

## *From the Practitioner's Corner*

# No Mulligans: When Good Entrepreneurs Make Bad Decisions

Joseph E. Levangie

**S**ome of the best entrepreneurs fail early and often. Less talented or less committed entrepreneurs do not even get a second chance. Failure and setbacks, however, can be instructive. What lessons can be learned from these experiences? How can the entrepreneur (and investors) navigate around the potholes on the New Venture Highway? Read on.

It was reported that on a Nova Scotia fishing trip many years ago, Ted Williams, the Boston Red Sox star hitter, and Sam Snead, the standout golfer of his era, entered into a conversation concerning the relative difficulty of their two sports. It went something like this:

Teddy Ballgame: "Sam, golf is easy. The ball just sits there on the ground. When you're good and ready, you hit it! In baseball, I face a pitcher slinging the blurry white pill at 95 miles-per-hour! And I don't get any second-chance Mulligans like you golfers!"

Slamming Sammy responded: "Ted, every time you hit a foul ball, you are really getting a Mulligan! You get to hit the next pitch. In golf, we have to hit our foul balls from wherever they've landed!"

While I've personally attained certain levels of incompetence in both sports, I know from my entrepreneurial activities that we can draw two object lessons from this classic conversation. First, it is generally moot to compare one particular challenging venture directly to another; a single dissimilarity can outweigh all points of commonality. Second, unless you cheat or passively await divine intervention, there are no Mulligans in entrepreneurship to help you succeed. You should intend, therefore, to meet the rigors of conceptualizing, implementing and operating your new business venture without the benefit of "a free pass". In this Age of Entitlement—a term coined by Robert J. Samuelson (1996)—increasing numbers of people seek the easy path. There are few entitlements, however, for small business, and the entrepreneur should look in the mirror for self-help. Entrepreneurship requires serious, well-focused endeavors and an enormous amount of blood, sweat and tears! Good decision-making entails all that effort—plus unbiased and intelligent sorting of alternate actions.

The statistics of success in decision-making suggest that entrepreneurs face daunting odds. In the chaotic world of

venturing, you are expected to be near perfect. You must succeed at each step of the business development journey. Ted Williams, by contrast, failed to get a hit more than 6 times out of 10. At each hole, Sam Snead generally needed 3 to 5 shots to get the ball in the cup. Sports metaphors undoubtedly trivialize the plight of the would-be entrepreneur. In striving to be near perfect, entrepreneurs confront a series of complex tasks: planning, product/service development, marketing, financing, operations/organization building, and sales.

The road map for a new venture can be depicted by a complicated, occasionally impressive, decision tree that sequences these tasks in a cascade of branching actions and outcomes (Ulvila and Brown 1982). The underlying logic, thankfully, can be simplified. If the conditional probability (i.e., conditional upon the previous venture stages being successful) of each of these six stages is a respectable 80 percent, the probability of success is only 26 percent (0.8<sup>6</sup>)! Not good enough for many early-stage investors. Improving each of the conditional probabilities to 90 percent produces a 53 percent probability of success. You'll still fail half the time! Success and bad decisions obviously don't mix well!

### **Dilemmas Influencing Decision-Making**

When we analyze how small business CEOs make choices, we are reminded that in the hierarchy of decision influences, survival heads the list. Staying alive, however, cannot be taken for granted. Risk abounds. Small business continues, nevertheless, as an important subset of a dynamic economy.

Small and emerging companies contribute both job creation importance and volatility to our economy. The Wall Street Journal (Bounds 2004) recently culled some data from the Small Business Administration that underscore the extent to which small firms permeate, if not dominate, the U.S. economy.

Small businesses:

- employ half of all private sector employees;
- generate 60–80 percent of all new jobs annually; and
- pay 44.3 percent of total U.S. private payroll.

Life cycles of business births and deaths in 2003:

- business births—572,900

- terminations—554,800
- bankruptcies—35,037

The real dilemmas an entrepreneur faces in decision-making—which can ultimately threaten his survival—involve all the usual factors: external factors beyond the firm's control; competition; financing difficulties; operational problems; personal problems of the entrepreneur; and calamities, including fraud, natural disasters and theft.

### **External Factors**

The entrepreneur has little control over external factors. His (or her) decisions should be crafted, however, with an informed sensitivity to the company's changing environment. A few years ago, when the dot.com bubble burst, thousands of development stage companies were swept under in its wake. Dozens of New England companies canceled or postponed their IPOs. Many entrepreneur-investors took a severe financial "haircut," laid off people, closed operations, watched loans go bad and, at not an insignificant cost, acquired new-born humility. Diminution of personal net worth aside, the rigors of an economic downturn can introduce much needed discipline to the entrepreneur. The dilemma of a nasty business climate has, ironically, reintroduced old basic concepts such as "bootstrapping" and "moonlighting" (Denison 2000) to venture decision-making. The harsh reality requires the entrepreneur to squeeze incremental value out of scarce available resources. This renewed discipline serves well to remind CEOs that the crazed days of investors throwing funds at deals is history; that party is over and it's time to sober up!

In addition to the vicissitudes of the economy, there are other external decision-making challenges for the CEO imposed by new regulations. An important regulatory example is the ever-present Sarbanes-Oxley (S-Ox) with its requirements for improved corporate governance. Berry (2004) reports that while presently only public companies need comply with S-Ox regulations, it is possible that some offshoot of S-Ox will ultimately apply to privately-held firms as well as not-for-profits. The real decision tree for the entrepreneur is whether to become S-Ox compliant now, or wait until the rule extension is imposed; and how to craft an exit position for investors—be it an IPO or a buy-out by a publicly held company. In either case S-Ox compliance will be necessary. Still, I find many entrepreneurs staunchly resisting S-Ox under the guise that compliance is expensive and they're saving money. It is like the old Fram oil filter commercial—"You can pay me now or you can pay me later!"

### **Competitive Factors**

An enlightening acid test to see if an entrepreneur really knows his business is to ask, "How do you rate your compe-

tion?" Having interviewed well in excess of a thousand entrepreneurs over three decades, I would assess—anecdotally—that a full third of these would-be captains of industry give a knee-jerk response of "Oh, we really don't have any competition!" Wrong answer! The essential dilemma is that the company's strategic decisions cannot be made in a competitive vacuum.

If one learns nothing else in an MBA program, one should remember to address strategic issues by employing the venerable notion of SWOT—Strengths, Weaknesses, Opportunities & Threats. *CFO Magazine* reports (Durfee 2004) that the typical reaction for CEOs is to use half of SWOT—to focus on the positives of the external business environment and to deemphasize the negatives. When bad things happen to these good entrepreneurs—say the flop of a new product launch—it is not credible for them to blame "bad luck" if the risks of competitive threats have not been considered. The better you analyze critical decisions, the better your "luck!"

Over the last 25 years, the reigning guru of competitive analysis has been Michael Porter of the Harvard Business School, supplanting the Boston Consulting Group with its "experience curve" ("profitability is directly related to market share"), so ballyhooed in the '60s and '70s. Warsh (1994) reports that Porter imputes four competitive forces impacting the profitability of an industry:

1. rivalry among existing firms;
2. the bargaining power of both buyers and suppliers;
3. the threat of new entrants to the business; and
4. the threat of potential substitute products.

Porter introduced the "value chain" framework of interrelated marketing functions (customer base, brand name, distribution, service). The value chain contributes to the strength of a firm's product presence and calls attention to the competitive advantages that many big companies enjoy. Entrepreneurs, who often view big firms as outmoded dinosaurs, need to assess realistically the competitive risk of all market participants in the marketplace—including large firms—in the course of strategic decision-making.

How does the enlightened entrepreneur discover more about the competition? While there are no Mulligans in this arena, there are ways to improve your odds. Caulfield (2004) reports that initiating the proper due diligence is key. The right "course management" involves culling data from the public domain, overlaying your knowledge about your own company with that of the industry, and connecting the dots to draw patterns. Specific steps include:

- Research easily accessible databases to determine competitors' health.

- Check competitors' Securities and Exchange Commission (SEC) quarterly and annual filings at [www.sec.gov](http://www.sec.gov) to find product line margins, customer base, research spending, and personnel background.
- Check competitors' credit with Dun & Bradstreet, which will sell you detailed reports for \$122 each.
- Creatively dig up important competitor information.
  - Attend professional courses taught by competitors' management which might reveal their private financial and marketing information.
  - Access competitors' presentations to analysts at investment conferences and on conference calls which might represent the informational mother lode (e.g., I once plugged into the conference call of my biggest competitor, asked a question, and obtained an answer that swayed a critical strategic decision of our emerging company!).
  - Check the Help Wanted pages to see if competitors are hiring; and if so, what kind of technical skills they are seeking.
  - Analyze your foes' web sites. Email some queries to the web master—who knows, maybe he will spill the beans on something important and proprietary!
- On the defense, assume that turnabout is fair play.
  - Be careful to screen all your company's web site postings, press releases, presentations and vendor discussions.
  - Compartmentalize information among your company's different departments. Apple Computer, for example, can trace internal leaks because it assigns different code names to different departments for the same development project.
  - As appropriate, if threatened by overseas rip-off companies, have some fun. If your company needs to file a patent (that works), file several others that do not work and have the foreign firms waste their reverse engineering budget chasing a red herring!

### ***Financing Factors***

The area of finance is where the aspiring entrepreneur generally has the biggest dilemma in decision-making. Issues abound.

- How much capital do we need? When do we run out?
- What kind of capital should we seek with what structure?
- Where do we find the investors?
- How much will it cost our ownership in terms of dilution and control?
- What is involved in negotiations?
- How do we close the deal?

A cute ode by DeGarmo (1991) regarding an entrepreneur's quest for funding reflects well the financial decision-making climate:

*We were hungry for money, our nerves were all frayed.  
To survive, our expenses could NOT be delayed.  
In the past our agreements on handshakes were made.  
We just did not know how this new game was played*

*As we battled each crisis of mistimed receipts  
We bluffed, we negotiated, made impassioned entreats.  
The nights we spent tossing and whipping the sheets.  
The days were reserved for strategic retreats.*

*Now we're losing our stakes, being left with the rinds,  
From those equity penalties we shouldn't have signed.  
We brushed off our lawyers. We were caught in a bind,  
By those last-minute threats: "We're changing our minds."*

In late 2004, there is good news and bad news for entrepreneurs as they consider capital raise-ups. The bad news is that while venture capitalists invested \$833 million in 74 deals in New England companies in the second quarter of 2004, according to an Ernst & Young report (Witkowski 2004), only 32 percent of the deals involved seed or first round financings. The remainder went to bolster existing portfolio companies. The good news is that venture capital is not the only source of funds. Gennari (2004) reports that of *Inc. Magazine's* 2003 list of the 500 fastest-growing companies, only 2 percent used venture capital as their source for start-up funding, and more than 70 percent were started with \$100K or less. Healy (2004) reports that private investor groups, such as the Lexington, Massachusetts, Common Angels, are dramatically increasing their deal review activities. The dilemma for entrepreneurs is how to tap in on these positive developments.

### ***Operational Factors***

Peter Drucker (2004) has consulted to business for 65 years. His recent writings address several aspects of the operational dilemma of decision-making. Drucker concludes that successful managers can be "charismatic or dull, generous or numbers oriented." But every effective executive followed eight simple practices:

1. They asked, "What needs to be done?"
2. They asked, "What is right for the enterprise?"
3. They developed action plans.
4. They took responsibility for decisions.
5. They took responsibility for communicating.

6. They were focused on opportunities rather than problems.
7. They ran productive meetings.
8. They thought and said “we” rather than “I.”

Drucker explains, “The first two practices gave them the knowledge they needed. The next four helped them convert this knowledge into effective action. The last two ensured that the whole organization felt responsible and accountable.”

Entrepreneurs who remain blind to this kind of invaluable advice are far more likely to make decision errors.

### ***Personal Factors***

Among the unfavorable traits you might find in an entrepreneur, the following could most negatively impact effective decision-making:

- naiveté;
- arrogance;
- inexperience;
- lack of relationship-building; and
- emotional immaturity.

As chronicled in the article “The Young and the Clueless” (Bunker et al. 2002), such negative personal characteristics outweigh, in case after case, the benefits of being high-energy, intelligent and aggressively hard-working. I regrettably have my own war stories of unfortunate personal traits in entrepreneurs confounding otherwise normal decision-making:

- A London investment banker looked over at our technical founder/CEO and quietly asked me if his secretary might not take our “boy entrepreneur out shopping so the rest of us can complete the financing.”
- A cofounder and CEO in one of our technology companies was so emotionally committed to the company’s original target market that he could not concur with the board of directors’ decision to change direction and target a larger, more quickly accessible, faster growing, higher margin market. Despite being a large shareholder, he defamed the company to Wall Street, and started to spiral emotionally out of control. With an armed guard on premises, the board of directors voted him out of the company. Thankfully, no shots were fired! This entrepreneur’s self-destructive decision-making remains, however, a dilemma to many of us, years later.

### ***Calamities, Fraud and Other Surprise Factors***

A question for the ages: If fortunes are destined to go really bad for your company, would you rather mess up on your own or have it “done to you?” This dilemma is not really a

binary decision since the choice for some entrepreneurs depends on whether the calamity is an act of God (e.g., a flood) or an act of man (e.g., fraud). Some of us can—reluctantly—accept outcomes beyond our control (e.g., the dot.com market bubble burst) far easier than fraud by a trusted member of the entrepreneurial team:

- The CEO of a firm we were acquiring dropped dead only 20 minutes before signatures on the closing documents were to be obtained, thereby aborting the deal (sad, but the kind of busted deal which we can understand and accept).
- The CEO of a newly public development-stage company that we helped sponsor took a two-month post-IPO vacation to Australia on company funds to improve his tennis game after his eight-year struggle to raise funds (fraudulent and unacceptable, of course, leading to his dismissal, and forfeiture of his 40% equity interest).

Watkins and Bazerman (2003) suggest that signals of future calamities generally lie all around us and it is up to us to be astute enough to recognize them. Truly out-of-the-blue surprises aside, these researchers employ a concept called the “RPM process”: recognition, prioritization, and mobilization.

- Recognition
  - Marshal resources to scan the environment for emerging threats.
  - Analyze and interpret the data.
- Prioritization
  - Brainstorm the possible surprises.
  - Analyze the cost-benefit of such consequences.
  - Prioritize those threats with the highest costs.
- Mobilization
  - Select the most serious threats.
  - Take precautionary measures commensurate with risks.

### **The Entrepreneurial Decision-maker**

I have always found it fascinating to observe how business decisions are made. Large corporations—to their CYA credit—need to get consultants on board, purchase pricey market research reports, and conduct a seemingly endless chain of meetings. Some sessions may even be held off-site to stimulate the (presumptive) latent, lateral-thinking juices of the management team. Only then can they line up “the right players” to deliver “the big green light” of approval. Time is not usually deemed as critical; in fact, the time needed for a decision tends to be an exponential function of the number of people involved. A sidebar to this contorted decision route is the university setting where some schools actually flaunt their “committee on committees” as a desirable level of faculty involvement in the decision-making process.

In contrast, on dozens of occasions I have witnessed an entrepreneur take less than 90 seconds to make a monumental decision. Often while eating, and dripping pizza slime over an original document for his signature, he will ask a few key questions and say aye or nay. The ramifications of his instant decision might impact 150 percent of the company's cash balance or 30 percentage points in the venture's probability of success. "No matter," says the entrepreneur, "time is of the essence!" He continues eating.

This dichotomy of decision-making approaches underscores a certain conundrum: Can a professional manager become an entrepreneur or can an entrepreneur act like a manager? As O'Neal (1993) reports, even the venerable Peter Drucker skirted this issue in his writings on the subject by disclaiming that he would not discuss "psychology and character traits" of entrepreneurs. O'Neal notes, "While [Drucker's] probably right that the nuts and bolts of entrepreneurship can be studied and learned, the soul of an entrepreneur is something else altogether."

Amen, amen. So it comes to pass I will take a stab at deciphering this quandary of the entrepreneurial soul. Some observers of the scene, of course, believe that certain entrepreneurs whom they've encountered are, in fact, soul-less! The issue facing business schools, for example, is that the principles and mechanics of entrepreneurship can be taught, but the notions of creativity, drive and appetite for risk-taking remain well below the surface.

Prospective entrepreneurs come in all colors, sizes and shapes. Few are obvious daredevils or snake oil salespeople. Not many are impulsive or flamboyant. Most have an entrepreneurial idea and an intense need to exploit that idea "their way." O'Neal (1993) reports on a Purdue University study on why entrepreneurs "take the plunge." Based on 2,995 people who had decided to go into business for themselves, they responded "very important" to the following reasons (approximate percentage responses):

- to use my skills/ability 56%
- to gain control over my life 54%
- to build for the family. 52%
- to pursue the challenge 48%
- to live how/where I like 32%
- to gain respect/recognition 19%
- to earn lots of money 18%
- to fulfill other's expectations 9%
- to follow the best alternative available 7%

One can interpret this underlying motivation for the entrepreneurship life in the framework of decision-making traits, quirks and weaknesses by addressing the following:

- Does the stage of business life impact how decisions are made?

- How do personality and power/control issues impact choices?
- What type of bias creeps into decisions?
- What is the consequence of the decision-making methodology?

### ***Stages of One's Decision-Making Life***

Bennis (2004) references Shakespeare's seven ages of man (*As You Like It*) with a remarkable combination of business and literary acumen. Paraphrasing the Avon bard, Bennis applies the following seven stages to the development of leadership, and, derivatively, decision-making:

1. The "infant executive" needs a mentor before he's even given the leadership job. He must recruit a real team to back him up. His decision mistakes are typically from inexperience.
2. "The schoolboy, with shining face" as a first-time leader, is potentially unnerved by the spotlight and scrutiny surrounding his initial words and actions. He senses that he has only one chance to make a first impression. New team members will show either trust or distrust, either support or resistance—yet some of the negative feedback on his decisions may actually be accurate. His errors in decision-making may stem from nervously looking over his shoulder.
3. "The lover, with a woeful ballad" experiences the dilemmas of setting new boundaries in leading his former colleagues. Evaluation of his team's job performance, strategy formulation, and task prioritization can be in potential conflict with his "loving" relationships with his old cronies. His decision errors often emanate from the confusion of changing relationships.
4. "The bearded soldier" becomes comfortable with his leadership position. A danger evolves that he may forget the visceral impact of his words and decisions on his staff. As a result, his team may only tell him what they think he wants to hear. The true leader avoids this communications barrier by being open with his people. He may decide to hire talent better than himself and praise them for their accomplishments, rather than being jealous at their stars glowing perhaps brighter than his. Conversely, the degree to which the entrepreneur might have any self-doubt about his own shortcomings can create a nonrational (and possibly an irrational) decision-making environment.
5. "The general, full of wise saws" becomes arrogant and does not see or hear the dangers around him. Like Shakespeare's Julius Caesar, he does not heed the soothsayer's Ides of March warning or Calpurnia's pleas. Arrogance can keep the "general" from building alliances and coalitions in his senior team that will pro-

vide him with valuable input and the “reality check” he needs for his difficult decision-making. He lectures a lot, listens little.

6. “The statesman, with spectacles on nose” is in a position to pass on his wisdom without worries of personal ambition. For short periods of time, the statesman can be quite effective in making important and difficult decisions without personal career considerations.
7. “The sage, second childishness” is the older mentor who wants to create a legacy by imparting knowledge to a younger generation of entrepreneurs and to provide structure for more mature decision-making. The sage reminisces, orates and teaches.

One of my all-time favorite business shrinks, Abraham Zaleznik (1967), penned the following, back when I was a mere youth in his first-year HBS class:

*One of the major contributions of psychoanalytic psychology has been to demonstrate the place of conflict in the development of the individual. Each stage in the life cycle involves personal conflict because the individual has the task of giving up one set of gratifications and searching for alternatives that take account simultaneously of biological, psychological, and social challenges. Failure to relinquish gratifications impedes development, while overly rapid learning establishes a gap between instinctual-emotional processes, on the one hand, and cognitive-rational capacities, on the other. This gap leads often to a highly rigid set of conditions for the exercise of competence.*

Whereas I might characterize an egregiously misbehaving entrepreneur as “a \*\*\*\* jerk,” Dr. Zaleznik would say it with so much more panache!

### **Personality and the Need for Power**

Whenever I meet an entrepreneur for the first time, I know that there’s a 95 percent chance I’ll be encountering a Type-A personality. He or she will likely be bright, aggressive, impatient and egocentric. That’s the easy part. Which of these entrepreneurs will be successful (and why) is more challenging to assess. Here’s where good and bad decision-making comes into play. Manfred F. R. Kets de Vries (Coutu 2004) has devoted his life’s work to understanding how capable, visionary and inspiring executives can, nevertheless, make irrational decisions. This has led him into the fields of psychiatry and psychoanalysis to study the complexities of the business leader. Kets de Vries observes: “People in mental hospitals are easy to understand because they suffer from extreme conditions. The mental health of senior executives is much more subtle—[leaders] are insulted to hear that certain things in their minds are unconscious. But like it or not, people have blind spots, and the

non-rational personality needs of decision makers can seriously affect the management process.”

Another analytical framework involves the laws of the jungle—more specifically, chimpanzees. Dutch primatologist Frans de Waal (Lesly 1995) has studied chimps and views evolutionary psychology as a useful backdrop for explaining the subtle jockeying and constant gamesmanship of the workplace. Chimps demonstrate that the leader cannot allow himself to be too aggressive since his lieutenants will then dedicate themselves to finding a way to topple him. Our innate ape-like aggression may well derive from our inherited gene pool!

The entrepreneurial animal may extend this pattern of behavior. Without the counterbalance of investors—through the board of directors—or trusted advisors, an unbridled bully entrepreneur can desensitize employees, cause organizational neurosis and induce a chain of nonrational decisions. The bully personality takes many forms, as reported by Carey (2004):

- The snake—Jekyll-and-Hyde type who badmouths you behind your back while smiling to your face
- The screamer—a fist-pounder who exhibits public displays of bravado, if not real rage
- The nitpicker—an insulter who employs insinuation to erode the confidence of his underlings
- The gatekeeper—a cold and controlling “god” who plays favorites, permitting some employees to succeed and withholding resources from others

### **Bias**

Decision-making is rarely objective. An entrepreneur’s distorted perception of the world often impacts his decision-making reality. Bias can be introduced in a number of ways.

**Anti-managerial Bias.** Kaplan (1987) writes that once the hero worship surrounding the vogue of entrepreneurship wears off, entrepreneurship may devolve to being viewed as a cliché by critics in large companies and just another opportunity for a hustle. In physics, every action has an equal and opposite reaction. So too it is with entrepreneurs. The chasm between entrepreneurs and professional managers often rivals that of two political parties. The entrepreneur may view the large corporate manager as stodgy and overly protective of his backside. A suggestion to an entrepreneur that a corporate -type might be innovative or enlightened is deemed as oxymoronic as vegetarian meatloaf.

This entrepreneurial bias can preemptively eliminate any opportunity for collaboration with big companies. In two different companies, we have had a founder make a knee-jerk reaction, dismissing out-of-hand the prospect of a strategic alliance with a Fortune 500 company. In each case, it was a

terrible decision. A subset of this bias is the anti-MBA bias in the engineering community. Roberts (1992) suggests, "Though their attitude is beginning to change, engineers still regard people in management schools as irrelevant or stereotypically crass."

**Metaphorical Bias.** We are all guilty of using buzz phrases from other disciplines as a crutch to communicate the virtues of our own little venture. We might reference guerilla marketing (from military science), viral marketing (from epidemiology) or the Internet bubble (from physics). I've demonstrated earlier (with Mulligans), that we can tap into a wealth of sports metaphors. As von Ghyczy (2003) notes, metaphors are a useful complement to business models: "Metaphors can be good or bad, brilliantly or poorly conceived, imaginative or dreary—but they cannot be true." We had one entrepreneur who would not agree to any decision unless it could be explained in battlefield terms. War comparisons, of course, can help in certain aspects of strategy formulation, but fall short in others—say, customer satisfaction!

**The Bias of Optimism.** When the entrepreneur suppresses pessimistic opinions from his team while rewarding optimistic ones, the venture team's ability to think critically is thereby undermined. Lovallo and Kahneman (2003) comment that while optimism is not a bad trait, it generates more in the way of moral-boosting enthusiasm than decision-related realism. Although optimism enables people to be resilient in confronting difficult challenges, it is less helpful in contributing to difficult, realistic decision-making involving large sums of investor money.

**Ethical Bias.** Some of my best business friends have acted unethically at one time or another. One entrepreneur was fined millions of dollars by the federal government for performing and invoicing the same contracted R&D [Small Business Innovative Research (SBIR)] work for different federal agencies. Gellerman (1986) addresses how usually honest, intelligent, compassionate colleagues can act in ways that are callous, dishonest and wrongheaded. He cites four rationalizations that have long been used to justify questionable behavior: "(1) believing that the activity is not 'really' illegal or immoral; (2) that it is in the individual's or the corporation's best interest; (3) that it will never be found out; or (4) that because it helps the company the company will condone it."

The old situational ethics issues emerge: How far is too far? What's the line between being smart, and being—as the Brits say—too smart by half? Such ethical bias undermines decision-making and may introduce considerable downside risk.

## **Decision Methodology**

The entrepreneur can encounter decision pitfalls in the very methodology he employs in making decisions. Simple decisions sometimes are not that simple. Decision-making can succeed or fail based on the logic of the decision structure, the initialization values used, the kind of financial variables employed and available information.

**Time Sequence.** Typically, we think "backwards" in time to diagnose historic patterns and intuit possible chains of causation. We think "forward" in time, using variables in mathematical formulation, to predict or assess future outcomes. Einhorn and Hogarth (1987) argue that forward and backward decision-making are interdependent and can be combined to improve decision-making. A simple example: "How do we get there from here and what are the consequences?" Targeted future scenarios can be rolled back to influence current decision-making.

**Anchoring and Adjustment.** Entrepreneurs often make forecasts or estimates for decision-making by starting with a favorable, easily available reference value and making adjustments to that value. Often the anchor value is either a result of too much optimism or an oversimplified rule-of-thumb. The ultimate decision can thereby be skewed by the initial anchoring value, and may result in unfortunate outcomes with undue risk.

**Framing.** A decision is impacted by the way it is structured, or framed. As Teach (2004) suggests, if a frame is poorly presented, an entrepreneur can unwittingly make an "unprofitable" decision. An example might be whether to frame a decision using gross margin (a financial accounting number) or contribution margin (a cost-accounting number). Not acknowledging the distinction between fixed and variable costs can sway the decision—say, whether to accept a contract at a certain price—the wrong way.

**Data.** Is a little knowledge a dangerous thing? Apparently not always. Sutcliffe and Weber (2003) contend that the accuracy of information is less important in decision-making than the way in which the entrepreneur interprets his competitive environment. If the entrepreneur structures the decision correctly—with the right time sequence, anchoring and framing—then the decision analysis should be okay; if the structure is not correct, perfectly accurate information won't save the day. Again, there are no Mulligans in entrepreneurship!

## Parting Shots—Do's and Don'ts

### *The Don'ts—Where the Snakes in the Grass Lie*

The list of decisions not to make is long enough to fill a shelf full of business texts. I choose to identify four major areas of dangerous decision-making.

***The Wrong Choice of Business Target.*** No entrepreneurial activity proceeds exactly according to the business plan. The size of the market can be misjudged, as can the timing of its maturation. The barriers to market entry can be underestimated. Competition can be minimized or ignored completely. In my venturing past, there have been several companies that initially targeted the wrong market. I discussed previously the case of the stubborn CEO who was dismissed for not redirecting the company in a more profitable direction. Two successful examples of flexible decision-making in start-ups come to mind.

- A solar electric company changed its target from power generation to power conversion (uninterruptible power supplies), transforming it from a technological curiosity to a major corporation that now has revenues over \$1 billion and over 6,000 employees.
- A color-matching company was redirected from the dental market to the retail paint market, resulting in profitable sales and a successful IPO on the London Stock Exchange.

Sometimes the decision to reconsider and reassess the business concept represents a series of “small corrections” that can add up to a substantial and positive change. In the case of Il Giornale, an espresso bar, Szulanski and Winter (2002) report that the founder was eventually convinced to stop piping in Italian opera, which customers universally disliked, and to not force the servers to sport uncomfortable bowties, which made them grouchy. Was it worth the decision to change? Upon its renaming, the store morphed into Starbucks!

***The Wrong Decision Regarding People.*** Back in the '70s, I attended a seminar at MIT's Sloan School that featured Admiral Hyman Rickover, “father” of our nuclear navy program. When asked about the biggest obstacle to success, the diminutive military man snapped, “People! The moment you hire your first employee, you have personnel problems!” One need not be a misanthropic nuclear engineer to be wary of the “people issue.”

We employ a simple question to bedevil many entrepreneurs: “Why did you hire each member of your staff?” While

some of these hot shots provide rationales, others—in the mode of a cranky three-year-old—whine, “Well, because...” Consider how important having a good staff is:

- For years, the mantra in the Boston venture capital community has been that deals are more successful if one has a grade B idea with grade A people than a grade A idea with grade B people. The logic is that the entrepreneurial environment is highly dynamic, and flexibility in strategic decision-making is required (witness the previously cited cases where the company's target market was redirected). This means no relatives or high school buddies are brought on board unless they would have been hired from their resumes, references and interviews. Same thing for the (occasional) “idiot sons” of angel investors; you take in funds for the merits of your venture, not for executive baby-sitting! I've walked from countless deals when I see that the company has a number of clueless hangers-on who are there because of “special circumstances.” As the popular phrase goes, the clue train stops regularly and these folks simply don't take delivery!
- When early-stage funds are obtained for a venture, some founders tend to overhire staff, perhaps to off-load some of the workload or, in some cases, to serve as palpable testimony to their success-to-date. While, in principle, labor is a variable cost—the reality is that added payroll becomes an integral part of the monthly “nut” that must be covered by revenues, vendors (accounts payable) or investors (cash). Further, as benefits are added to attract the best and the brightest talent, overhead expenses can escalate. Stires (2004) reports that in the critical area of medical insurance, the average annual premium per individual, paid by employers, is projected to increase from \$9,608 in 2003 to \$14,565 in 2006. Bad decisions in personnel have costly repercussions.
- The shelf life of the individual entrepreneur must be monitored carefully for on-going viability. There is a concept of “entrepreneurial nostalgia” that might be observed. Many company founders have difficulty coping with the steady-state calmness of a smoothly running operation. They crave that old-time adrenaline surge associated with survival and crisis management. They try to recapture past feelings of being really needed—a big boost to their ego affirmation. On one occasion, I monitored my own shelf life and decided that I was sufficiently bored with the calmness of success in a company that I cofounded. I made a personnel decision: I “fired” myself! On that deal, my entrepreneurial warrant had expired!

***Self-Destructive Decisions in Financial Dynamics.*** I am a devout believer in modeling the financial dynamics of an enterprise on a regular basis. The very act of building the financial model forces the entrepreneur to think through in detail the key elements of the operation in an integrated manner. Many entrepreneurs will agree with me up to this point. They demur, however, when it comes to justifying input data (e.g., purchase orders/letters of intent for sales, bill of materials for cost of goods sold, payroll for labor costs, and so on) and testing the validity of key assumptions. I believe strongly that most critical decisions can be assessed a priori on a “what if” basis. The resistance to this desirable discipline in decision-making evolves from several rationales:

- The information is not available.
- The information is not “knowable” (a Donald Rumsfeldesque term-of-art).
- “We’re not a big company, and I don’t have time to waste on these fantasy exercises just to make the board of directors and investors happy!”
- “I don’t understand!”

Without such analytical discipline to support entrepreneurial decision-making, important errors can crop up.

- The ramp-up of sales can be overstated.
- The cost of goods sold can be incomplete and therefore understated (gross margins are thereby inflated).
- The build-up in personnel cannot be justified by the levels of revenues and gross profit.
- Expense pools can build up too fast.
- Cash flows are less well assessed, diminishing the accuracy of capital planning.
- Less contingency planning occurs.

Given that there are no Mulligans in entrepreneurial decision-making, studying the venture’s financial dynamics with an integrated model is a unique opportunity to make “mistakes” merely on paper, without suffering the cash consequences of real-world decision errors.

***Ongoing Errors in Strategic Decision-making.*** Don’t target a market that is too small for your mission, your operational infrastructure or your investors’ expectations.

***Don’t Overly Focus on One Product, Particularly as the Company Becomes Robust and Profitable.*** The only direction a successful one-product operation takes is towards lower market share, lower prices and eroded margins. An example is Sharper Image. Lee (2004) reports that the company’s Ionic Breeze air purifier represents 40 to 50 percent of company revenues, and the cheaper knock-offs from

Brookstone and others have slowed Sharper Image’s sales and slashed its profits.

***Don’t Forget to Bootstrap Activities Whenever Possible.*** Conservation of cash is a golden rule.

- Virtual CFOs and accountants can be hired on a part-time basis to minimize staff expense while assuring proper reporting to investors and banks.
- Outsourcing is now so popular that venture capitalists routinely ask, “What’s your India plan?”

***Don’t Leave the Company Open to Fraud.*** We don’t want people spending the precious resources of the company on themselves! We don’t want counterfeiting of company checks or the fraudulent issuance of checks to nonexistent employees or vendors. Wolf and Company (2004) reports that 1.2 million worthless checks enter the banking system each day, and only about 13 percent of check fraud losses are ever recovered. It is recommended that you:

- Use secure check stock (treated inks, safety papers).
- Maintain tight security over the check stock.
- Reconcile bank statements and report any losses immediately.
- Conduct periodic audits.

***Don’t Forget to Protect Proprietary Assets and Intellectual Capital.*** Expensive patents are not necessarily the answer—ideas, know-how and processes can and should be secured inexpensively. A corollary of this is to assure that retiring baby boomers are debriefed to retain the critical information they have accumulated over the years. Zarrabian (2004) reports that in 2005 there will be a staggering 39.7 million Americans between 55 and 69 years old. Their skill and knowledge is valuable beyond numbers! Don’t decide to let these seasoned pros leave the company without extensive debriefing.

***Don’t Get the Wrong Investors or Wrong Partners Involved with the Enterprise.*** I once spent the better part of the first year in one venture unraveling—from my position as board member—a situation where the smallest investor was the crankiest, and the two company principals were incompatible. The company survives, but the dysfunctional staggering-and-reeling that these problems caused out of the starting gate has extracted a significant price.

***The Do’s—How to Operate Smarter and Make Better Decisions***

***Keep Your Administrative Housekeeping in Order.*** This discipline will save you time at critical junctures in

decision-making when you want to focus on the merits of the business issue, not on how to find a missing piece of paper. The biggest administrative housekeeping chore, of course, is to implement compliance with Sarbanes-Oxley regulations.

**Perform Due Diligence!** If there's one area that approximates a Mulligan, it is due diligence. The Chinese fortune cookie reads: "A peek is worth a thousand finesses!" In venturing, an intelligent peek represents both good offense and good defense. As discussed earlier, there are ways to unearth important data on competitors. For potential merger and acquisition deals, due diligence is critical. Rosenberg (1996) reports that fully 10 percent of M&A deals are cancelled because of what is found in due diligence. In an additional 25 percent of the cases, the due diligence findings either cause the deal to be altered or help the acquirer to negotiate a better price. Similarly, due diligence may uncover facts about a prospective executive hire that red lights certain factors. One company found out through investigators that the leading candidate for CEO was more than \$100K in arrears in child support payments! The situation was eventually resolved, but the company made a more informed decision with the help of due diligence.

**Attract the Right Type of People.** The entrepreneur wants to make people decisions that result in a confident, resilient organization:

- Harvard's Kanter (2004) defines confidence as "the sweet spot between arrogance and despair. Arrogance is the failure to see any flaws; despair is the failure to acknowledge any strengths."
- Regarding resilience, Coutu (2002) notes that more than education, experience or training, an individual's level of resilience will determine who succeeds and who fails. This is true in the Olympics, the cancer ward and the boardroom. Resilient people possess three characteristics: a staunch sense of reality, a deep conviction that life is meaningful, and a remarkable capacity to improvise.

**Provide Praise.** Rath and Clifton (2004) surveyed—through Gallup—more than 4 million employees and found that:

- Negative employees can scare off customers.
- Praise is an important leadership trait, helping to diffuse whining, unappreciated staffers.
- Praise increases productivity, and praised employees generate higher loyalty and satisfaction scores from customers. The results are better safety records and fewer accidents on the job.

### **Always be Customer-sensitive.**

- Revenue is the best way to fund the company.
- Customer-related decision-making is bolstered by data mining, or business intelligence. Example # 1: A retail mart decides to retain slow-moving French cheeses because the informational tracking system tells them that those people who do buy these overpriced cheeses are the mart's best customers. Example # 2: A pub can use software to assess the impact that "happy hour" offers have on daily sales. If discounting a particular drink increases sales one day, that can be repeated. Business intelligence provides the capacity to track inventory accurately and reprice offerings dynamically.

**Try to Be Creative.** To cite an example: As a board member of a business I cofounded, I became involved in a negotiation with a large company that wanted to invest in our emerging (publicly-traded) company so that we could further our product development. Rather than have them become a shareholder, I convinced all parties that the same ends could be met by having the funds enter our company as contracted R&D revenue—which on our part we could report as sales with modest profits, not as a total R&D expense write-off. The funding company could recoup its investment through product royalties—for them, a much more straightforward exit position than equity. It was a win-win scenario that rewarded creative decision-making.

### **Parting Shots**

Building upon my opening sports metaphor, the opportunity for success involves keeping it close on the back nine (golf) and being within a run or two in the seventh inning (baseball). In the end, success generally occurs when everything is on the line. In the game of entrepreneurship, good decisions, with informed board of directors' oversight, are vital to company success. In this age of corporate governance, I can summarize my observations on entrepreneurial decision-making with 10 questions that a diligent director of the company should ask. Compiled by Charan and Schlosser (2003), these questions underscore how good entrepreneurs can and should be directed to make good decisions.

1. How does the company make money?
2. Are customers paying up?
3. What could really hurt—or kill—the company in the next few years?
4. How are we doing relative to our competitors?
5. If the CEO were hit by a bus tomorrow, who could run this company?
6. How are we going to grow?
7. Are we living within our means?
8. How much does the CEO get paid?

9. How does bad news get to the top? entrepreneurs, directors can be granted Mulligans.  
10. Do I understand the answers to questions 1 through 9? They can ask questions over and over again until the  
(If not, try again—decision-making is a process. Unlike entrepreneur gets it right!)

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### About the Author



**JOSEPH LEVANGIE** is a Boston area investor, adviser and entrepreneur. Over the last quarter century, he has helped launch several dozen new business enterprises from first a large company platform, then from a not-for-profit incubator, and later as an venture adviser, as an independent entrepreneur, as an active investor and as a passive “angel.” His companies have competed in a wide array of industries: financial services; renewable energy; uninterruptible power sources; biotech; computer hardware, flex circuits and software; medical lasers; electronic retail color-matching systems; radioactive medical implants; food technology; modular housing; semiconductor equipment; specialty materials; and waste tire recycling. The number of Joe’s ventures successfully completing an IPO has now reached double figures. Joe has served on the BODs of dozens of private and public companies, and has been a guest reviewer at Business Plan contests at MIT and Harvard Business School. Joe is an active alumnus of both institutions. He currently is vice chairman of Ardour Capital, a NYC investment banking firm.