



# Against the Odds

Startups that  
Make It

Derek Lidow

# It is one of our saddest economic statistics: More than half small businesses fail within a few years of startup.

Unlike the cheery pictures presented in advertising or the success stories showcased on *Shark Tank*, a significant percentage of fledgling enterprises sputter and eventually die. Only 1 in 43 has any employees after 10 years. These startups don't create much economic value. The vast majority don't even earn as much for their founders as those people could have earned working for someone else. Dreams die, jobs are lost, and communities lose their vitality.

It does not have to be this way. In fact, if we want a robust economy with job growth, we must do something about it. I think that the solution is deceptively simple: entrepreneurs should stop thinking so much about the idea behind the business and focus instead on how to lead it.

Simple, however, doesn't make it easy.

I don't want to discount inspiration, but thinking up the new widget is relatively straightforward. I have started companies and studied enough entrepreneurs to have seen the thrills, challenges, and pitfalls that comprise the harsh reality of trying to get a business off the ground and keep it there. Turning an idea into a viable business takes a lot of hard work, a certain amount of luck, and a particular set of skills that change as the venture evolves through a predictable sequence of four stages every new business must traverse as it evolves toward maturity: customer validation, operational validation, financial validation, and self-sustainability. Each stage has distinct leadership needs and challenges.

Leadership, I admit, has become something of a catchall term; there is no commonly accepted definition of it in the academic literature and it seems to get tacked onto every business book title and executive education seminar. So let me explain what I mean: entrepreneurial leaders, ELs, are the people who can take an enterprise from its first customer—that's when something goes from "Aha!" to being a business—through the point where it is able to adapt and innovate to thrive amidst changing market conditions and customer needs. These ELs exert their leadership by mastering five behavior and skills: self-awareness, relationship building, motivation, leading change, and enterprise basics.

This is a distinct departure from those who advocate that an intense amount of effort go into a business plan. I have witnessed any number of failed endeavors with absolutely stunning business plans. The PowerPoint deck was pristine and the elevator pitch finely honed. My experience is that the business plan ought to get at most one-quarter of your time because it won't save you when things inevitably go differently than planned. The successful serial entrepreneurs I know use an effectual strategy through which they experiment to test hypotheses as they go along. Yes, you need to have a fix on how you think the business will make money, but creating detailed financials early in the process is simply a waste of time because the assumptions you make in stage one are not likely to survive contact with actual customers.

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# The Four Stages of a Business

Startups come in many forms: product businesses and service businesses, technology businesses and bricks-and-mortar businesses. They all go through four distinct phases. The first phase is finding a customer. This provides what I call *customer validation*: someone is willing to pay money for what you offer. Without a customer, you simply don't have a business no matter how excited you are about your idea. One of the startup leaders I profile in my book is Wendy Kopp, founder of Teach for America. She developed her idea for a teacher corps in her senior thesis. She used the thesis to generate funding proposals. She found two corporate executives willing to provide seed money. This was the beginning of a going concern.

In the second phase you deliver the product or service, whether it is hamburger or a software package. You have to demonstrate that your business can satisfy the customer you've found and find new ones. This is *operational validation*. It was great that Kopp found her initial investors but with that came the need to deliver recent graduates trained to teach to the school districts that had agreed to receive them. She gave her team a small window in which to pull this together and Teach for America almost crashed and burned in this phase.

In the third stage, the business must prove that it can create economic value under changing market conditions. You are not simply executing as you planned but adapting to real world conditions. Customers make demands. Supply chain realities kick in. Competitors take action. When you show that the business is nimble enough to make money in these conditions, you achieve *financial validation*.

In the final stage, the business makes a step change: it can innovate to meet changing customer needs and expectations. No business exists in a void and none operates in a static environment. As the context changes, the business must continue to evolve. This is often the point where it becomes clear that the business can live beyond the founder. This is *self-sustainability*.

In the early stages, the activities are about breaking new ground and creating change. There is a lot of iteration as you test and refine your offering. This is project work. You are doing things differently as you work toward filling a true market need. I looked at Peter Thiel and Levchin, the founders of PayPal. The success story that we all know actually represents the fourth iteration of their business. They cycled through stages one and two until they hit on something with verifiable commercial potential.

In stages three and four, the business needs greater predictability and efficiency. This is process work. You are finding ways to do things the same way so that you minimize variability. Work in these stages takes a different kind of discipline. If you loved stages one and two, you likely won't find stages three and four nearly as exciting. This isn't the fun part for most ELs but you can't skip a stage because you don't like it. Trying to avoid a stage puts the business at great risk.

Looking at a business in this way, it becomes clear that an EL must be facile with different skills at different times. Only when you have mastered the five qualities can you adapt to meet the needs of the enterprise. This is what I call being selfish enough to be selfless. You are selfish enough to want the rewards of the business succeeding that you can be selfless in putting the needs of the business ahead of your own preferences. You are willing to change and grow for the benefit of the organization you have created. This can be difficult because entrepreneurs often shape their original conception of the enterprise around their particular personality and functional skill set.

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# The Five Essential Qualities

Call them traits, behaviors, capabilities, or skills, the five qualities are the essential ingredients for building an idea into a viable and sustainable enterprise. They create the pathway for knowing yourself, knowing others, and knowing the business. As few as 1 in 50 start with sufficient mastery of them all. However, they can be mastered. This is the truly exciting part. The high failure rate of small businesses is not carved in stone. You can increase your chances of success when you know where to focus your attention and effort. I call this developing a personal leadership strategy.

A brutally honest assessment of your strengths and weaknesses is the first step. How well do you perceive how others respond to what you say and do? How do you react to stress? Can you delegate or are you a control freak? Are you open to honest feedback? Can you focus or do you prefer to work on five things at once? These questions all get to your level of self-awareness and emotional intelligence. Leading others requires the ability to lead oneself. Only with a realistic understanding of your physical, mental, and emotional capabilities in addition to your functional skills can you do this. Working with mentors is an effective way to get direct, honest feedback when you ask for it.



High self-awareness is the foundation of the second skill, relationship building. Unless your aspiration is to be a one-person operation in a garage—the kind of business that typically finds limited success or fails—you are going to need to work with other people. These include customers, employees, suppliers, distributors, and others who will constitute your enterprise eco-system. Building healthy relationships with these people is the only way that your business will scale. It is terrific that you are a talented baker but if you want to build a commercial-scale wedding cake business, you must be as adept with relationships as you are with flour and eggs.

Anyone who has been in a significant romantic relationship knows that they require effort and attention. The same is true of work relationships. I have someone who has been a long-term COO to my role as CEO. We have learned how to cooperate, compete, and defer to each other in service to the agreed-upon goal of building the value of the business. We acknowledge each other's strengths and weaknesses. We can be forthright with each other, even at times when it is uncomfortable. We trust each other.

How can you build such relationships? Any relationship is based on shared objectives; you agree on what you ultimately want to accomplish and how you will measure success. The relationship of each person to the objective, however, can take one of three stances: cooperative, competitive, or retreating. Cooperative means that you both agree to agree on how the costs and benefits

will be allocated. In a competitive stance, you and the other person have different perspectives on the best way to do things. In a retreating stance, you cede decisions on how benefits will be allocated while agreeing to bear some of the costs. Any healthy relationship has a mix of all three and an EL who has mastered relationship building knows how to optimize the mix. With my COO, we cooperated on the over-arching goal of creating business value but competed on ideas to create that value in order to test whose ideas were best. We cooperated on creating a corporate culture which required that we align on values and vision in this area. I retreated in areas of compensation plans, deferring to his greater expertise.

It is a mistake to think that one stance is always good or bad. Each is a strategic choice and can be right or wrong depending upon the situation and the people involved.

Motivation is the third essential skill. This means understanding what truly drives you as well as how to tap into the aspirations and driving forces of others. In any enterprise that makes it to stage four, there are rough spots to put it mildly. Often, there are times that you will find yourself staring into the abyss: A big customer may walk away. You have to dip into personal savings to make payroll. You find yourself in conflict with key team members or a critical supplier. At these times, you will be tempted to ask yourself why you are on this crazy journey. Why not just go get a job?

Tapping into your foundational motivations is where you will find the answers that will sustain you. As you lead the business through the four stages, you may find that you need to let people go who were instrumental to your early success. You may need to bring in people who make you somewhat uncomfortable as they add structure to the enterprise. What motivates the crazy coder who keeps your products innovative is not the same thing that inspires the person who makes sure that new releases are delivered on time and on budget. As an EL you must balance these, tending to each while always keeping the needs of the business foremost.

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The fourth quality is leading change. The four stages mark a progression in time, structure, and maturity. It is up to the EL to make those transitions personally and to bring the organization through them. I studied the EL of a training company. He saw that his company was going to fade into irrelevance unless it adapted to changes in the marketplace. The changes frightened this EL as well as some of the members of his core team. Stasis, however, was only a choice to decline.

Like every EL, this individual needed to get his ducks in a row: Everyone responsible for implementing the change had to understand and embrace the need for it. Their motivations had to align with the change. The team had to have the skills and resources to accomplish the change. And throughout, the mantra was communicate, communicate, and communicate some more. It can be tempting to mandate change from the top. This is why change efforts often fail. When an EL attends to the prerequisites above, it is much harder to go wrong.

The final quality is an understanding of the business. This may seem obvious, but you would be surprised at the entrepreneurs I encounter who are in love with the idea of their business but who do not understand how the mechanics of the business work. Unless you can master cash flow, inventory management, customer acquisition costs, or whatever are the key indicators for your enterprise, you will ultimately fail because you will make flawed decisions. You can only get so far on gut feelings and optimism. This can be particularly difficult for non-financial entrepreneurs. You have to be enlightened enough to understand that financial realities do not go away. Even if it isn't your strong suit and you hire a great CFO, you must understand enough to comprehend the health of the business and the validity of the assumptions under which sales, manufacturing, and other functions are operating.

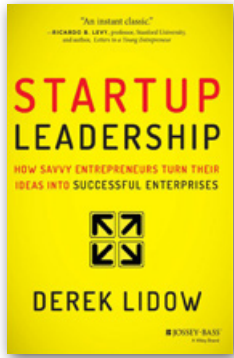
So, too, is there a world beyond the numbers. The intangibles of relationship to a brand or the value of design, as Apple and others have demonstrated, mean that mastering the business requires more than financial acuity.

## EL is About More than Entrepreneurship

I started this manifesto with what I believe is a tragic statistic: the high failure rate of new enterprises. My motivation in teaching at Princeton and writing my book—and this piece—is to change that. It pains me to see smart, engaged people fail. Research has shown that almost all job creation and economic growth is the result of an entrepreneur's idea successfully taken to scale. Decreasing the failure rate by even a few percentage points would unlock tremendous benefits for society. Extending an understanding of EL dynamics to non-profits and social enterprises can increase their impact on the world.

**The viability of small business transcends ideology. It depends upon more than the usual platitudes and generalities. The skills of EL can help animate organizations and communities at every scale. 🌱**

# Info



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**ABOUT THE AUTHOR** | Derek Lidow is a longtime global CEO, innovator, and startup coach. He is widely-known as one of the world's top experts on the electronics industry; his contributions range from patents to value chain applications that have forever improved companies as diverse as Sony, Samsung, Philips, Goldman Sachs and IBM. Among his many accomplishments, Derek is a successful entrepreneur who built iSuppli, a leading market research firm. In 2010 he sold his company for \$100 million to global information leader IHS. You can follow him on twitter at [@DerekLidow](#).

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