow money to support itself. At this point the money previously borrowed is paid back and investors have stock that is, presumably, worth more than the money invested.

The authors' research shows that the more successful companies have better cash flows, and a better understanding of their cash flows, than their less successful counterparts. A strong correlation between cash flow and customer acquisition was found as well. Less successful companies had higher cash flow in the seed round of financing which declined as time went on. This is attributed to having too much high cost staff early in the company life cycle. According to interviewee Yuchun Lee, no successful software startup that reached a billion dollars in sales ever lost money after its revenue hit \$15 million. From this, we can infer that most that most successful companies are profitable very early on.

Knowing market size is important to a startup. However, bigger is not always better when it comes to market size. The authors point out that companies targeting smaller markets were better "able to manage growth and add more value over time." As counter-intuitive as it seems, going after a market that is too large or having too much startup capital causes companies to be unsuccessful. Companies that require less money and move in on smaller markets become profitable more quickly.

Hand-in-hand with knowing the market size is understanding the target customer. Using the example of Captivate, a company that places televisions in elevators to deliver information and advertising, the authors demonstrate how to know the target customer and how to leverage that knowledge into revenue.

To understand a company's position in the market, the authors suggest analyzing its cost structure, sales cycle, value proposition,

patents, efficiencies, partnerships/channels, and analysts' and consultants' responses to the company. Sometimes the entrepreneur's vision creates the market position *a priori*. When this works well you get market defining companies like Microsoft or Nike. When the entrepreneur's vision does not mesh with the consumer's reality you get the equivalent of startup roadkill, such as Pets.Com or *Rosie* magazine.

The authors suggest that a thorough understanding of the market and customers is in itself a competitive advantage. Niche marketing and discounting also provide powerful advantages. Investing the time to identify the market, the company's competitive advantages, its customers, and then to validate that market makes the business model development go much more smoothly.

While the marketing plan focuses on delivering value, the business model is essentially how the business captures value for itself. "The business model determines the viability of the company" say the authors. It is an "inward facing" model of how the company does business and how that business leads to growth and profit. The first step in business model creation is to understand what business the company is in. This is where previous work in competitive and customer analysis factors in. For example the authors discuss Virgin Atlantic as a company that understands what business they're in. According to Kurtzman and Rifkin, Richard Branson decided that Virgin Atlantic was in the entertainment business not the transportation business, and that decision has been a key factor in its success. As a result, Virgin Atlantic offers a very unique flying experience for world travelers.

A business model must include pricing, manufacturing, distribution, and all the other aspects of commerce in a combination that is scalable, sustainable, and nimble. If this is achieved growth will not be interrupted, and

customers and suppliers won't be inconvenienced, thereby creating drag on the company.

Successful product development involves the actual product, the customers' involvement in the development process, the manufacturing process, financial inputs, and other decisions.

One interesting finding was that "a more developed product is not always better." If a company spends too much time or too many resources getting the product right, the market may already be captured by another company. Even if it has not, the company may have squandered the resources allocated to penetrate the market. Because many products have an iterative nature (for example a new cell phone comes out every week), getting to market quickly is more important than getting to market with a perfect product. This does imply that there will be a continuing budget for product development, and it may be larger than some companies anticipate.

Four keys to product development are mentioned: product development must be market focused, prioritization is key, product development can not be linear, and cash flow is king. Three are obvious or have been previously explained. However, product development can not be linear is an interesting point, and the authors state that "startups must extrapolate product development out into the future, making the difficult but necessary decisions about where technology is going to be." This appears to be a daunting task without a crystal ball, but companies like Apple do an amazing job of it.

This book has some solid findings for companies in search of customers. "Lighthouse customers," i.e., customers that believe in the company and its products and who are willing to provide references, are crucial to success of most startups. Shorter sales cycles are better for startups because

being able to generate more sales means a quicker path to economies of scale and market penetration. It is also re-noted that a quicker product is preferable to a more developed one.

One often used strategy for ramping up sales is to hire a “gunslinger.” This is a person (usually brought in as a VP of Sales) who has been responsible at various companies for generating five million dollars in sales for one product after another. Sung Park, one of the interviewees claims that “Every startup needs a gunslinger. They’re wild and impossible to manage, but to get past the gatekeepers you need those kind of guys[.]” Another strategy is to get a champion inside a company’s first key account. That way the product is sold from the inside out.

The startup company should seek direct customers first, channels second, and alliances last according to Kurtzman and Rifkin. That being said, a channel partner like Microsoft if your company is in the computer industry or Sony if it sells an electronic device or component, can be a valuable ally, lending their credibility and aid in deflecting troubling questions such as ‘will you be here in a year?’ or ‘can you support your product?’

The more successful companies reviewed showed a good mix of direct sales, channels, and alliances. Companies that had successfully negotiated channel deals had significant advantages over those who had not. Of course, this might not be causal in nature. Angel invested companies had a significant leg up on channel sales development, presumably due to the nature of assistance that angels bring to a company. However, the most successful companies focused directly on customers and less on channels and alliances.

In conclusion, ten tips are given. They summarize the book well and are good touchstones for future reference for entrepreneurs, scholars, and students. They

are:

- 1) Start with a large group of three or four founders
- 2) Make certain a marketing or sales person is a member of the founding team
- 3) It’s all about teams
- 4) When building the business, don’t worry about your exit
- 5) Manage your cash
- 6) Start with a market
- 7) Find a great first customer
- 8) Build a board that’s a great “sounding board,” not just a good watchdog
- 9) Make your product or service high quality and unique, then brand it in a way people won’t forget
- 10) Enjoy the ride

I think these rules, combined with the rest of the book, are good reading for any potential entrepreneur.