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Guest Speaker: What You Need to Succeed

Treat people right and they will eat nails for you, and other lessons I learned building Staples into a giant company.

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"The child is father to the man," the saying goes. Just so, the start-up is father to the large successful company. Now that I'm a venture capitalist, helping entrepreneurs build into their small frames the bones of billion-dollar corporations has become my mission.

The premise is less obvious than it sounds. In my experience, entrepreneurs often confuse envisioning what a business will be with laying the foundation for what it could be. So they dream big dreams and construct detailed business plans, which is fine. But it's nowhere near as important as putting in place as early as humanly possible the people and systems that will carry them through their journey, no matter what unexpected directions changing markets or technology force them to take.

That's why I don't get hung up on business plans. I read them, of course. But whatever the plan says, the company will end up looking different. When we started Staples (NASDAQ:SPLS) in 1986, for example, our business plan proclaimed we would never deliver. Delivery added costs; we figured we couldn't afford it. Also, there was no expectation of delivery in the industry.

Nine months later Office Depot (NYSE:ODP) and Office Club got into delivery, so suddenly the expectation existed. Also, we found out that delivery appeals to a different--somewhat larger--customer than we had imagined. Consequently, average delivery orders were larger, which made cost-effective delivery easier to pull off. So we changed course, as all successful companies change course--over and over again. One thing entrepreneurs know for sure: If they do well, the business will get bigger. Always be preparing for bigger.

To me, business plans are interesting chiefly as indications of how an entrepreneur thinks. Here at Highland Capital Partners, the venture capital firm I'm part of now, we spend most of our time talking about what really matters: management and market. If you have the right management team and an exciting market, the rest will take care of itself. I suspected that was true before I came here--it had always been true for me. Now I know it for a fact.

The right people: Folks who have been there and done (something like) that. So what constitutes the right management? I love entrepreneurial passion and am probably overendowed with it myself. Also, I don't discount M.B.A.'s. At Harvard Business School I made contacts and learned lessons that have served me well. But nothing--I mean nothing--counts like brass-tacks, in-the-field experience. I want to work with people who have faced similar challenges. I don't care whether they've succeeded or failed, so long as they've learned. These days I am advising four emerging companies (all in retail, which remains my specialty). In each case, I looked at the entrepreneur's professional background and said yes,

this is someone I can work with.

For example, Barry Perzow, co-founder of the pharmacy chain Pharmaca, has more than 40 years of retailing experience in the U.S., Canada, and Europe--that's more than I have. He's worked for big companies and small companies. And now he's reinventing an old model (as we did at Staples) by combining prescription drugs and natural remedies under one roof. Then there's Chip Wilson, founder of Lululemon Athletica, a yoga apparel chain based in Vancouver, British Columbia. Never heard of it? You will. Before starting Lululemon in 1998, Chip spent 18 years building West Beach, a skate and ski clothing business that he eventually sold to an investment group. I remember he told us, "I know there's an opportunity. And I know if we're left to our own devices and don't have a real management team we'll never get there. I'm going to pick as my investors those people who can help me build this into a big business."

That's exactly what I mean by laying the foundation for what could be. Chip has hired some strong people, but they can't support the business as it scales. You don't wear the same clothes your whole life--your body outgrows them. Similarly, companies need different kinds of talent and professional skills at every stage. Staples had four CFOs in 20 years and each was just right for his era. We had the perfect CFO for a start-up, the perfect CFO for a small-cap public company, the perfect CFO to help us through some nasty growing pains in the '90s. I want to work with founders who accept that they won't always dance with the ones they brought. Ideally, both the founders and their teams grow into larger jobs, but often they don't. I want them to be realistic about their limitations, to recognize that over time their roles will narrow.

I also look for entrepreneurs who can align employees' financial and emotional needs with their own. Howard Schultz is a genius at this. He quickly realized that Starbucks' (NASDAQ:SBUX) frontline baristas made all the difference. So he gave them health benefits, flexible hours, a pleasant work environment, a sense that they are appreciated. Don Perkins and Franklin Lunding, who ran Jewel Companies, the first major business I worked for, used to talk about an idea called the upside-down organization chart. They argued that the boss's first job is to serve and assist the people in the field, and I really believe that. It's especially crucial in consumer-facing organizations because field staff is where the customer meets the road. If you treat these people right, they will eat nails for you.

The right market: Preferably, it involves an absolute mob scene. Unless there is real market demand, you will fail. Why is Federal Express a success? Because people need things delivered overnight. Why is Google (NASDAQ:GOOG) a success? Because people need to find information on the Internet.

Try plugging your company into that construction and see if the resulting statement makes sense. Dean Kamen should have done that before investing so much in Segway. He is one of the most brilliant inventors of modern times, backed by a prestigious venture capitalist. But try saying, "People need an electric scooter to shoot them around town." Lacking genuine demand, the proposition just kind of lies there.

The great thing about retail is the ease of assessing your market. You see your customer every time you're in the store. There's one, trying to flag down a clerk for assistance. There's another, staring in frustration at some ambiguous signage in aisle seven. I've been telling entrepreneurs "Know your customer" so long that people must think I have it tattooed somewhere on my body. But it's still the most profound lesson in the business canon. You can tell when an idea derives from observing real people in real situations, as opposed to when it just dropped from the sky into someone's brain pan. I always get excited when an idea rings true. Then I go out and verify.

Take Lululemon. Before we invested there I dropped in at one of its stores on a Thursday afternoon. It was an absolute mob scene. Customers grabbing things off racks. Lines at the cash registers. The name wasn't even on display outside the store: It just had a logo. What does it say if people can't even see the

name of a business and they're coming in in huge numbers?

The experience with Lululemon reminds me of a lesson I've had reinforced as a VC: Understand the customer but never assume that *you* are the customer. It is always dangerous to make business decisions based on your personal consumer needs. Entrepreneurs will say, "I started this business because I was trying to buy X or have X delivered a certain way and couldn't."

I started two companies out of just those types of frustrations: Zoots because I never found time to get my dry cleaning done, and Olly Shoes because I had trouble finding shoes at traditional stores that fit my kids. Still, I invested in tons of market research before starting them and have always asked for real customers' feedback rather than basing decisions on my own preferences. Working with a company like Lululemon is a great change for me because I have no consumer biases--I'm not a yoga guy. I did buy one of their sweatsuits, though, and I've got to say, it's the softest thing I've ever worn. And it wicks away the perspiration like that!

The right answers: Sometimes you need an outside perspective. One thing I like about my new position is the chance to be a fresh pair of eyes. When you're running a company, you live so much inside its problems that sometimes you can't see them clearly. I look at these businesses as an outsider, and I can tell what they need.

For example, one of my portfolio companies, Blue Tulip, is a gift store chain that specializes in unusual handmade cards and wrapping paper. It's based in New Jersey, and the founders told me they plan to expand up and down the Eastern Seaboard. My immediate thought: "That is one tough real estate market." So I advised them to hire a top-notch, high-level person to manage that, and helped them put one in place. In general, entrepreneurs wait too long before establishing professional management of real estate and technology--two functions that often cause the most trouble as you're scaling up.

I've also been working with companies on questions like where to locate stores and whether they should be franchises or company-owned. I've been helping Rec Room, a Chicago-based business that sells game-room furnishings like pool tables and bars, attract customers through a more entertaining retail environment. We're talking about holding parties and celebrity poker tournaments, and these stores are the ideal venue. And I'm advising Lululemon on expanding overseas, about which I've urged them to be cautious. Staples had a very rough time in Europe--it took years for us to succeed there. I've suggested that Lulu cement its presence in the U.S. and Canada first and then, when it does go global, it should do so as part of an alliance.

I look at businesses like these and think how lucky their leaders are. The early days of company building are so exciting: Happy endings are even more fun to anticipate when you don't know exactly what they'll be. Still, I don't envy these entrepreneurs. Time pressures these days are incredible, and I don't want to subject myself to that. I'm not tempted to get back into the founding game. Venture capitalism is the perfect third act for a guy like me. I get to apply all that I've learned. And I get to invest in people's dreams and help make them a reality.

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