Strategy vs. tactics from a venture capitalist - *Arthur Rock*

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Strategy is Easy but Tactics are hard

As a venture capitalist; I am often asked for my views on why some entrepreneurs succeed and others fail. Obviously there are no cut-and-dried answers to that question. Still, a few general observations about how I evaluate new businesses should shed some light on what I think it takes to make an entrepreneurial venture thrive and grow.

Over the past 30 years, I estimate that I've looked at an average of one business plan per day, or about 300 a year, in addition to the large numbers of phone calls and business plans that simply are not appropriate. Of the 300 likely plans, I may invest in only one or two a year, and even among those carefully chosen few, I'd say that a good half fail to perform up to expectations. The problem with those companies (and with the ventures I choose *not* to take part in) is rarely one of strategy. Good ideas and good products are a dime a dozen. Good execution and good management -in a word, good *people*- are rare.

To put it another way, strategy is easy, but tactics-the day-to-day and month-to-month decisions

'Bad news, chief, we're facing a takeover bid by the Easter Bunny."

required to manage a business-are hard. That's why I generally pay more attention to the people who prepare a business plan than to the proposal itself.

Another venture capitalist I know says, somewhat in jest, that the first thing he looks at in a business plan is the financial projections. Frankly, how anyone can figure out what sales and earnings and returns are going to be five years from now is beyond me. The first place I look is the resumes, usually found at the back. To me, they are the essence of any plan. (Maybe no *one* reads the middle section!)

I see the plan as really an opportunity to evaluate the people. If I like what I see in there, I try to find out more by sitting down and talking with the would-be entrepreneurs. I usually spend a long time on this. (Unless their first question is "How much money am I going to get?" Then the interview is very short.) I don't talk much during these meetings; I'm there to listen. I want to hear what they've got to say and see how they think.

Some of the questions I ask have little to do directly with the particular business under discussion: Whom do they know, and whom do they admire? What's their track record? What mistakes have they made in the past, and what have they learned from them? What is their attitude toward me as a potential investor—do they view me as a partner or as a necessary evil? I also ask specific questions about the kind of company they want to develop-say, whom do they plan to recruit, and how are they going to do it?

I am especially interested in what kind of financial people they intend to recruit. So many entrepreneurial companies make mistakes in the accounting end of the business. Many start shipping products before confirming that the orders are good, or that the customers will take the product, or that the accounts are collectible. Such endeavors are more concerned about making a short-term sales quota than about maximizing the long-term revenue stream.

Granted, the pressure on new businesses to make sales quotas is strong. And that's precisely why the company needs a very, very tough accounting department. Otherwise, it will get into trouble. I always ask what kind of chief financial officer the entrepreneurs plan to bring on board. If they understand the need for someone who will scrutinize the operation closely and impose appropriate controls, they are more likely to be able to translate their strategy into a going concern.

This may go without saying, but I also look at a person's motivation, commitment, and energy. Hard work alone doesn't bring success, of course, but all the effective entrepreneurs I've known have worked long, hard hours. And there's something more than the number of hours: the intensity of the hours. I think of two software entrepreneurs I know who are going at 110 miles per hour, 18 hours per day, 7 days a week. And they have instilled their intensity and their belief in the business in all the people who work for them.

Belief in the business, clearly, is critical. If you're going to succeed, you must have a burning desire to develop your idea; you must believe so firmly in the idea that everything else pales in comparison. I usually can tell the difference between people who have that fire in their stomachs and those who see their ideas primarily as a way to get rich. Far too many people are interested in building a financial empire instead of a great company.

I want to build great companies. That's how I get my kicks. I look for people who want the same thing.

At a presentation I gave recently, the audience's questions were all along the same lines: "What are the secrets to writing a business plan?" "How do I get in touch with venture capitalists?" "What percentage of the equity do I have to give to them?" No one asked me how to build a business! And here's a question that both amused me and bothered me: "How do I get rid of the venture capitalists after they've made their investment?"

I'm looking for entrepreneurs who ask, "How can I make this business a success?"—not "How do I make a fortune?" And I prefer someone who *wants* me to play a role in the enterprise's decision making. Obviously, when they come to me entrepreneurs are interested in getting my money. Many have the attitude, "Uh oh, is this guy going to want to come to staff meetings and open his big mouth?" But they should realize that I can be a resource for them in more ways than one. I've been around for a long time; there just aren't many business problems that I haven't seen before. And most entrepreneurs can use all the help they can get in developing and implementing the tactics that will make them successful in the long run.

There's a line between refusing to accept criticism and sticking to your guns.

When I talk to an entrepreneur, I'm evaluating not only his (or her) motivation but also his character, his fiber. And the issue I set the most store by is whether he is honest with himself. It's essential to be totally, brutally honest about how well-or how badly-things are going. It's also very difficult.

Too many businesspeople delude themselves. They want so much to believe that they listen only to what they want to hear and see only what they want to see. A good example is a top executive in the parallel-processing industry; he believed his engineering people when they told him the product would be ready on time, and he believed his marketing people when they told him how much they could sell. So he developed a sales staff and doubled the size of the plant and built up inventories before he had a product to sell. The computer was late because of some last-minute bugs, and he was stuck with it all. The first 98% of designing a computer is easy; the bugs always come up in the last 2%. Fixing the problems took time, which ate up all kinds of overhead. And when he was finally ready, he couldn't meet the company's forecasts-which had been unrealistic from the beginning.

This story illustrates well my thesis that strategy is easy; execution is hard. The company's product was two years ahead of its competition. Execution of the idea, however, was terrible. That the strategy was good is obvious now; several other manufacturers have entered the field and are doing very well. But the company has lost the competitive advantage it would have enjoyed if its management had been better.

I can cite a similar example, also from the computer industry. The three people who started the company were the president, the manager of the software division, and the manager of the hardware division. The two managers kept telling the president that things were going swimmingly, and he wanted to believe what they said. Then one day, faced with an order the company couldn't fill, the software division manager called the president, who was out of town, and let forth a blast that in essence said, "We've been making a lot of mistakes we haven't told you about. We're at least a year behind."

Now, that's a ridiculous situation; the president should have known the status of product development. He had enough background in the field, and he knew the managers well enough that he shouldn't have been caught by surprise. But he didn't look closely enough, and he didn't ask the right questions. In the meantime, the business had a rather large marketing and sales force. Then the question became whether to keep the sales force (which by this time was fully trained but doing nothing) or to let everyone go and wait for the software to be finished. If the latter, they'd have to hire and train a new sales force-a no-win situation either way.

Failure to be honest with yourself is a problem in any business, but it is especially disastrous in an entrepreneurial company, where the risk-reward stakes are so high. As an entrepreneur, you can't afford to make mistakes because you don't have the time and resources needed to recover. Big corporations can live with setbacks and delays in their "skunkworks"; in a start-up situation, you'd better be right the first time.

After being honest with yourself, the next most essential characteristic for the entrepreneur is to know whom to listen to and when to listen, and then which questions to ask. Sometimes a CEO listens only to what he wants to hear because he's afraid of the truth; in other cases, it's because he's arrogant or has surrounded himself with yes-men. A lot of managers simply will not accept criticism or suggestions from other people; they demand absolute loyalty from their subordinates and call disloyal anybody who tries to tell them something they don't want to hear.

It's usually easy to spot this trait by the way someone talks with outsiders about the organization. If the entrepreneur says, "This guy's lousy and that one doesn't know what he's doing, but I saved the company "-or if he explains how brilliantly he performed at his last job, even though he got fired-I get wary. That kind of attitude is a red flag, like the statement, "I'll be honest with you": you know you're not getting the whole story.

To be sure, there's a thin line between refusing to accept criticism and sticking to your guns. Good entrepreneurs are committed to their ideas. In fact, I knew one company was in trouble when the CEO accepted almost everything I told him without argument or question. But some people have an almost perverse desire to prove to the world that their way is the right way-and the only way. I remember one CEO who had a great strategy-an idea for a unique computer architecture-but who refused to accept any advice on anything from anyone, including potential customers. He ended up with a product that had to be totally re-engineered, and a weak staff. The company is now under new management and may be able to make something out of what is still a good idea, but the CEO's tunnel vision sure stalled it at the starting gate.

A great idea won't make it without great management.

Another important quality-one that also has to do with taking a hard look at oneself and one's situation-is to know when to bring in skills from outside and what kind of skills.

As I see it, a company's growth has three stages. During the start-up, the entrepreneur does everything himself: he's (or she's) involved in engineering the product, he makes sales calls himself, and so on. After a while, the company grows and he has to hire other people to do these things-a vice president of sales, a vice president of engineering-but they report directly to him, and he still knows everything that's going on.

The company reaches the third stage when it hits, say, $100 million to $200 million in sales. At that point, it's just too large for the president to be involved in all the doings. More management layers are in place and a fleet of executive vice presidents, and it now calls for entirely different skills to run the company than it did during its infancy. The president has to work through other people instead of doing it himself, and he has to get his information through two or more organizational layers.

The ideal would be a president who could manage a company at all three stages, starting the business from scratch and staying involved until he retires. Alfred Sloan at General Motors and Tom Watson at IBM were able to do just that, and the leaders of Teledyne and Intel have done it more recently.

But not all entrepreneurs can manage a large company. And many don't want to. Some people who relish business start-ups are simply not interested in running a formal, multi-tier organization. After Cray Computer grew to a fairly good size, for example, Seymour Cray wanted to get back to designing computers. Similarly, Apple Computer's Steve Wozniak and Steve Jobs (at least in the early stages) recognized that their genius was technical and promotional, not managerial, and that they needed experienced, professional managers to oversee their company's growth.

Other entrepreneurs have been less aware of their own limitations. Consider the experience of Diasonics and Daisy. Both flourished when they were small enough that their founders were able to control all aspects of the business. But they grew too fast, and the managers didn't realize that they now needed a different style of management and control. In both cases, a resounding initial success turned into an ignominious mess. And today, as a result, both enterprises have been reorganized.

Sometimes problems arise because the entrepreneur doesn't grasp the importance of strong management. I know of one young company that has already gone through two CEOs and is looking for a third. On the plus side, the men who founded the business acknowledged that they were engineers, not managers, and they went out and looked for a CEO. They considered their strategy so brilliant, though, that they figured anyone could carry it off. The first man they hired talked a good game but had been a disaster at two other corporations,- eventually they had to let him go. He just couldn't manage the company. Then the directors hired another CEO who lasted only a few months. The company's product is still a good one, but without equally good leadership it may die in infancy.

The point of these examples is simple. If entrepreneurs do not have the skills required to manage the company, they should bring in an experienced professional. And they should never settle for someone mediocre by telling themselves that the business is such a winner that it doesn't need the management and controls that other companies do.

An entrepreneur without managerial savvy is just another promoter.

A great idea won't make it without great management. I am sometimes asked whether there is an "entrepreneurial personality." I suppose there are certain common qualities; a high energy level, strong commitment, and so on, but there are as many different personal styles as there are entrepreneurs. Henry Singleton of Teledyne, for example, reminds me of de Gaulle. He has a singleness of purpose, a tenacity that is just overpowering. He gives you absolute confidence in his ability to accomplish whatever he says he is going to do. Yet he's rather aloof, operating more or less by himself and dreaming up ideas in his comer office.

Max Palevsky, formerly at Scientific Data Systems (SDS), is, by contrast, a very warm person. At SDS he'd joke around with his employees and cajole them into doing what needed to be done. His very informal style was evidenced by his open shirt and feet up on the desk.

The CEO's personality is extremely important because it permeates the company, but there's no one style that seems to work better than another. What is important is to *have* a style. An "average Joe" won't inspire others and lead a business to success.

"The first challenge, of course, will be to get the company back on track."

I look for an entrepreneur who can manage. A conventional manager isn't risk oriented enough to succeed with a new venture, while an entrepreneur without managerial savvy is just another promoter.

Good entrepreneurs are tough-minded with themselves and with their teams. They can make hard decisions. They have to be able to say, "No, that won't work" to colleagues who come to them with ideas, or to say, "That's a good idea but we can't do it because we have other priorities." To make such professional judgments, managers should ideally be well versed in the technology on which the company is based.

There are exceptions, of course. John Sculley at Apple Computer comes immediately to mind. When Apple was looking for someone to fill the top slot, it instructed the executive recruiter to find a CEO with a technical computer background. But the recruiter asked Apple to consider someone from left field (from the soft-drink industry), and I need not point out that the results have been excellent. It was a lucky fit. In fact, as far as the "secrets of entrepreneurial success" go, it's important to recognize that a little bit of luck helps and a lot of luck is even better.

Another company I know, formed by two young, inexperienced men, benefited from a lucky break. Though very knowledgeable, they seriously underestimated how long it would take to write the 1,500,000 lines of software code they needed to launch their product. Consequently, they were two years late in bringing the product to market. But the market was also slow in developing. If the product had been ready on time, the company probably would have gone bankrupt trying to sell something for which the market wasn't ready. As it turned out, the market and the product were ready at the same time, and the company could exploit the product without competition. Many business success stories are due at least in part to simple good luck.

I emphasize people rather than products, and for good reason. The biggest problem in starting high-tech businesses is the shortage of superior managers. There is too much money chasing too few good managers. I have always preferred to wait and have entrepreneurs come to me, to approach me because they have a great desire to build a business. Now with all the megafunds available, it's often the venture capitalist who goes out to start a company and looks for people who can head it up.

Those who call us "vulture capitalists" do have a point; some venture capitalists lure away a company's best people, thus hampering its growth. How can an enterprise develop and thrive when its top executives are always being pursued to start new companies? Unfortunately, in the high-tech industries, more and more businesses are being formed simply to make a buck, As for myself, though, I will continue to look for the best people, not the largest untapped market or the highest projected returns or the cleverest business strategy.

After all, a good idea, unless it's executed, remains only a good idea. Good managers, on the other hand, can't lose. If their strategy doesn't work, they can develop another one. If a competitor comes along, they can turn to something else. Great people make great companies, and that's the kind of company I want to be a part of..