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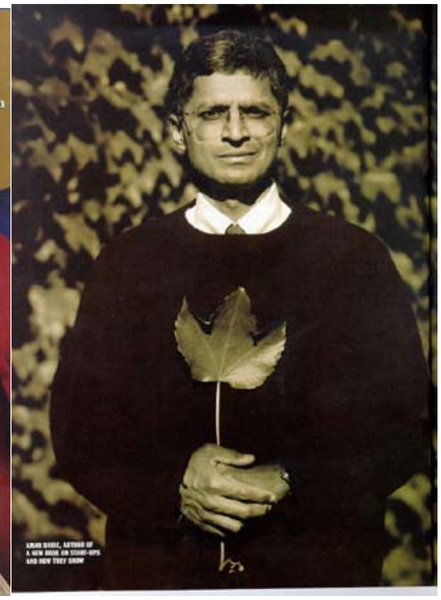

The Origin of the Entrepreneurial Species

Inc. editor-in-chief George Gendron and Amar Bhidé, author of *The Origin and Evolution of New Businesses,* discuss Bhidé's surprising conclusions about risk taking, bootstrapping, and successful start-ups.

By George Gendron

Finally, an answer to the question, What's the secret of start-up success?

I can't even begin to calculate how often people who are thinking about starting new businesses have asked me to name the one book that illuminates, more than any other, what it's essential to understand in order to create a successful start-up. For close to 20 years now, I've had to answer that there is no such animal. Don't get me wrong -- there are lots of perfectly acceptable books about almost every imaginable aspect of starting and running a new venture, from writing a business plan to raising capital. The limitation of such books is that, important though those tasks may be, you can get them right and still fall flat on your entrepreneurial face.

But with the recent publication of *The Origin and Evolution of New Businesses*, by Amar V. Bhidé (Oxford University Press), there is now a book I can recommend to anyone starting a business.

This is no *60-Second Entrepreneur*. The book is a demanding read and is based on research Bhidé conducted over a 10-year period at the Harvard Business School, research that sheds light on the mother of all entrepreneurial questions: What differentiates a successful start-up from the masses of new businesses that are created every year? During a series of interviews, Bhidé and I talked about that subject and discussed topics as diverse as his contention that risk taking is irrelevant to early-stage company building, and the implications of young Internet companies' skipping a crucial stage of entrepreneurial development. --*George Gendron*

Getting started

***Inc.*:** So many of your findings challenge conventional wisdom about entrepreneurial success. I'm curious: What has surprised *you* the most?

Bhidé: I grew up with an entrepreneur. My father started a series of businesses and eventually built a fairly significant glass-related business. He was adventuresome, to use that old-fashioned word. The way he started his companies was ad hoc and improvised and not planned and not systematic. I had attributed his behavior to his own eccentricity. So I was very surprised at the extent to which the way he built his businesses was the same as was true of the founders of *Inc.* 500 companies. I was even more surprised that the improvisation was the natural, logical outcome of the sorts of opportunities that those individuals pursued, of the capital constraints that they faced, and of their relative lack of human capital. And that it all made sense.

*Inc.***:** So much of your research focuses on the difference between ordinary start-ups and those gazelles, or "promising companies," that go on to achieve significant levels of success. Could you give us an overview of how successful companies get started?

Bhidé: Here it is in summary: Most successful entrepreneurs start without a proprietary idea, without exceptional training and qualifications, and without significant amounts of capital. And they start their businesses in uncertain market niches.

*Inc.***:** What you're saying is, it's not the exceptional start-up that has those characteristics but most growth companies, right?

Bhidé: Right.

*Inc.***:** Well, then, let's start with the notion of no proprietary idea, no novel product or service to offer, which will come as a surprise to many people. How do these promising businesses get started?

Bhidé: Most are started by someone who is working for another business, who sees a small niche opportunity -- one in which the company he or she is working for is already taking advantage of, or one in which a supplier or customer is involved. And the person jumps in with very little preparation and analysis but with direct firsthand knowledge of the profitability of that opportunity -- and pretty much does what somebody else is already doing, but does it better and faster. These entrepreneurs don't have anything that differentiates their business from other businesses in terms of technology or in terms of a concept. They just work harder, hustle for customers, and know that the opportunity may not last for more than six or eight months. But they expect to make a reasonable return on those six to eight months. And along the way they'll figure out something else that will keep the business going.

*Inc.***:** The idea that you build a company around novelty -- around a unique proprietary idea -- is very ingrained in our culture.

Bhidé: You're right. All my students, when they think of how they're going to start a business, want to start with a clever idea. I have very few students who come to me and say, "I want to start a business -- I see X do this, and he's incredibly profitable. I want to do the same thing." That's not the way people seem to think. Yet that's the way most successful entrepreneurs start up. They make a small modification in what somebody else is doing.

Inc.: OK, so having a terrific idea for a business is not a requirement for success. Next, you say that most of these promising start-ups bootstrap their companies.

Bhidé: It's interesting but not that surprising when you consider that historically venture capitalists have funded only a few hundred start-ups every year.

Inc.: I agree. But what does seem to fly in the face of popular wisdom is the case you make -- quite compellingly -- that risk taking is totally irrelevant to start-up success.

"What surprised me is that irrationality is central to the successful start-up, but it's not the entrepreneur who acts irrationally." --Amar Bhidé

Bhidé: I think we have to distinguish between risk taking and a tolerance for ambiguity. Going to Las Vegas and taking a bet on a roulette wheel requires a lot of risk taking, in the sense you must be prepared to lose what you put up. But a tolerance for ambiguity, which is a characteristic of successful start-up entrepreneurs, is a willingness to jump into things when it's hard to even imagine what the possible set of outcomes will be. It means going ahead in the absence of information and in the absence of having much capital and in the absence of having a novel idea. In fact, just by looking at the amount of capital that people put on the table, you can see that those entrepreneurs don't have a lot of financial risk, and because most of them are young, their opportunity costs are not that great.

Inc.: But, wait. This is huge: great ideas and risk just aren't relevant to start-up success.

Bhidé: But it's true. Most founders of promising companies do not start out as innovators or risk bearers. Those roles do become salient at a later stage of the enterprise.

Inc.: I want to get into that, but before we do, there must be millions of undercapitalized start-ups with nonproprietary products. What distinguishes the promising ones from your everyday laundry or lawn-care company?

Bhidé: The elite start-ups, although on the surface they may look a lot like the laundry or the lawn-care company, are actually born under different circumstances. They seem to be dispersed across the economy, but in fact there are pockets in which they are found. Part of the great joy of discovery of this process for me was to be able to characterize the nature of those pockets through talking to the entrepreneurs at great length and finding recurring facts -- facts such as most of these companies were serving other businesses rather than consumers. On the surface that's not a terribly exciting fact in and of itself, but it's one piece of the puzzle. Another clue is the sort of products and services they offer. They are not impulse buys. The products and services require days or weeks worth of selling rather than the 10-minute vacuum-cleaner sale.

What's the ticket price? What's the unit purchase? Well, it's usually not a million dollars, but it's not the $5 or $10 purchase either. It's a purchase that is in the five hundreds or the thousands or the few thousands. How are these things sold? Well, they're almost never sold through intermediaries. They're sold direct to the end user.

Who's the salesperson? The entrepreneur himself or herself is the salesperson. And if you pull all those facts together and you put the stories together, you begin to get a deeper level of understanding of what it is that makes those promising start-ups different from the great mass of start-ups.

Inc.: You talk about the entrepreneur as a salesperson and as someone who has a high tolerance for ambiguity. Tell us about some of the other personal characteristics you've discovered that differentiate those who start successful companies from those who don't.

Bhidé: Well, of course, there's a certain amount of luck. You can't deny that. But from their stories you can begin to figure out a whole bunch of other things. In the face of uncertainty, for instance, the capacity to adapt becomes absolutely critical. You hear stories of "I went to try to sell x to my customers, but none of them would buy x, so I decided to sell y." And it's that capacity to make a quick switch that becomes important. And it's the capacity, in a sense, to use smoke and mirrors, to convince people that you are a more stable and long-lived enterprise than you actually are. That, too, becomes critical. The capacity just to listen well to what people are telling you -- an essential element of salesmanship.

Inc.: In your book you say that not only are successful entrepreneurs not risk takers, but they get the people around them to take the real risks.

Bhidé: Absolutely. I mean, the biggest risk in many of these businesses is ultimately taken by the customer. So, in a sense, who is financing this business? It's customer revenues that are financing this business. And the risk that the customers are taking is much more than just the amount of money that they're putting up for the product or service. They're spending a lot of time, and they're incurring potentially quite substantial switching costs if the start-up goes under. There is this idea that the entrepreneur is a crazy, irrational person and that only someone who is overoptimistic and who doesn't have a good sense of the odds would go ahead and do these things. What surprised me is that irrationality is central to the successful start-up, but it's not the entrepreneur who acts irrationally. It's the people whom the entrepreneur uses to get the business going.

The mind-set of people who spot and respond to opportunities quickly may interfere with their capacity to build a large company.

Inc.: The idea that entrepreneurs seem to possess this incredible innate or intuitive ability to lay off the risk against the customers and, to some extent, employees is fascinating. But to change directions a bit here, when you tell us that successful entrepreneurs are not doing anything particularly new but instead are improving on what others are doing, it makes starting a business sound so, well, mundane.

Bhidé: There may not be any big new ideas, but in our research we did hear about a lot of creativity at the tactical level. People were telling us, "I have to do this in order to just see someone or to overcome their concerns about whether we'd be in business for five months or not." So while the basic idea for the business may be mundane, the implementation or the execution of the idea-- particularly the overcoming of the constraints of the lack of money or track record -- involves a great deal of creativity.

Inc.: You said that these companies start in uncertain market niches. What do you mean by that? Or, more practically, what should entrepreneurs look for in a niche?

Bhidé: Two things to look for: One is an area where there is a lot of external change going on. The computer industry has been a classic example of that. The second characteristic is a business in which customers don't quite know what they want. They have these amorphous needs and they can't really compare one vendor with another. That's where the entrepreneur's personal capabilities can affect the customer's perceptions of the product or service.

Inc.: Could you give us some examples?

Bhidé: Well, take a laundry. In a laundry, people have a pretty straightforward idea of what it is they want. They want their clothes cleaned. They want their buttons not broken. They want their coats not to get lost. And most of whether that gets done or not is pretty much out of the hands of the person who runs the store. But in fields such as entertainment or professional services, buyers place a high value on fuzzy attributes that they cannot easily measure or define. If you look at the computer industry, in which you find many successful start-ups, you find that a significant proportion of them started out in arenas where there was a lot of hand-holding. That sort of niche allows entrepreneurs to differentiate their offerings by tapping into the psyche of their customers or by responding to their unspoken wants. That's where the entrepreneur's personal effort can make a big difference.

Inc.: Of the hundreds of thousands of businesses started each year, only a small percentage go on to become "promising companies," and very few of those promising companies go on to greatness.

Bhidé: I think it takes an unusual person to start a promising business. It takes a really extraordinary individual to build on that business -- extraordinary in terms of someone who has an almost maniacal level of ambition. Not just ambition to make a comfortable living, to make a few million dollars, but someone who wants to leave a significant mark on the world.

It's people like Ford, people like Sam Walton. As Sam Walton says in his autobiography, lots of people started discount stores in the early 1960s because it was relatively easy to do. However, most people who started those businesses then sold out to the larger chains. And Walton was just not happy to do that. He wanted to leave a legacy and build something that would be on the scale of a Kmart. I think that very few businesspeople have the drive to do that.

Inc.: But it's not just motivation. You say it's also about how few people have the capacity to be improvisers at the start and then become strategic thinkers later on.

Bhidé: That's right. Think about the early 1980s. There were a lot of people who without any great insight or any great creativity figured out that there was quick profit to be had by reselling PCs, basically living off the IBM world. Now, of a thousand people who might have thought that was an interesting idea, only a hundred or so might have had the gumption to actually do it. And then of the hundred or so who had the gumption to do it -- because they were opportunists, they were resourceful, they jumped into the stream -- very few had the capacity to say, This could be a springboard to building something like a Gateway or a Dell. So, I think, fundamentally, that the mind-set of people who are good at spotting opportunities quickly and responding to them quickly may actually interfere with the capacity to step back later on to ask, What's the big picture?

Inc.: So it is in that context that risk -- so unimportant during the start-up stage -- becomes a crucial factor?

Bhidé: Absolutely. Now you do have assets; you have something you can lose. And to grow the business, you have to make a lot more investments.

Inc.: One of the things that begins to be a prerequisite, if you will, to taking your business to that next level is the ability to take big risks. And the second is to learn to substitute planning for improvisation?

Bhidé: Absolutely. And to have a long-term view about how things will accumulate to add up to something. Many entrepreneurs start out in businesses in which the uncertainty is very high and you can do nothing but adapt. But for somebody like Michael Dell, establishing a long-lived business required a distinctive vision of what his business would be like.

Inc.: It's interesting, and ironic, that the traits that hold companies back at a crucial stage of their development are the only traits that founders tend to romanticize. Perhaps most common is the lack of any disciplined planning -- the idea that plans are for large companies, that real entrepreneurs sketch out ideas on the back of an envelope and then go execute.

Bhidé: Yes, because early on you want to be incredibly adaptive. You want to be changing your mind a lot. And you want to be open-minded. But if you remain that open-minded, you won't have the constancy to principle that is needed to actually implement a long-term strategy. I think Bill Gates is a fantastic example of someone who has been able to do that.

Inc.: So the cliché is true then, that all those things that contributed to your success can become your undoing.

Bhidé: Absolutely. For example, you typically have the wrong set of employees. I have this lovely picture of Microsoft from 1980 or something, maybe 1979. There's only one person from that picture who is still with the company. The same thing is true of Cisco. It started off with friends. And then VCs and professional managers came and cleaned up the place. Unless you're prepared to go through that upheaval of cleaning up, you don't become a large company. Unless you stop being opportunistic, you don't become large. By that mean that unless you begin to say, "I'm going to give up some cash-flow opportunities, because I have this long-term view, and I'm, in fact, reducing current cash flow in order to build this company -- and I'm not going to chase after every little opportunity that I see, because I have a vision of where I'm going" -- unless you can do that, you're not going to become a large, long-life company.

Wal-Mart and Microsoft started off in this undercapitalized and improvised fashion, and the way they became a success in the long term was to abandon the very policies that made them successful to start with.

Inc.: Let's talk a little bit about what you think your research tells us about how the Internet economy might evolve. What are the parallels and differences between the start-ups you document in your book and what's happening now in the Internet world? Why don't we start with bootstrapping, which has been a critical part of the start-up process as you describe it.

Bhidé: There probably are many Internet start-ups that are being bootstrapped as we speak: entrepreneurs providing Web creation and maintenance to large corporations, for instance. What's different is that the number of relatively inexperienced individuals with fuzzy ideas who are getting significant amounts of funding from angel investors and venture capitalists is incredible. So, many of the ventures that would otherwise have been bootstrapped are not. Similarly, we see lots of unformed companies go public at rather extraordinary valuations.

Inc.: And with so much capital -- human and financial -- going into Internet ventures, what effect do you think that will have on the economy? Not just the Internet economy, but overall.

Bhidé: I think the implications are disturbing. New technologies and markets usually emerge through many small adaptations rather than through one great leap forward. Innovation requires a lot of trial and error. The entrepreneur tries something on a small scale and if it works, scales it up, and if it doesn't, tries something else.

We find the same process in the building of companies: great organizations like Hewlett-Packard and Microsoft take decades to build; entrepreneurs have to undergo a lot of on-the-job learning before they can effectively scale up. The easy availability of capital and unquestioning beliefs in first-mover advantage jeopardize this process of trial and error. Entrepreneurs are taking expensive, big leaps into the unknown. They can't easily change direction and don't even have a compass for doing so.

Historically, bootstrapped entrepreneurs have had to change course if they didn't generate positive cash flow; profits represented the primary measure of the success of their experiments. In Internet time everything is supposed to happen immediately -- except the appearance of profit. I cannot believe this represents a sensible approach to durable innovation.

Similarly, I cannot believe that many of the companies going public without having shown any capacity to generate profit on a small scale will subsequently develop the capacity to generate profit on a large scale when they are exposed to the many pressures of operating as public companies. Would Federal Express have effectively refined its business model if it had been able to go public when it was still losing money rather than having to wait until it had turned the corner?

Inc.: And the long-term consequences?

Bhidé: In effect we have broken a critical link. Financial markets used to take their cue from the "real" markets and provide capital to companies that demonstrated some evidence of profitability. Some specialized intermediaries, namely venture capitalists, did underwrite the losses of a few glamorous ventures, but for relatively short periods of time. Companies like Go and Momenta that failed to get into the black in a few years used to be cut off. Now, in a strange twist, capitalist financiers have the same disregard for profits that the socialist governments of Europe did in the 1960s. Those governments poured taxpayer funds into "national champions" that turned out to be world-class losers. A healthy capitalist economy keeps its entrepreneurs on a tight leash -- they live or die by the profits they make.

At first, scientists didn't believe that species could become extinct. Here's the history of how that changed.Â In the 17th century, the origin of fossils was still a mystery. Proposed explanations for them ranged from the idea that they were the remains of mythical creatures, such as dragons, giants or unicorns; to the idea that they were victims of a global flood; or to the idea that they were simple forms generated spontaneously by earth itself. In the 18th century scientific research showed that fossil bones could be compared with bones of modern animals â€“ an explanation that however raised even more questions. Many identified fossils belong to animals unknown in Europe (like elephants) but found on The Origin of Species The Making of a Theory. Teacher materials. Fact patterns: a film guide. Overview.Â A. Darwin and Wallace independently discovered the natural origin of species and formulated the theory of evolution by natural selection based on distinct sets of observations and facts. B. The natural origin and evolution of species explain the diversity of life, the distribution of species, and the sequence of change found in the fossil record. C. Natural selection acts on variation among individuals within populations. The differential survival and reproductive success of individuals with certain traits can cause populations to change from one generation to the next. The origin of species by means of natural selection; Or. The preservation of favoured races in the struggle for life.Â I will here give a brief sketch of the progress of opinion on the Origin of Species. Until recently the great majority of naturalists believed that species were immutable productions, and had been separately created. This view has been ably maintained by many authors. Some few naturalists, on the other hand, have believed that species undergo modification, and that the existing forms of life are the descendants by true generation of pre existing forms. Creating entrepreneurial ecosystems poses various challenges for policy-makers. There are several general principles that need to be followed. Policy intervention needs to take a holistic approach, focusing on the following: the entrepreneurial actors within the ecosystem; the resource providers within the ecosystem; entrepreneurial connectors within the ecosystem and the entrepreneurial environment of the ecosystem. Finally, it is important that policy-makers develop metrics in order to determine the strengths and weaknesses of individual ecosystems so that their strengths and weaknesses can This is no 60-Second Entrepreneur. The book is a demanding read and is based on research BhidÃ‰ conducted over a 10-year period at the Harvard Business School, research that sheds light on the mother of all entrepreneurial questions: What differentiates a successful start-up from the masses of new businesses that are created every year? During a series of interviews, BhidÃ‰ and I talked about that subject and discussed topics as diverse as his contention that risk taking is irrelevant to early-stage company building, and the implications of young Internet companies' skipping a crucial stage