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IlLUminate Blog Transcript: Josh Ehrig on How a Start-up Can Survive a Pandemic

Recorded March 27, 2020. [Listen to it here].

ROB GERTH: 00:00	Welcome, I'm Rob Gerth, Director of Marketing and Communications at Lehigh University's College of Business. Today is March 27th, 2020, and we're talking with Josh Ehrig about what it's like for startups, or even probably small businesses in the middle of this pandemic. Josh is a professor of practice in the Department of Management, in the College of Business at Lehigh University. He is teaching undergrad and graduate and he teaches courses in entrepreneurship, strategy and innovation, and tells me that previously he was a serial tech entrepreneur. Welcome, Josh.
JOSH EHRIG: 00:30	Thank you for having me, Robert.
GERTH: 00:35	Let's start with a quote I read on the internet, "If your business model today looks the same as it did at the beginning of the month, you're in denial and possibly out of business." What's your reaction to that?
EHRIG: 00:47	So your business model should be continuously evolving as a startup regardless of the macro environment. Most startups are in that search stage, not the execution, where they're searching for a product market fit, searching for a viable business model. So, quite frankly, startups should always have some kind of continuous feedback mechanism across the value chain, I think it's really important. I think that's actually important for all companies, but specifically startups where you have reduced time and resources involved and I think that's kind of what we've been seeing a lot, Rob, with a lot of the literature that's been coming out related to COVID-19 and startups in general.
EHRIG: 01:37	And there's really a paradox going on in this situation in that generally startups have some kind of product market fit, where they've identified a specific market and have a product/service to address with that market. And their goal really is to scale at that point. And that's really where venture capital funding comes in and this becomes more of a high-growth/high customer acquisition cost proposition. So you probably have seen this with companies, maybe companies you know like Uber, Lyft, or some of those tech-related companies where the acquisition costs are high, but their potential to be number one in market share is very high as well.
EHRIG: 02:26	But now the attention is on extending runway. Runway meaning the amount of cash flow you have remaining as a company and it's all about the cash flow. So reducing the net burn, what you bring in verse what you bring out. And it's really become about client preservation, Rob. One of the companies I'm on the advisory board for, they lost about a quarter of their bookings in one day about two weeks ago. And they went from complete client expansion to complete client preservation. So really we've seen the risk/reward pendulum kind of swing in the opposite direction and really startups are kind of entering what we call a nuclear winter.
GERTH: 03:15	What do you call it?
EHRIG: 03:17	Nuclear winter.
GERTH: 03:18	Nuclear [laughter].

EHRIG: 03:19 Yeah, so it's simply not something I've come up with, but essentially--entrepreneurship's really hard let alone all this additional adversity. So in this environment your projected lifetime value of a customer may not be realized, at least as fast as you'd want it to be. And that's where the burn rate and runway becomes more of an issue. And as a result, you may need to not only reduce headcount, but also your customer acquisition costs and actually be smart with your marketing sales spend to keep the CAC/LTV ratio viable (where CAC = customer acquisition costs and LTV = lifetime value of customer). Once again, it's a paradox. Because with customer acquisition costs, you'll likely need to increase it to gain market share over the long run and (ultimately) enhance lifetime value of that customer. So really it's become about sustaining high growth verse preservation. Sequoia Capital, one of the larger VC firms out there, at least one of the most well-known in a sense given its history, just wrote a post on Corona being the Black Swan of 2020. And we've seen this play out before as I believe Sequoia had a similar letter to investors (LPs), back during the financial recession of 2008-2009.

GERTH: 04:54 And do I remember, did you tell me that you had-- you were a startup at that time, right? You were running a startup.

EHRIG: 05:00 Yeah, so I've helped co-found, build or advise various companies. One was actually in 2009. And it's really interesting because even though you have this crisis acceleration happening, there's all these resultant structural changes, economic, social, psychographics, political, that really create large opportunities. But of course this could be really, really challenging because at the same time it becomes all about having this more lean mentality where you don't have a lot of capital, or the ability to employ capital. But once again, that creates opportunity because you see technological innovation, you see these societal shifts that are occurring that help create this opportunity.

EHRIG: 05:56 And at least in technology, Robert, at least from my perspective, we've seen this with the dot com bubble, right? It kind of sparked some of those Web 2.0 companies that you probably use every day now, like a LinkedIn, like a Facebook, during the dot-com bubble. You've seen the conversions of a lot of different things, such as the economy took a downturn, all of a sudden we went from good times to bad times and all of a sudden, as a society, we start having to hustle a little bit more, so to speak, right, we have that term hustle the economy that was born out of the 2008/2009 recession. Not quite sure how I feel about that term. But at the same time, that spurred the sharing economy, so companies such as Uber, Lyft and Airbnb, which I believe's going to go IPO in 2020. So that creates challenges.

EHRIG: 06:53 At least in my case, one of the companies that I had created back in 2009 was actually acquired later that year by a company that provided advertising and so forth to weekly and monthly publishers. And next thing I know, their funding dried up and I was in talks with private equity firms at that point to help the company that acquired me get acquired. So being an entrepreneur, psychologically, is really hard. And there's really interesting stats on that, entrepreneurs as a whole are likely to suffer from depression three times more so than the average. And so when you kind of bring all these other kind of forces at hand, it just makes it that much more difficult. I'm pretty fortunate in the sense that I've been through it, I understand it and when I talk with startup companies that I've worked with, I can feel that pain a little bit. And the pain is real.

GERTH: 08:15 Does a CEO at this point, is he - and you're talking to some folks out there in the world in startups - is denial and delayed action, is that really the biggest mistake that a CEO can make at this point?

EHRIG: 08:30 Yeah, so I think it's really important to look in yourself in the mirror and-- because these are kind of moments that define you, whether it's personally or professionally. In the case of startups, it's also about kind of conceptualizing who you are as an organization, now and moving forward, right? Because a lot of these-- you know when you have this kind of crisis acceleration and these structural changes that create opportunity, for certain companies, startups specifically, they may be able to be more reactive and responsive to those situations, assuming they had the appropriate runway. Or they may be pivoting based on the fact that they want to conserve runway, but I think in certain cases it actually sparks a lot more creativity in the process. So I think there are advantageous means to being in this environment, in this situation.

EHRIG: 09:30 Robert, I may be guilty of having my glass half full in life, but at the same time, I think you have to progress and move forward, but conceptualizing who you are as an organization now and moving forward, while simultaneously trying to be reactive in the existing environment, as well as investors. Depending on whom they are. In certain cases, investors may not have runway themselves, or may not deploy the amount of risk capital in this environment may be necessary to allow some of these opportunities to come to fruition.

GERTH: 10:10 You know, I was going to--

EHRIG: 10:11 Yep.

GERTH: 10:11 I was going to ask you about investors. It's a hard time for them too, I guess. I mean, they have more money than the startup guy has, but they still don't have infinite cash. So that must put them in a bad place.

EHRIG: 10:25 Yeah, I mean, everyone has runway, right, Robert. Whether it's you personally as a startup, or as an investor. In these situations it becomes more about solvency and capital preservation at this point from any constituent viewpoint. So, yeah, it is challenging for the investors as well. What I've seen - and I don't want to speak on behalf of every investor - but from those who I've spoken to, this is kind of a really a watershed moment to actually look at the opportunity and once again, those economic social, political, psychographic structural changes that are occurring. But also kind of being mindful of timing, right? Because timing matters a lot. If you're going to create an autonomous transportation to go to Mars, that may be a good idea, but the timing's not good at the moment.

EHRIG: 11:29 But while timing matters quite a bit, it's all kind of interconnected within the startups ecosystem, so it'd be somewhat simplistic just to look at timing as a whole. And if you're in a complete reactive mode, Robert, and the mainstream media is talking about it, or Entrepreneur Magazine has a cover story on it, or your neighbor is talking about it for that sake, there's probably a higher probability that you've already missed that opportunity.

GERTH: 12:03	Are there hard questions that startups, and maybe even small business owners, need to be asking themselves right now when they're looking in the mirror at themselves?
EHRIG: 12:15	Yeah, so, when you're building a company, you have various stakeholders at the table who rely on you, right? Whether it's an investor relying on you for a return. Whether it's employees relying on you for their livelihood. And you're ultimately probably going to be faced with, how do I manage all of those expectations, while also managing the additional stress and not reacting to, or not staying in that reactive state?
EHRIG: 12:51	So it's already stressful enough to ramp up once you've raised funding, and I've seen those situations -- probably the best idea to raise funding when you get to that point is to really focus on sales growth, but at that point it becomes a real challenge for you as a CEO of a startup to manage all those expectations, including your home life expectations right now. A lot of us have gone into working virtually at this point in time, and for some, that, in and of itself, leads to some challenges. But for other startups who have to be lean, have to be nimble, because they don't have the capital so to speak, may already be running virtual operations and therefore this really hasn't changed the game too much, except (potentially) from a customer preservation aspect.
GERTH: 13:55	And then at some point these companies need to develop what I think is referred to as a lifeboat strategy. Can you explain what that means?
EHRIG: 14:08	Yeah, so effectively, once again this gets right back to the runway burn rate question, right? It's really difficult because your net burn rate's probably negative if you're in a high-growth startup situation. And all of a sudden if you start-- you know, and if your projections are of high customer growth and then all of a sudden crisis acceleration happens, so to speak, and your net burn goes from X to 4X overnight, well, then, you know, I mean, the simple math will tell you that all of a sudden your runway is drastically reduced. And so how do you manage that and mitigate that in a way to get through the crisis while still keeping your eyes on the ball, so to speak, in terms of actually executing on your business model.
GERTH: 15:15	So lifeboat strategy refers to like if I'm going to get in the boat, what do I need to take with me? What's the minimum thing I need to take with me, I guess, like how do I stay alive and still be able to function and what do I need to jettison. Is that a fair assessment?
EHRIG: 15:38	Yeah, and I certainly-- you know, this isn't obviously a good situation, but at the same time, there is opportunity there. Right? So in this case, if you look at this at least from an incumbent perspective, this could be a really troubling time, right? But from an entrant startup perspective-- there's a lot of unintended consequences that are going to emerge based off these structural changes right now, that I think are going to define or disintermediate certain industries. For example, if you look at the sharing economy, so to speak, if you were-- you know, it was kind of a secret 10 years ago. You know, this is kind of a fundamental truth as kind of somebody like Peter Thiel would mention around something that fundamentally a lot of people don't agree with you on, right? But now it's become acceptable. If, Robert, if your kids had come up to you 10 years ago and said, "Hey, I'm going to actually be at a sleepover this weekend, so I'm just going to rent my room out to a stranger. I don't actually need a ride

because I'm actually going to have a stranger pick me up." 10 years ago you would have laughed and 10 years later, that happens all the time.

GERTH: 17:08 Yes, that's great.

EHRIG: 17:09 So some of these fundamental truths start emerging, but these unintended consequences, so, I mean, if you look at like the web browser, right? That created social, like Facebook, LinkedIn, it created Amazon, which enabled-- which disintermediated retail, right? You look at Wikipedia, Twitter, and different ways of content dissemination which disintermediated newspapers and so forth. And so the question becomes as psychographics change based off these structural changes, what are the opportunities there that will-- and the unintended consequences involved with those opportunities that would create disintermediation and enable startups to actually capitalize on total addressable markets, that didn't even exist five years ago.

GERTH: 18:07 So I'm seeing disaster and you're seeing opportunities.

EHRIG: 18:11 Yeah, I mean, if we don't continue to progress, Robert, in these times, in these circumstances, what are we doing? And it's kind of like when everyone wants to deploy capital, you're probably at the end of a cycle. But ironically when capital preservation mode is on, this is probably when you want to deploy capital. So it almost reminds me of the-- it definitely reminds me of the Warren Buffet quote where when people are fearful, be greedy and when people are greedy be fearful. So cycles play out. Human behavior never fundamentally-- seemingly never fundamentally changes. The games and rules just evolve over time and how do you evolve with those games and rules? I mean, building a company, it's really a game at the end of the day. And the rules do evolve over time. So when you talk about optimism verse pessimism, either way you need to adapt, especially given limited time and resources of startups.

GERTH: 19:23 And how much do you think-- because it's not like when the market crashed in what, 2008, that was one thing the market was bad and businesses all sort of got nervous about everything and investors got nervous about everything. But the whole idea that you can't meet with people, you can't meet face-to-face, how big a factor is that going to be in the fundraising and even just for onboarding and hiring and just even for startups building a culture?

EHRIG: 19:50 Yeah, I mean, look I think people evolve with these situations, right? I mean, when you talk about face-to-face interaction, Robert, we both work in education. We see students all the time and hopefully, we're going to see them in person again fairly soon. When we walk past them in the halls, we observe them doing what? They're fixated on their technology, right?

GERTH: 20:18 Right. Right.

EHRIG: 20:19 And you can see different behaviors and things already occurring as a result. I think as technology mediums change, this just evolves over time. But, Robert, one thing that you brought up that I think's really important is culture. A company's culture is usually created within the first 100 employees. And that starts at the top and I think as some startups are going through this time, they need to be mindful of culture, but they also need to kind of put emotions to the side to a degree as well to make good financial and business model decisions.

GERTH: 20:59	And do you think on the other side of this, will it be a better time for startups, or will it be hard to get your startup up and running?
EHRIG: 21:09	Yeah, I mean, look, I'm pretty optimistic about this overall, right? If anything, these nuclear winters that we talked about have resulted in individuals who might have maybe otherwise not taken the risk to take the risk. So I view entrepreneurship and my own experience, I'm always trying to de-risk, right, and so I think that's what you're seeing a lot of startup entrepreneurs as well as investors doing right now. But quite frankly, I think opportunities will be there and investors who have the runway to take advantage of these nuclear winters generally do really well. And so that might sound somewhat contrarian because we're kind of in this reactive fight-or-flight-type mentality right now, right? But once again, it goes back to understanding cycles and understanding when to deploy capital during those cycles. I do generally think that creativity, because you have to be leaner and reactive to those structural changes in crisis, do enable new ways of thinking and do enable people to kind of create that mentality, right, so.
EHRIG: 22:43	So I personally-- again, I'm certainly not excited by the circumstances though I'm excited by the resiliency and reactivity of entrepreneurs to be opportunistic and to fundamentally change our environment in a better, more effective, more efficient way.
GERTH: 23:07	And let me talk about CEOs one more time. Is there a special way, or in your experience, is there a method that CEOs should be using to handle their staff? And we've been talking about the money and about the business ideas, but we haven't really talked about the people that are involved and the people that have moved to take a chance in this startup and invested in this startup, whether emotionally at the very least, financially maybe even. Is there tips for CEOs at this point that you would like to see them do as far as handling people?
EHRIG: 23:45	So from startup CEOs I've spoken to recently, my biggest advice, Robert, has been, be honest. Be honest with yourself; be honest with them, right? Because this is their lives at stake as well. But you've got to be honest and make those hard decisions. It's kind of like firing somebody, not firing them fast enough if they're not a good fit. Because it only creates more problems and issues and is more costly later on. So in this case, it's pretty simple - be honest about where you're at, what you need to do to have that lifeboat as you said, Robert, and go from there. I mean, you certainly-- building a startup is not about making everyone happy all the time. In fact, it can be quite miserable sometimes, right? I mean, if it was so easy everyone would be doing it, though everyone would have the same haircut I have, at the end of the day.
GERTH: 24:51	Which is not much hair, I might mention.
EHRIG: 24:53	Yeah, I mean, you know, I like to say it's by choice, but…But it's really, it's stressful but you know, you see it all too often where emotions can potentially get in the way, right, of making these hard decisions. Ben Horowitz wrote a great book called, The Hard Things About Hard Things, which I would recommend to you and everyone who listens to this to read. It talks specifically about this, make the tough decisions, but make them fast. Because quite frankly, you just don't have the time and resources to dance around it. And I would say that in any crisis or non-crisis situation. I kind of view, at least in my own experiences, building a startup as almost like a crisis situation every day. You know, there's a great quote about being an entrepreneur, jumping off

the building and learning how to build a plane on the way down. And I think it's really true, right? And that's like every day, so.

GERTH: 26:04 That's a perfect place to end, Josh. Thank you so much.

EHRIG: 26:07 Excellent.

GERTH: 26:08 So my guest today has been Josh Ehrig. He's got degrees in economics, poly sci and history, all from Lehigh. You're truly a company man, I see, Josh. This podcast is brought to you by ilLUminate, the Lehigh Business blog. To hear more podcasts featuring Lehigh business thought leaders, visit us at business.Lehigh.edu/news and follow us on Twitter at Lehigh Business. Thanks for listening.