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Paychex Founder Tom Golisano's Advice for Innovators

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MAJOR TAKEAWAYS:

- ***Make sure you totally understand an industry before you get into it.***
- ***Don't assume that somebody with equity in your company will work harder.***
- ***Compliment your competitors in front of customers.***
- ***Keep your business plans under three pages.***
- ***If you're seeking investment, don't try to hang on to most of your shares.***

Fifty years ago, Tom Golisano left a comfortable job at Electronic Accounting Systems (EAS) to start a new Rochester, NY-based company focused on a market that nobody else wanted: payroll services for small businesses with fewer than 20 employees. Golisano was married and had a son with special needs, just $3,000 in cash and a lot to lose. A half century later, that company, Paychex, has a market capitalization of more than $30 billion, annual revenue of more than $4 billion and more than 650,000 clients. Along the way Golisano made some bold moves that went against conventional wisdom and paid off, and a few mistakes that cost him.

Today Golisano remains chairman of the board of Paychex. He is also a philanthropist, angel investor, civic leader and former owner of the Buffalo Sabres hockey team. Committed to helping new business owners and future entrepreneurs learn from his experiences, Golisano recently published a book, "Built Not Born,"(http://www.golisanofoundation.org/Tom-Golisano/About-BuiltNotBorn.aspx) *that chronicles the story of Paychex and his own journey as an entrepreneur. He talked via Zoom recently with EIX editors Jon Eckhardt and Cathy Buday to share the major lessons he's learned from building Paychex and taking it public. Here is an edited version of that discussion.*

EIX: You started Paychex in 1970 with an idea for a service that other payroll companies thought wouldn't work. How did you get that idea?

I was in sales and sales management for EAS, a typical payroll processor whose customers were companies with at least 50 or 100 employees. It was one of the giants in the payroll processing business, along with ADP, its major competitor. In general, the larger the client, the happier these big payroll processors were, because they thought the revenue is much more important. Well, I was driving around one day and noticed the very large number of small businesses lining the streets. Since we couldn't do online research back then I went to the library, and found out that 98% of all employers in the country have fewer than 100 employees and around 80% of them have fewer than 20 employees. These were companies that were not likely to have a payroll expert on staff; typically somebody did it part time and made a lot of costly mistakes.

I went to my manager at EAS and offered to start a division of the company that would serve that market. I shared three innovations we could offer that were really counter to what the market was doing. First, the client could call in the payroll information on the phone, instead of filling out a complicated computer input sheet. Second, we would include payroll tax returns as part of the service -- nobody was doing that. And we would charge a fee that small business clients would accept. I knew it would be easier to sell ten 10-person payrolls than one 100-person payroll, because there were so many more of them out there.

EIX: Why did your company pass on the idea?

Back then many companies were using CPAs to do their payrolls. The EAS people told me that CPAs wouldn't like us cutting into their business. And I said, “I disagree with you entirely, because doing payroll tax returns are tedious, and accountants really can’t bill out their time for that at a rate that will make them happy.”

EAS also didn’t see value at the low end of the market. Because of the way its pricing worked, the smaller firms had a higher cost per employee. In other words, if you had five employees, you might be paying $1 per employee back then; if you had 50 employees you might be paying 25 cents. But we saw that our proposed pricing scheme would generate 2 ½ times more revenue for us without 2 ½ times the overhead. We could offer it at an attractive price for the proposed market and more profitable for us.

EIX: In your book you talk about the difficult early years of Paychex. You had $3,000 in startup cash from selling another venture, and you needed 300 clients to break even, but that didn’t happen for four years and it was scary at times for your family. How did you survive, and what would you advise entrepreneurs about getting through times like that?

I spent that $3,000 on direct mail. My goal was to get 16 clients in the first 60 days, and I ended up with six. So obviously, I developed a real cash flow problem. Fortunately, I had some friends who worked with banks that were able to give me consumer loans when I couldn’t get a business loan. My sister lent me $30,000. What I learned is that you’d better have a realistic view of the amount of capital you need to get to where you're going. Too many entrepreneurs think that because they put up their shingle or put their nameplate on a wall, the world will come to them. It doesn't. You’ve got to go out, dig it out and figure it out.

You also must learn to manage your expectations about how much of the market you can gain. Today we do some entrepreneurial investing, and when somebody comes in with a business plan that says they’ll get 5% of the market in three years I’ll tell them it just doesn’t happen.

One of my early challenges was that payroll processing for very tiny companies was unheard-of back then. But one of the things that made me confident is that our first six customers and others that followed thought the service was great, delivering real value. So I learned that I had a market education job to do. And I figured the best way to do this was through the CPA community.

EIX: This was one of many unconventional moves you made to build your company: tapping an unusual source for sales leads.

We started selling Paychex’s services through direct mail, and once we got a few clients we started calling on their CPAs. We’d tell them, we have a mutual client and this is what we're going to be doing for him. You don't have to do payroll tax returns anymore. Do you have any other companies that are having a problem doing it? And we discovered our original hunch was right: the CPAs were eager to unload that work. That was a very pleasant surprise.

> "I can’t emphasize this enough: The more industry knowledge you have going into a business, the better off you are."

Today there are still some CPAs who do payroll processing but they are a very tiny part of the marketplace. In fact, our marketplace is still wide open: Paychex, plus the two other big payroll companies and more than 1,000 other small companies that might do payroll, still only have about 25% of the total market.

EIX: What gave you the confidence to ignore your bosses at EAS who told you there was no market for what you wanted to do? When should entrepreneurs question the wisdom of business elders?

There’s nothing more important than industry knowledge. EAS, the payroll processor where I was working, served large businesses, and my proposed

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market niche and the processes for serving it were different. But the processing concept and the value of the product were pretty much same. So I had the mental ideas and concepts to put Paychex in place, and I was sure about the facts that supported my thinking. I can't emphasize this enough: The more industry knowledge you have going into a business, the better off you are. And if you don't know everything, you have to know what you *need* to know, then go after that knowledge.

EIX: What kind of mindset must somebody have to do that?

If somebody truly is going to be an entrepreneur, they have to be intensely curious about every business they see, how that business makes money and whether its business model works. I remember looking at a hamburger place or video store – even a cigar factory I visited in Cuba -- and calculating what the average sales might be, what they might need to pay for rent and other expenses, and how much volume might come through the door on an average day. Just standing outside a store, anticipating what their markups might be on their products, and how many sales it might take to cover their overhead and to make a profit, is a great exercise and a lot of fun. If I'm going to invest in an entrepreneur, I want him or her to be thinking that way all the time. They shouldn't be thinking about starting businesses that don't have a chance. Unfortunately you see that happen a lot. I knew the video store wouldn't make it based on the volume that I saw going through the door, and within six months it had closed.

EIX: What are some of the other big moves you made as you built Paychex?

Moving to the franchise model was one. Consolidating all those franchises into one company a few years later was another. Paychex was initially set up and designed for one owner -- that's me -- in Rochester, New York. But a friend wanted to set up an office in southern Florida and proposed being a franchisee rather than a partner. After some deliberation, we decided we'd set up a franchise in Miami, and soon we had other franchisees and I decided this might be a good way to build a national organization. After four years, we ended up with 10 franchisees and sub franchisees, which was a great way to expand.

But that model brought some problems. The franchisees' ambitions varied: some wanted to open one office and then quickly open a second or third office in a nearby city; one guy was happy with one office and didn't care about the rest of the cities in this state. Some people were very good in sales and terrible in operations, or vice versa. And financially, we weren't very strong because many of our franchisees had sold their houses, exhausted savings or borrowed money to get into the business, and I wasn't exactly flush with cash either. Our liquidity was not good.

> "Just because someone invests their own money in a company does not necessarily mean they're going to do a better job than a hired employee."

That's when we decided to merge all 17 offices into one corporation, making all of us employees and shareholders and with a five-year timetable to either sell the company or take it public. I got all the major players together in the Bahamas to unveil my idea and talk about the stock allocations. Eventually they all agreed to it and we emerged as a new consolidated company. We spent the next three years building a sales organization and opening new branches.

In retrospect, if I had to do it over again, I'd have not used the franchisee model.

EIX: What did you learn from that experience?

Just because someone invests their own money in a company does not necessarily mean they're going to do a better job than a hired employee. Sometimes a franchisee may get up to 300 or 500 clients, and now that he's making a comfortable living he doesn't feel the need to work very hard. Well, you're losing tremendous opportunity by having a franchisee with that attitude. And believe me, you do end up with franchisees who have that attitude and you can't do anything about it. So just because a franchisee or individual has equity in an enterprise does not necessarily mean they're going to manage their part of it well.

I also found that I had to negotiate with a whole bunch of franchisees at once. And that's not a lot of fun compared to dealing with them one at a time. It's harder to move quickly when you've got a bunch of other folks you have to get yeses from. With a company structure, I can have more control over our destiny.

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EIX: You have a very generous view of competition, which you talk about in your book. Many entrepreneurs feel fearful about competition and always ready to do battle, but your attitude is to admire and compliment them.

Paychex is one of three big companies in the payroll processing space, and there are thousands more little ones. But the big three and the smaller players together have only about 25% of the total market for payroll services, so the great thing about the payroll processing industry is there can be multiple players in it, and unlike in politics, we can all be successful.

Francis Ford Coppola once sent me a note that said, “Remember, stay close to your friends and even closer to your enemies.” I can think of one CEO with whom I had a terrible relationship. But with other CEOs, we would call each other and offer helpful suggestions. I just think it's a nicer way to live. It's also very disarming to a potential customer, if they bring up your competition and you say, “you know, they're a great company. And from what I understand, they do a very good job.”

EIX: You were able to boot-strap Paychex in its early days through your own capital, loans from banks and help from family. You didn’t go to a venture capital firm back then. Can entrepreneurs build a company like Paychex today without going to a VC?

I think there are a lot more angels out there. I'm one right now; I’m invested in about a dozen different companies that are all fairly new. I think there's a lot more of that capital available today than there was back then. But I'm also very skeptical about venture capitalists. You have to remember a couple of things about them. They are usually on a different timetable than entrepreneurs because their investors want their money back. And secondly, they're better negotiators than you are.

> "I don’t believe in business plans that are longer than three pages. In fact, many of them can be boiled down to one page with just the essentials."

So be very careful when you're dealing with them. Again, there are a lot of situations in which venture capitalists are very helpful. They make good connections for you. Obviously, they provide capital if you need it, or when you need it.

EIX: As an angel investor yourself, what do you look at when somebody is pitching you a potential investment opportunity?

I don’t believe in business plans that are longer than three pages. In fact, many of them can be boiled down to one page with just the essentials. And even for a decent idea, I pay attention to the equity percentages being proposed. If somebody sends me a business plan, and the first thing they tell me is that they want to sell 49% of it and keep 51% of it regardless how much money I invest, I’ll heave the proposal right into the waste basket. When I consolidated Paychex I didn’t own 50% of it. We had 17 other major shareholders who had been the franchisees. And they had the power to make me leave the company if they wanted me to leave. So if you own, say, 30% of a your company and 10 other shareholders own the other 70%, you should feel reasonably secure that you’ll keep your job unless all 10 of those shareholders say you need to get out. And if that happens, you should probably get out.

EIX: What advantages and disadvantages did you see from taking Paychex public?

Being a public company, along with helping our liquidity, gave us more credibility, especially as a professional services firm handling a lot of clients’ money. Because our financial statements are public, CPAs can look at them and determine if we're qualified to be handling their clients’ money. Also, it helps with recruiting because if you're a public company, you appear more stable than a private firm. And third, you can incentivize people with the use of stock options; stock options in a private company are just about useless.

That being said, a lot of CEOs say that going public puts pressure on them to manage quarter to quarter, and to show improvements every quarter. That was on my mind, too, when we took Paychex public. And I felt reassured, because we were a very predictable company back then and we are a very predictable company today. We have this huge market, we have growth and we have a great sales staff selling great products. And we feel we will continue to do a good job and continue growing. But I caution many entrepreneurs

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that they shouldn’t count on going public.

EIX: What would your advice be to successful entrepreneurs contemplating starting another venture?

If you are successful with something, don't think you're immortal or that you can do anything. Because you may not be able to because of a lack of knowledge, because the lack of a market, or maybe not enough capital. You may be successful in a second venture, but I will say this: if you do get involved in something like that, be sure you don't bet the farm.

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