Street Smarts: Secrets of a $110 Million Man

There are no guarantees when it comes to running a business. But the best entrepreneurs I know follow these guidelines.

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I've been an entrepreneur for almost 30 years now -- 29 years and two months, to be exact, but who's counting? -- and one thing I've learned is that there is no formula for success in business. Believe me, I wish there were. I would love to be able to give you a step-by-step guide to achieving your business goals. But I can't. That's because no challenge in business is identical to any other. Each is shaped by a multitude of factors that give it unique characteristics, and your response has to be tailored accordingly.

Then how is it, you might ask, that some entrepreneurs are able to start one successful business after another and rarely -- if ever -- fail? By *successful*, I mean a business that lives off its own cash flow, provides a good living for its owners and employees, and generates the profit it needs to keep growing. You have no doubt run into people with the ability to create such businesses almost at will. In the media, they are often referred to as serial entrepreneurs. I suppose I'm one of them, although I have certainly had my share of failures. So what do serial entrepreneurs know that allows us to have a relatively high batting average when it comes to starting businesses? Or is it just a matter of luck?

Far be it from me to downplay the role of luck in any business venture, but I don't believe luck alone accounts for the success I have enjoyed. Nor does it explain the successes of other accomplished company builders I have had the privilege of knowing. Rather, what we have in common is a certain mentality, a way of thinking that allows us to overcome many obstacles and take advantage of many opportunities as they arise. I call it the knack.

What exactly is the knack? I think it boils down to a set of rules that can be applied to a wide variety of situations. Some of these rules we learn as children. Others we pick up from mentors of one sort or another. Most we develop the old-fashioned way -- by making mistakes, falling down,

picking ourselves up, and figuring out how not to do it again. However we learn the rules, they are the tools we use to deal with the challenges encountered in the course of building any business from scratch. Not that the rules guarantee success, but they do improve our chances significantly. We win more than we lose, and the longer we stay in the game, the more often we come out on top.

I believe that almost any person can learn these rules and use them to create the kind of life he or she wants. Granted, they will come more easily to some people than to others, and not everyone will have the same success in applying them. In business, as elsewhere, some individuals have God-given gifts that allow them to play the game better than others. We can't all be Tiger Woods or Picasso or Shakespeare, but anybody can learn to play golf or paint or write a sonnet, and we can all learn how to be financially self-sufficient as well.

It would take a whole book to list these rules and explain the logic behind them. In fact, my co-author, Bo Burlingham, and I have written one. It's called *The Knack: How Street-Smart Entrepreneurs Learn to Handle Whatever Comes Up*, and it goes on sale this month. Rather than repeat what's there, I thought I would give you what I believe are the 10 most important lessons I have learned over the past 29-plus years, the rules that I still rely on today:

1. Numbers run a business. If you don't know how to read them, you are flying blind.

When I started out, I thought that CEOs ran businesses with the help of their top executives. What I didn't realize is that a business is a living entity with needs of its own, and unless the leaders pay attention to those needs, the business will fail. So how do you know what those needs are? There's only one way: by looking at the numbers and understanding the relationships between them. They will tell you how good your sales are, whether you can afford to hire a new salesperson or office manager, how much cash you will need to deal with new business coming in, how your market is changing, and on and on. You can't afford to wait until your accountant tells you these things. Nor do you have to become an accountant. You do have to know enough accounting, however, to figure out which numbers are most important in your particular business, and then you should develop the habit of watching them like a hawk.

2. A sale isn't a sale until you collect.

There's a common assumption that when somebody buys something from you, it's like money in the bank. Sooner or later, you are going to get paid. That's not always true, of course, and just how much sooner or later the payment arrives can make a big difference. But most people don't think about that when they first go into business. The term *bad debt* doesn't enter their vocabulary until they suddenly find themselves with a receivable they can't collect. By the same token, the

concept of collection time doesn't become meaningful until they discover they don't have enough cash to pay their bills despite having made a lot of sales.

As I have written previously, every business that generates receivables is, in effect, a bank (see "**What Are You, a Bank?**" November 2007). When you deliver a product or a service in the belief that the customer will eventually pay you for it, you are making a loan, and you should treat it accordingly. That means determining whether customers are creditworthy and finding out in advance how long they take to pay their bills. It also means getting into the habit of checking the quality of your loan portfolio regularly and making sure your average collection time is what it should be.

3. When your short-term liabilities exceed your short-term assets, you are bankrupt.

The vast majority of people in small business, I suspect, have no idea what a balance sheet is or how it differs from an income statement (also known as a P&L). The balance sheet certainly doesn't figure into their decision making. It didn't figure into mine until I wound up in bankruptcy court with my first company, Perfect Courier. There I learned that a company is bankrupt -- at least technically -- when its current liabilities (that is, the ones that have to be paid within the next 12 months) are greater than its current assets (the ones that will turn into cash within the next 12 months). That information comes straight off the balance sheet. I could have saved myself a lot of grief and pain if I had gotten into the habit of looking at it on a regular basis and keeping track of the most important ratio derived from it -- the current ratio, which measures a company's ability to meet its short-term debt obligations. You calculate it by dividing your current assets by your current liabilities. If the ratio is 1.25 or higher, you are in fairly good shape. If it's less than 1.00, you could be headed for trouble. Yes, you may be able to juggle your payables and other short-term debts for a while, but you should move quickly to restore your liquidity. Otherwise, you are taking a risk of one day finding yourself with no cash to pay your bills -- a potentially fatal condition.

4. Forget about shortcuts. Run a business as if it's forever.

Building a business is a lot of hard work. Everything that a great company needs takes a long time to develop -- a diversified base of loyal customers, experienced managers, a vibrant culture, efficient systems throughout the business, a sales force that works as a team, a great reputation in the industry -- everything. Of course, we all look for shortcuts. That's only natural, especially when you are on your first venture. You constantly search for easier ways to make your company grow faster, and sometimes you find them. Unfortunately, they almost always come back to haunt you.

I speak here as someone who is more impatient than most and who has tried just about every shortcut in the book -- like hiring salespeople from competitors and promoting employees just because they are available. It finally dawned on me that my shortcuts were serving only to prolong the process of building the great company I wanted. Why was I in such a hurry, anyway? A great company is one that can last forever, and I needed to make decisions in that frame of mind -- even though I fully expected to sell the business someday. My records-storage business, CitiStorage, would be worth more if I took my time and did what was best for the company in the long term. Indeed, it was. As you may know, I ultimately sold it and two related businesses for $110 million.

5. Cash is hard to get and easy to spend. Make it before you spend it.

Most people don't understand the value of cash when they go into business. If they did, they wouldn't waste it by purchasing brand-new furniture, paying designers to produce logos, ordering fancy business cards and stationery, or spending money on dozens of other things that they don't really need and that deplete their start-up capital without getting the business any closer to viability -- that is, the point at which the company can sustain itself on its internally generated cash flow. If the cash runs out before you get there, the ball game's over. The business dies.

But it's not just start-up entrepreneurs who waste cash. The corporate landscape is littered with the corpses of companies whose leaders thought the good times would last forever and spent money they hadn't yet made on luxuries they didn't need. I made that mistake myself once and paid the consequences. One of the lessons I learned was: Make the money first. If you are smart, you will put some of it aside for a rainy day. Whatever is left over, you can spend as you please. You can pay big bonuses to your employees. You can make big donations to charity. You can buy a corporate jet. You can run for President. Whatever. But first you must earn it.

6. You have no friends in business, only associates.

Some habits are more difficult to maintain than others, and I constantly struggle with a really important one: Don't do business with friends. I have broken this rule several times and always lived to regret it. In the early days, I didn't hesitate to buy products or services from friends. I couldn't imagine why I shouldn't help someone with whom I had a close, personal relationship. But friends, I learned, inevitably make assumptions that hinder your ability to do what's best for the business. Even though I would tell them up front that they would be treated like any other vendor, they still expected me to make exceptions for them. When I wouldn't, the relationship went sour, and I lost a friend as well as a supplier.

It's even more important to understand that you can't be friends with your employees. I'm not saying you shouldn't treat them with respect and affection. You can laugh with them, cry with

them, be happy and sad with them, but neither you nor they should ever forget that it's a business relationship. I had seven employees when I started my first business and became social friends with six of them. All six of those friendships became a problem for the business. And the seventh person? He now runs CitiStorage.

7. Don't focus on the top line. Gross margin is the most important number on the income statement.

In the early days of a business, everybody obsesses about sales. We want to see them increasing every month, every day, and every hour -- the faster, the better. I know that's how I felt. The first thing I would check each morning was the report of the previous day's sales. My investors were the same way. Not once did they ask about the company's profitability. They cared only about sales, and most of them were accountants! But focusing exclusively on sales is very dangerous, especially when you are starting a business with a limited amount of capital. Why? Because sales do not necessarily result in cash flow, and cash is what you need to survive. You run out of cash, you go out of business. End of story.

Instead, you should be focusing on your gross margin -- that is, the percentage of profit you make after covering the direct cost of whatever it is that you are selling. In my opinion, gross margin is one of the two or three most important numbers in any business and by far the most important one in a new business. You have to pay all your expenses out of gross profit -- your salary, your rent, the phone bill, gas, electricity, photocopying, and so on. If your gross margin is 10 percent, you need $10 in sales for every $1 of overhead just to break even. If your gross margin is 40 percent, you need only $2.50 in sales for every $1 of overhead. So you will have more to show for the same amount of work with a high gross margin than with a low one. And if you are just starting out and have limited capital, that could be the difference between failure and success.

8. Identify your true competitors, and treat them with respect.

Here's something else I didn't know starting out: Not everyone who does what you do is your competitor. Rather, you compete against only those suppliers that offer the same services, are more or less equally reliable, and charge prices similar to yours. That doesn't mean you won't meet other types in the marketplace. In every business I started, there were people around who claimed to provide a service like ours at a fraction of the price. Invariably, they had tiny operations with little, if any, overhead. If the owner-operator got sick, or if a truck broke down, the customer would be stuck. Customers willing to put up with that risk were not good candidates for us. Conversely, customers that demanded reliability -- and were willing to pay for it -- were not good candidates for the mom-and-pop operations.

As for our real competitors, I came to see that they were extremely important to our long-term

success. They played a critical role in shaping our reputation in the industry -- which was our most valuable asset -- if only because their opinion carried more weight than that of any other group. When they spoke well of us, everybody listened. So I made a habit of treating them with the respect I hoped they would show us, and I insisted that our salespeople do the same.

9. Culture drives a company. In the long run, the boss's most important job is to define and enforce it.

When I started my first business, it never crossed my mind that I was creating a culture as well as a company. I didn't even realize that companies had cultures, let alone that the cultures might actually affect the businesses' performance. It was only 15 years later -- when my wife, Elaine, joined CitiStorage -- that I began to think seriously about the matter. She introduced programs that fundamentally changed our culture, making it much more employee friendly, with business games, contests, educational programs, new employee benefits, and group activities of various sorts. I couldn't help noticing how much better the company functioned as a result.

Along the way, it dawned on me that setting the culture was ultimately the CEO's responsibility. Although Elaine was doing the heavy lifting, she couldn't have succeeded without my support. Not only did I have to give her the resources she needed, but I also had to modify my behavior to fit in with the new regime and make sure that everyone else went along. Among other things, I had to learn how to hold my tongue and respect the chain of command. That was probably the most difficult new habit I have ever had to develop -- and certainly one of the most important.

10. The life plan has to come before the business plan.

It took a major whack on the head for me to get my priorities straight. For my first eight years as an entrepreneur, I always put my business goals first. As a result, I missed my first daughter's childhood. I spent too little time with my wife and friends. I didn't do any of the reading or traveling or gardening that I enjoy. My life was one full-bore, supercharged, nonstop, 24/7 rush to create a high-growth business. You know how that turned out.

Fortunately, my descent into Chapter 11 came early enough in my life for me to learn the appropriate lessons and make a fresh start. The most important lesson was this: Building a successful business is not an end in itself. It is a means to an end. It is a way to create a better life for you and those whom you love, however you -- and they -- may define it. You need to do the life plan first and then keep revisiting it, to make sure it's up to date and your business plan is helping you achieve it. That habit, I can assure you, will prove to be the most important of them all.

Norm Brodsky is a veteran entrepreneur. His co-author is editor-at-large Bo Burlingham. Their

book, The Knack, *will be published by Portfolio this month.*

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