Unfortunately, they are usually wrong. But what separates the men from the boys, so to speak, is what they do when their first plan fails. The entrepreneurs and other visionaries featured in this book tend to lick their wounds, get back on their feet, and morph their newly found insights into great businesses. Small retail shops selling bags of freshly ground coffee are not what made Starbucks a household word. And an effective free search tool is not what made the word *Google* a verb nor made billions for Google's investors. Both of these now-global brands owe their success not to their Plan A, but to Plan B.

Your Entrepreneurial Dreams

It is a widely accepted fact that successful entrepreneurs and their fast-growing companies deliver the vast majority of economic development—in both the developing and developed worlds. In the United States, for instance, firms that were less than five years old generated all of the net job growth between 1980 and 2001. Those are good results to aspire to. Older firms actually lost jobs![4] But if so many Plan As fail, why on earth are nearly one in ten American adults—and one in fifteen Brits and millions more in almost every country around the world—actively involved in starting or running a new venture, most of which are based on Plan A?[5]

There are many reasons why so many aspiring entrepreneurs are pursuing entrepreneurial dreams today. There's the opportunity to be your own master. No more punching the clock in your look-alike cubicle in a dead-end job. There's the opportunity for the thrill and excitement—the just plain *fun*— of creating and growing an entrepreneurial venture (we know, because we've both been there, multiple times). Some are pulled into entrepreneurship by what they think is a great idea. Others are pushed into it for financial reasons.

Still others hope to use their business' success to contribute to making the world a better place, in some small or not-so-small way. The Body Shop's Anita Roddick, for example, wanted to make the world of cosmetics "greener" and more socially responsible. Google's Sergey Brin and Larry Page wanted to better organize the world's information, no simple task. Great reasons for starting a new venture.

Alas, despite the best of intentions, experience shows that the vast majority of these entrepreneurial dreams will fail to bear the fruit their

enthusiastic and passionate proponents intend. And that's a shame. If more people harboring the dreams of Roddick and the Google founders, for instance, were to have a more informed crack at it, society would be stronger for it. A crucial question, then, is why most entrepreneurial dreams—the founders' Plan A—won't work.

Why Plan A—Yes, Yours—Probably Won't Work

Let's step back for a moment and take a candid look at the success and failure of new ventures, whether new products in established companies, small lifestyle businesses, or ambitious new ventures bent on raising a boatload of venture capital to shoot for the moon.

The research on new product success and failure indicates that it takes fifty-eight new product ideas to deliver a single successful new product.[6] Difficult odds! Thus it's often the case that the solution an entrepreneur is pursuing isn't quite what the customer—or user, policy maker, whatever—will embrace. Figuring out what the customer wants and will buy sounds easy. It's not. Figuring out what customers will buy is a process—one that lies at the heart of this book—not a guess. And a handful of focus groups or surveys isn't likely to uncover the answer.

Another common culprit is cash. When a new venture dies an early death, the reason often given for its demise is, "We ran out of cash." But running out of cash isn't a cause, really. It's a symptom. It's a symptom or signal that the company's business model didn't work. Why don't most new companies and their business models work? Perhaps the combination of what it costs to invent, finance, produce, and deliver your dream simply isn't sustainable at a price the customer is willing to pay or at a valuation at which the required investment can be attracted. Perhaps your customers were too few in number or too expensive to attract. Developing viable business models means getting all the economic elements to work together just right. Otherwise—poof!—you're out of business in a heartbeat.

So let's return to Max Levchin. When we left Max, he was feeling pretty uncomfortable camping on his friend's floor, but rather confident that his millions were just around the corner. We reckon you can see the writing on the wall. Let's watch what he does.

Max Levchin's Plan B . . .

You guessed it: Max Levchin's Plan A was not to be. Demand for security on handheld devices never materialized. He remained a vagabond. But he was cooking another idea.

Max pursued a Plan B that centered on cryptography software. "It's really cool, it's mathematically complex, it's very secure," said Levchin.[7] But once again, no one really needed it. Plans C, D, and E didn't work out any better. Levchin's Plan F, still based on his cryptography expertise, was a system for securely transferring cash from one PalmPilot to another. As part of that effort, Levchin's team built a Web-based demo version that did everything on a Web site that the PalmPilot version could do. By early 2000, people were using the Web version for actual transactions, and the growth of the Web demo was more impressive than for the handheld version. "Inexplicable," recalled Levchin. "The handheld one was cool and the Web site was . . . unsexy . . . a demo. Then all these people from a site called eBay were contacting us and saying, 'can I put your logo in my auction?' We told them 'No. Don't do it.' Eventually, we realized that these guys were begging to be our users. We had the moment of epiphany. For the next twelve months, we just iterated like crazy on the Web site version."[8] Levchin finally had a tool that filled a void, allowing ravenous eBay traders to safely transfer cash from buyer to seller.

Plan G—a little outfit called PayPal—was born. And did it strike gold. PayPal is the now dominant system of paying securely for online purchases. Eventually, eBay, whose internally run payment system was floundering, bought PayPal for $1.5 billion.[9] Max Levchin's Plan G was a winner at last!

Creating a Business Model That Works

Breaking through to get from Plan A to Plan B or Plan G is about discovering or developing a business model that really works. This won't happen by duplicating the models already in existence. Draw on them, yes. Play "me-too"?—generally no. If those are working, who needs yours?

But what do we really mean by *business model*? It's a phrase that, since its advent during the dot-com boom and bust, has come to mean everything and anything and nothing at all. By *business model*, we mean the pattern of

economic activity—cash flowing into and out of your business for various purposes and the timing thereof—that dictates whether or not you run out of cash and whether or not you deliver attractive returns to your investors. In short, your business model is the economic underpinning of your business, in all of its facets.

What we are advocating is not the same as contingency planning, however. We suggest you put only one plan on the table, starting with Plan A, and devote all of your scarce resources and energy to rigorously stress-testing that plan, as quickly and inexpensively as you can, at its most critical points of vulnerability. At each such point, you'll want to know whether it is still viable. If the emerging evidence says to move on to Plan B—and sooner or later it probably will—move on, and resume the process once again!

Street-Testing Your Plan A: The *Process*

As we will see, creating a business model that can turn your idea into the next PayPal or Google—or turn your long-established company into a juggernaut that disrupts your entire industry—means mixing and matching analogs and antilogs and identifying and addressing leaps of faith.

Let's recap the essentials of the Max Levchin example. Working experimentally, he examined a series of hunches or hypotheses about, among other things, what products his crypto skills might produce, what he might be able to sell, and whether customers would buy what he offered. Levchin was testing ideas and learning to see if they held water. Was he simply lucky? Perhaps. But he was also disciplined, smart, and—after some badgering from eBay users—open-minded about where his process might lead.

Such an experimental process, our research and our experience have found, can lead to the discovery of a new and more attractive customer offering and a potentially attractive Plan B. And the best news is this: you can follow this process systematically, with some helpful structure to keep the seeming chaos in check. Let's explore the four key building blocks of this iterative process:

- Analogs
- Antilogs

- Leaps of faith
- Dashboards

Don't Reinvent the Wheel: Analogs

Perhaps the most fundamental building block in the process we advocate is the recognition by the entrepreneur that others have probably done things at least somewhat like what you are thinking of doing now. There's no point in reinventing the wheel when key elements of it already exist. How can you do this?

To begin with, you'll need an idea that you want to pursue. The best ideas are those that resolve somebody's pain, some customer problem you've identified for which your solution might work. Alternatively, some good ideas take something in customers' lives that's pretty boring and come up with something so superior that it provides what we call customer delight. A fancy latte at the Starbucks on the corner, compared with a 1950s-style cup o' Joe, is an example.

Next, consider the *analogs* to your idea, successful predecessor companies that are worth mimicking in some way. There are many analogs out there, portions of which can be borrowed or adapted to help you understand the economics and various other facets of your proposed business and its business model.

Be Different: Antilogs

Next, consider what we call *antilogs*: predecessor companies compared to which you explicitly choose to do things *differently*, perhaps because some of what they did has been unsuccessful.

Information drawn about analogs and antilogs can be inexpensive and easy to find, because it's sometimes found in what marketing researchers call secondary data—data that's already been created or gathered and is lying around on the Internet, in libraries, in other companies' performance reports, and so on. It is just waiting for you to access it. You stand to learn a lot from it because it has actually happened. Often, primary market data—like responses to surveys and focus groups—reflects what people *say* they will do. But what people *say* is not always what they *do*, so such research can be misleading. Just because they *say* they will buy your new

spaghetti sauce based on your grandmother's old-world recipe does not mean that they will actually *buy* it once they have tasted it!

Ask the Right Questions: Leaps of Faith

Having identified both analogs and antilogs, you can quickly reach conclusions about some things that are, with at least a modicum of certainty, known about your venture. But it is not what you know that will likely scupper your Plan A, of course. It's what you don't know.

So the next step in the process is to identify the questions raised by your analogs and antilogs or other questions for which there are neither analogs nor antilogs that provide reliable answers. The questions you cannot answer from historical precedent lead to your *leaps of faith*—beliefs you hold about the answers to your questions despite having no real evidence that these beliefs are actually true. "Any minute now, there'll be millions of people begging for security on their handheld devices," believed Max Levchin.

To address your leaps of faith, you'll have to leap! That is to say, you must experiment. That may mean opening a smaller shop than you aspire to operate, just to see how customers respond. It may mean trying different prices for your newly developed gadget to see which price makes sales pop.

By identifying your leaps of faith early and devising ways to test hypotheses that will prove or refute them, you are in a position to learn whether or not your Plan A will work before you waste too much of your time, and your and your investors' money.

Guide and Track Your Journey: Dashboards

The final step in the process is to adopt a structured, disciplined, and systematic way to guide your set of experiments, track the results as they arise, and provide insight and answers to the questions that underlie your leaps of faith. You need metrics that will yield tangible, measurable evidence capable of telling you whether your leaps of faith are proven or refuted, and whether you are on the path to a strong business model, or a flop (in which case you, like Max Levchin, may decide to move on to Plan B). How is this best done? A *dashboard* is the answer.

A dashboard is a tool that drives an evidence-based process to plan, guide, and track the results of what you learn from your hypothesis testing.

In part, it highlights key indicators of your progress, much as the dashboard in your car tracks key information about your holiday trip to Grandma's house. But dashboards as we use them are much more than the dashboard in the family car. A dashboard in our sense is also a trip planner to help you determine the best route. It provides a detailed map of the hypothesis-testing journey you will take, as well as determining any necessary alterations as you travel.

Your dashboard serves four key roles.

1. It forces you to think strategically about the most crucial issues presently on the table that can—quickly and inexpensively—answer the all-important question, "Why won't this work?"

2. It forces you to think rigorously about how you can examine your leaps of faith by testing hypotheses whose results can be measured quantitatively, wherever possible. Numbers are more persuasive than naïve hopes or dreams.

3. If one or more of your leaps of faith are refuted by the evidence you collect, the results displayed on your dashboard are visible and dramatic indicators of the need to alter your Plan A and move toward Plan B.

4. A dashboard is a powerful tool for convincing others—whether members of your management team, investors or others, even yourself—of the need to move from Plan A to Plan B. If your tenacity or perseverance is questioned, you can show the evidence to support the move toward Plan B. You are not being erratic or flighty. You are systematically testing hypotheses to prove or refute your leaps of faith, and you are listening to what the data tell you.

The process we've just described—finding suitable analogs and antilogs, identifying leaps of faith time and again, and building a dashboard with metrics to guide your journey and keep track of the results of your hypothesis tests—is a straightforward one, really. It inevitably iterates, as will your leaps of faith and the hypotheses you develop to test them. Thus the process never ends, at least not until your final Plan B—in Levchin's case, it was Plan G—is a screaming success. And even then stay alert—things change.

Street-Test Your Plan A: A Framework to Organize the *Content*

At the heart of every Plan A or Plan B that works lies a set of economic fundamentals that, taken together, make the business viable. There is more cash coming in than there is going out. Or, if this isn't the case just yet, you have enough cash in the kitty to last until cash flow turns positive or until you can raise more capital based on the milestones you have met. If your business model works, you are unlikely to run out of cash unless the economic environment around you starts to crumble.

Every business model, whether viable or not, comprises five key elements. These elements, taken together, determine the economic viability of any business that you might pursue. They determine whether you're likely to run out of cash, or not. They are the *content* of your business model, the building blocks that underlie the financial statements that will eventually measure your company's results. Each of the five elements in our business model framework answers one or more key questions, each focused on cash—cash coming in, or cash going out:

- *Your revenue model:*[10] Who will buy? How often? How soon? At what cost? How much money will you receive each time a customer buys? And how often will they send you another check? This set of questions will not result in one, tidy number. It will produce many elements that should be supported by an analog or, if not, become a leap of faith and properly considered.

- *Your gross margin model:*[11] How much of your revenue will be left after you had paid the direct costs of what you have sold?

- *Your operating model:*[12] Other than the cost of the goods or services you have sold, what else must you spend money on to support the sale?

- *Your working capital model:*[13] How early can you encourage your customers to pay? Do you have to tie up money in lots of inventory waiting for customers to buy? Can you pay your suppliers later, after the customer has paid?

- *Your investment model:*[14] How much cash must you spend up front before enough customers give you enough business to cover your operating costs?

Put Process and Content Together: The Business Model Grid

Many companies achieve greatness though innovations in—and relentless focus on—just one or two of the five business model elements. For some such companies, their new business models create a Plan B for their industry that can disrupt the entire competitive landscape. Think Southwest or Ryanair in airlines. Skype in telephony. Google in advertising. Zara in fashion. We will dig into the stories of these and other companies in the chapters that follow. But first, we need to bring both process and content together into a single unified whole (see figure I-1)

The column headings in figure I-1 list the *process* issues you'll need to address as you break through to a better business model. These include identifying your analogs, antilogs, and leaps of faith, and developing your dashboard.

The rows list the five elements of every business model. It is these five elements that must ultimately create value for customers, shareholders, and others. Thus, the five business model elements constitute the five themes

FIGURE I-1

The business model grid

Your current idea and the customer pain that it resolves or the consumer delight it offers

Business model element	Relevant analogs and the numbers they give you	Relevant antilogs	Leaps of faith around which you will build your current dashboard	Hypotheses that will prove or refute your leaps of faith
Revenue model				
Gross margin model				
Operating model				
Working capital model				
Investment model				

about which your analogs, antilogs, leaps of faith, and dashboards must inform you as you navigate your way from Plan A to Plan B.

Your task in traveling the road to Plan B and in breaking through to a better business model than you probably have now is to underpin each of the elements of your business model with evidence, in most cases quantitative evidence. The process elements outlined earlier will help you do just that. If all goes well, they will deliver the numbers you need—whether from analogs and antilogs or from hypothesis testing—to answer the questions posed above (and others we flesh out in the chapters that follow) for each row. We'll say more in chapter 9 about how to use the business model grid and your own tailored set of dashboards to successfully travel the road from Plan A to a better Plan B.

What's Next?

We don't want to read about your failed venture in the broadsheets. We want to know that the business model you go on to develop produces an interesting product or service, attracts satisfied customers, pays its employees regularly, keeps the heat switched on, and still has the financial breathing room for some innovation and growth. Thus, in the pages that follow, we offer you a first line of defense against the considerable odds stacked up against your Plan A. By the time you reach the final pages, you will have a process in hand, as well as a deeper understanding of the content you need to consider as you establish a viable business model. Like this pursuit of a surefire business model, we have organized the rest of this book in two sections: process and content.

To start, in chapters 1 and 2, we dig deeper into the *process* of getting from Plan A to Plan B. Chapter 1 examines the case histories of three ventures that have traveled the road from an initial Plan A that didn't work to a vibrant and viable Plan B. We uncover some of the analogs, antilogs, and leaps of faith that got them there. In chapter 2, we examine the dashboarding process, and take a look at the varied forms that good dashboards can take.

In chapters 3 through 8, we address the *content* of the business models that path-breaking entrepreneurial companies—as well as longer-established innovators such as Dow Jones and Toyota—have created to go either from their initially unworkable or industry-standard Plan A to a more viable or more disruptive Plan B. In chapters 3 through 7, we focus on each

of the five business model elements one at a time—the revenue model in chapter 3, the gross margin model in chapter 4, the operating model in chapter 5, the working capital model in chapter 6, and the investment model in chapter 7. Chapter 8 deals with companies whose innovative business models are based on not just one of the five business model elements, but multiple elements that work together in intriguing ways.

Along the way, we'll dissect the case histories of twenty companies and the often inspiring characters—entrepreneurs and executives—who led them. Some of them, like PayPal, made successful transitions from a Plan A that was not working or would not work to a Plan B that ultimately worked. Others created a disruptive Plan B that played havoc with the existing industry structure, sometimes creating entirely new industry segments that made life exceedingly difficult for traditional players.

Included are the case studies of particularly inspiring companies with nonprofit (rather than for-profit) mission-driven business models. Their tales will be of particular interest to readers who want to do more than just make money for their shareholders. It is our fervent belief that the best of today's companies do much more than deliver an ever-growing financial bottom line. They make the world a better place. They create jobs where jobs are hard to come by. They accomplish what others in the public or private sector have been unable to accomplish. And they create a more livable planet to pass on to our children and grandchildren. In short, they are not just for-profit. They are for-benefit, too.

Finally, to close the book, we address a concern we coauthors share: all is not well in today's culture of business planning. It is an indisputable fact that, despite the overwhelming interest in all things entrepreneurial, most business plans simply don't deliver. Few plans raise money, and the vast majority of plans never even get read. So, in chapter 9, we explore how the process we articulate in this book, focused on a suitable, perhaps revolutionary, combination of the five business model elements, should make the time and money spent on writing and pitching business plans more productive.

We'd like to see your venture turn out to be one of the standouts, one that promises—with evidence and, ultimately, performance, to back up your promises—the kind of economic and social returns that entrepreneurs in raw start-ups, in lifestyle businesses, in nonprofits, or in large for-profit organizations are so capable of delivering worldwide. Let's get on with our journey!

CHAPTER 1

Don't Reinvent the Wheel, Make It Better

Assembling Analogs, Antilogs, and Leaps of Faith to Get to Plan B

GETTING TO PLAN B is about taking your good idea and developing it into a business or other organization that has high impact, makes you and your investors money, solves the needs of your constituents—sometimes customers, sometimes beneficiaries or others—and is sustainable in the long-term. More importantly, though, it is a book about experimentation and growth, about finding a way for your idea to evolve over time into one that's not simply good, but *compelling.*

This book is also about not getting stuck in a rut or missing real opportunities. Mediocre success—finding a passable business but missing the real potential—is equally problematic. Arguably, it's worse than missing the target completely, because it will tie down your considerable talent in a venture with no real future. You and other entrepreneurs and innovators like you are the lifeblood of today's economy. And to waste your talent on something mediocre would be a real shame.

We'd rather that you make a difference, make the world a better place in whatever way is important to you. If that way is also important to your customers and to other supporters, have confidence—they'll sign on. How then, might you ask, do you go from the germ of an idea to one that's truly

compelling with a business model to match? How do you ensure that your epitaph doesn't read, "His business was OK, nothing special. It just kind of limped along"?

Goal for Chapter 1: Don't Start from Scratch

Let's take a step back and think about theater—the world of Shakespeare and Molière, of Rogers and Hammerstein, of Andrew Lloyd Webber. French playwright Georges Polti, drawing on the work of eighteenth-century Italian dramatist Carlo Gozzi, surmised that only thirty-six basic literary plots existed.[1] Thirty-six in total! Polti and Gozzi argued that you could take every play ever written and fit it into one of these thirty-six plot lines. Leonard Bernstein's *West Side Story* is Shakespeare's *Romeo and Juliet*, set in New York's Harlem in the 1950s. *The Magnificent Seven* is just another twist on *The Seven Samurai*. Thus, each time a playwright or screenwriter develops a new script she is really just building on something that has come before.

So, is business like theater? Can you grow your good idea into a successful business as playwrights do, by studying, leveraging, borrowing—even stealing—and learning from that which has been done before?

This chapter is about learning from the experiences of others, using both successful and failed endeavors to inform your decisions, and then develop and test hypotheses and mold your business. The beauty of this method is that by using other people's experiences to shape your decision making, you have the benefit of their mistakes, their blood, sweat, and tears. They have already waded into the water to test for jellyfish while you've been watching from the shore with a gin and tonic in hand.

Each of the companies whose stories comprise this chapter learned from their predecessors' successful and not-so-successful ventures. To learn about product concepts, business models, customer behavior, markets, and operational issues, they used *analogs*—successful predecessors worth mimicking in some way. They also learned from *antilogs*—predecessors (whether successful or not) in light of which one explicitly decides to do things differently. In both cases, they were looking for indications that, based on the experiences of others, their idea would be successful or not. And, for both analogs and antilogs, they took care to frame their comparisons in the context of the current market environment.

Thus, whatever you do, *don't* start from scratch. There are far too many examples that will spotlight the critical unknowns and risks you need to resolve. These examples will answer many of your questions, and they will also identify some crucial beliefs you may hold—what finance types often call *assumptions*—that lack any evidence to either prove or refute them. We call these beliefs your *leaps of faith*, beliefs about which neither analogs nor antilogs can provide satisfactory evidence. By identifying the critical leaps of faith early, you can then methodically focus your limited time and money where it will make the biggest difference, on proving or refuting the hypotheses that grow out of them.

Taken together, the process of uncovering analogs and antilogs, identifying your leaps of faith, and testing your hypotheses can provide the evidence you need to either continue with your Plan A or modify it into what might be a breakthrough to a better Plan B. (Chapter 2 focuses on how best to guide your journey as you undertake such tests.) We examine this process with three examples:

- We explore the transition that Apple made from an innovative but struggling PC hardware and software marketer to a consumer electronics and music distribution powerhouse. Apple shows how relevant analogs and antilogs can be found both inside and outside your own industry.
- We travel to India to examine the rapid growth of Pantaloon, India's largest retailer, and the experimental, trial-and-error process it followed. We'll see that leaps of faith don't always pan out. Failed experiments are good (if inconvenient) news, not necessarily bad.
- Finally, we witness in Africa a story that's unfolding as we write. The African Leadership Academy (ALA) seeks to provide a new kind of educational experience that can create the next generation of African leaders. The ALA's founders have relied heavily on analogs and antilogs to draw lessons from each into their plan. And we see how the ALA quickly made huge strides forward by finding an ingenious way to test its most critical leaps of faith quickly and inexpensively.

Each story offers unique lessons about getting to Plan B. But they also share a few common themes. First, analogs and antilogs can play a variety

of roles in helping to get you from Plan A to Plan B, all very useful. Second, analogs and antilogs can only take you so far. Real innovators don't blindly copy the analogs, they mix and match them and turn them upside down or give them their own unique twist. And it's the new twists on old models that sometimes set the world on its ear. Third, the process of getting from Plan A to Plan B is a *systematic* one, we believe—one you can easily learn and apply to your business old or new. So let's get on with the learning!

Case 1: Apple Branches Out from Personal Computers

If you ask anyone born after about 1990 what Apple is famous for, the answer will likely be "the iPod." And with half of Apple's 2006 revenue generated through sales of its iPod and music-related business, this young person wouldn't be all wrong.[2]

But those born before 1990 remember that Apple was once a computer company. Apple built the world's first PC with a keyboard. Apple developed sleek computers that were innovative in design and intuitive to use. By consistently offering the world a different and better computing experience, Apple grew a population of vocal evangelists: people who lived and breathed for Apple products and who were willing to stand in line to get a glimpse at the newest Apple creations.

The iPod catapulted Apple from its computer origins into the world of consumer electronics. The wildly successful portable music device and its associated music store did not magically appear out of Apple's DNA, however. Apple's music portfolio can be traced to a few key analogs and antilogs.

In 2000, Apple was looking for its next big product. The company had struggled for years in the hotly competitive personal computer industry and was in need of some dramatic reinvigoration—something as revolutionary as the Apple II had been to the computer world in 1977. So, rather than sticking to the company's bread and butter, Apple's legendary leader, Steve Jobs, decided it was time to take a stab at the new digital music phenomenon. Music and consumer electronics were not industries where Apple had any obvious advantage. They would have to innovate.

In 2000, the music industry was seeing a flurry of activity and change. Napster, the new peer-to-peer music-sharing site, was wreaking havoc on

record companies' bottom lines. In what can only be called a massive theft operation, Napster's users were—illegally, as the courts later decided—downloading millions of pirated songs to their computers. It was no surprise that the music labels grew increasingly hostile to digital music, opting to sue Napster for copyright infringement.

By late 2000, there was a seemingly voracious appetite for digital music. It appeared that everyone under the age of twenty-five was downloading tunes. Piracy of copyrighted music abounded. But without court action, there seemed to be no way to get people to start buying music, versus stealing it. And there were no well-designed products on which to play digital music, in Jobs's view. The scene was set for Apple to pounce.

Apple's Analogs and Antilogs

Jumping into a totally new industry requires more than just guts. It also requires some savvy about what works and what doesn't work. Fortunately for Apple, there were some analogs to light the way, starting with Sony's Walkman. This revolutionary product, introduced in 1979, was the first truly portable, personal music player. Sony CEO Akio Morita said, "Although I originally thought it would be considered rude for one person to be listening to his music in isolation, buyers began to see their little portable stereo sets as very personal . . . We found that everybody seemed to want his or her own."[3] Sure enough, within twenty-five years after it entered the market, Sony had sold more than 330 million Walkmans.[4] The Walkman analog proved that people all over the world enjoyed listening to music on their own and were willing to pay for a device to do so. Most importantly, it proved that personal listening on the go was a socially acceptable activity.

Further, some 26 million Napster users worldwide, sitting around in their jeans and t-shirts sharing their music files, made it clear that individual songs were just as much, if not more, appealing to music consumers than complete albums.[5] Napster proved to the world—and to Apple—that downloading music from the Internet was more attractive than going to the local record store. It also proved that people would go through the trouble of downloading digital music if it were free. Whether they would pay, however, was another question.

It was a question for which the record companies themselves offered some clues. Even before Napster opened the floodgates, the music industry

had experimented with selling downloadable digital music online. Various record labels launched Web sites from which music could be downloaded (for a fee, of course). The first, MusicNet and Pressplay, were subscription-based models; users paid a monthly fee to access the songs. With MusicNet, users could download songs to one computer, but as soon as the subscription ended or a bill wasn't paid, those songs disappeared. And MusicNet didn't allow users to download their songs to portable devices, so users had the option of listening to their music on their computer or not at all. Pressplay did allow users to burn a small subset of their songs to CDs for use on the go, but users of these two services didn't really own the music they purchased. And each of the record company sites provided only songs from the musicians that they represented. As a result, neither site contained an exhaustive music library, so users would have to shop from site to site to find the songs and artists they wanted. Consumer response was tepid at best.

From these two pay-for-music antilog sites, it became clear to Jobs and his team that users wanted all of their music in one place. And if users were in fact going to pay for music, they didn't want to rent it, they wanted to own it and be able to play it on their portable devices—not just on their computers. Moreover, people wanted songs, not albums.

Apple could learn from another antilog. In 1998, Diamond Media Systems launched the Rio, the first mass-marketed MP3 player. But its clunky user interface made it difficult for users to find or organize songs. There was only enough storage to play about sixty minutes of music. And transferring music from a computer onto the Rio was painfully slow. "The products stank," recalled Greg Joswiak, Apple's vice president of product marketing.[6] The Rio's struggle in the marketplace confirmed for Jobs that there was no market for anemic or complicated portable digital music players. If it wanted to enter the MP3 player game, Apple would need to solve the storage and user-interface problems that Rio presented.

Apple's Leaps of Faith

Jobs and the Apple team faced some tantalizing questions that led to their leaps of faith. Was there a different business model that would work? Jobs believed there was. Would there be consumer acceptance of a site that offered a huge selection of music for a small fee? It was a leap of faith that music lovers would actually *pay* for their tunes. What if Apple offered both

hardware *and* software—an MP3 player and the tunes to play on it—in such a way that the record companies would dance to Apple's tune? Would they play? Jobs was confident they would.

Step one for Apple was taken in early 2001. The iTunes Jukebox, launched in January of 2001, allowed Apple computer users to store, manage, and group their music from any source (otherwise known as creating "playlists") on their Macintosh computers. Around the time of the launch, Jobs also decided it was time for Apple to have its own portable music device, so Apple users could take their newly organized playlists with them. He gave his development team eight months to deliver and launch the new device.

The device—or *iPod* as it was coined—launched in October 2001 just in time for the holiday season. The iPod was a chartbuster from day one, contributing revenue of $143 million to Apple in its first year on the market.[7] Apple had officially entered the consumer electronics industry. But to complete the picture, Jobs needed a way to sell music as well. Let's use Gillette as an analog: Apple was already selling razors (the iPod), but Jobs wanted to sell the razor blades (music), too.

At about the same time, Napster closed its site in accordance with a court injunction. But the Napster analog had shown that an online music store with a large inventory of free music could be successful. Jobs knew the Recording Industry Association of America (RIAA) wanted to take down anyone who dared to enable copyright infringement. So, a pirated-music Web site like Napster wasn't going to work. But customers needed an easy—and legal—way to get digital music. Apple's solution was brilliant.

Jobs personally called individual artists, including the Eagles' vocalist and drummer Don Henley, to persuade them to make their music available on the service.[8] Apple was the first to negotiate and reach agreement with five record companies, allowing Apple to sell hundreds of thousands of songs from artists spanning all five major labels. In a revolutionary move, Apple worked out a deal to sell (not rent) each song for 99 cents. Once they shelled out the cash, Apple's customers could keep their songs indefinitely, share them on as many as three Macintosh computers, burn them to an unlimited number of CDs, and transfer them to any number of iPod portable music players.

The online iTunes Store was born in April 2003. On its first day, Apple sold a million downloads. By the end of July, it had sold 7.5 million tracks.[9]

Apple's iTunes would be named *Time* magazine's Coolest Invention of 2003. The iTunes proposition was straightforward. No subscription was necessary, and there was no variability in the song price: every track cost 99 cents. It was simple, clean, and easy for a user to buy, download, organize, and own music. Musician Seal described the iTunes store, saying, "You can't stop piracy, so you have to work with technology, and you have to get into the rhythm of it. That's what Apple has done here."[10] Best of all, the record labels were happy! One executive said, "Until Apple, it wasn't cool to buy digital music. This was about getting to that pivotal group of people—the people who buy the cool sneakers and wear the right clothes—and showing them that legally downloading music could be cooler than stealing it."[11]

Turning the Razor and Razor Blades Model Upside Down

Of course no one was really going to fill an iPod with thousands of songs at 99 cents each. Sure enough, by 2007, only about 3 percent of music on iPods was downloaded or copied from the iTunes music store.[12] The rest was downloaded from other places and was therefore unprotected and playable on any device. But Apple didn't care. The iTunes music store completed the user experience, and as long as a critical mass of people bought at least some of their music from the iTunes site, Apple could keep itself out of trouble with the RIAA. It didn't really matter to Apple financially if people bought only a small percentage of their music from iTunes, because the 99 cent price tag was barely enough to cover Apple's costs and the record companies' licensing fees. Shrewdly, Apple had turned the traditional "razor and razor blades model" on its head: Apple could make its money selling razors—the growing assortment of iPods—even if customers continued to steal most of the blades!

Lessons from Apple

Steve Jobs moved his well-established business in an entirely new direction—with new profit horizons—and took a bold leap of faith: that people would pay a premium for a snazzy portable music device and purchase at least some of what they had stolen before. Analogs and antilogs suggested—rightly, as things turned out—that his gambit would work. As Jobs unabashedly described his company's strategy, "Picasso had a saying: he said good artists copy, great artists steal. And we have always been shameless about stealing great ideas."[13]

The result of Apple's journey to its digital music Plan B? Apple transformed itself from an innovative but struggling PC maker to what is looking increasingly like a consumer electronics powerhouse, accomplished originally with just a single product line, the iPod, which Jobs has called the "twenty-first-century Walkman," and later with the iPhone.[14] In 2006, the company pocketed $9.6 billion from its music business (iPod, iTunes, and other music accessories).[15] By 2008, Apple had sold 6 billion songs to 75 million customers since its launch six years earlier.[16] How did Apple do it? Jobs and his team enabled the device to play and store large amounts of digital music. They found a way to legalize downloaded music that was sufficient to keep the RIAA off their backs. And they packaged all of it as only Apple can—in a sophisticated, cool, fresh, and usable design. In short, they placed a big bet on their leap of faith, though Jobs' confidence was backed by analogs and antilogs that suggested his gambit would work.

We now look at another company's journey in a different industry in a different part of the world. In the sweeping economic phenomenon that is today's India, we meet a pants merchant who has drawn on the stories of Macy's, Marks & Spencer, Walmart, and others while fine-tuning what has become India's largest retailer.

The Case 2: More Than Pants for Pantaloon

Halfway across the globe, in the world's second-most-populated country, another business mastermind had already begun to make his mark. Kishore Biyani, son of a Mumbai textile merchant, had grown up watching India's population multiply from 600 million people in 1975 to almost double that at the turn of the twenty-first century.[17] He saw that things were changing in India, and changing rapidly. Not only was India's population growing, but its demographics had shifted dramatically.[18] There was suddenly a significant and fast-growing number of young, educated, working-age people. Finding well-paid jobs meant moving to the cities. With incomes that would have seemed low to those in industrialized nations, these households could afford consumer goods like ready-made apparel, plus durables like air conditioners, washing machines, even hired help.

Biyani founded Pantaloon in 1987 (under its first name Manz Wear Pvt. Ltd.). At first Pantaloon was a menswear maker, manufacturing readymade

pants sold mostly in independent mom-and-pop retailers and kiranas.[19] In 1997, seeing the growing size and potential of the Indian consumer market and the lack of business savvy of many of the retailers who were his customers, Biyani decided to turn Pantaloon into a retail operation. He felt the world of manufacturing didn't offer enough of an opportunity, didn't provide him with a "big enough canvas."[20] Retail, on the other hand, would provide him with unlimited opportunity. But what did a pants merchant know about retailing?

Analogs in Retailing: Pantaloon Learns from Walmart

The first thing Biyani did was to start reading about leading retailers, looking for lessons—analogs and antilogs—that he could apply in India, noting, "I read every book on Sam Walton, Macy's, Marks & Spencer. And management gurus like Tom Peters, whose book *Re-Imagine!* impressed me." But almost in the same breath he declared that he didn't make a practice of visiting these stores. He reasoned, "By going to a Walmart or a Macy's, you could get overwhelmed into thinking that was the best model and stop learning."[21] Instead, Biyani combined his exposure to foreign retailers with his practical understanding of Indian attitudes and buying behavior.

"When a consumer thinks about Walmart," recalled Biyani, "the first thing that usually comes to mind is the store's huge selection of discount goods spanning hundreds of categories from sporting goods to apparel to food to hair supplies. When a fellow retailer thinks about Walmart, he thinks about the company's maniacal focus on its supplier relationships and merchandising."[22] Traditionally, Walmart purchased a large percentage of its products directly from its manufacturers. In so doing, the company eliminated the cost of doing business with wholesalers and was able to influence and more tightly manage relationships with its manufacturers. By removing the cost of a middleman, Walmart was able to pass along savings to customers. The company was also famous for its merchandising ability, focusing much of its energy on product selection and pricing. It institutionalized the concept of category management, using shopper analysis, customer research, and merchandising plans to determine what should sit on the retailer's shelves. In the end, the Walmart customer always found the right products at the right price.

For Biyani, Walmart served as the perfect analog for both supplier relations and merchandising. Both his hypermarkets, called Big Bazaar, and his

grocery stores, Food Bazaar, were modeled in many ways after Walmart. Like Walmart, but uncommon in India, Biyani went straight to his manufacturers rather than relying on wholesalers. Between 50 and 60 percent of Big Bazaar's products were bought directly from manufacturers.[23] Like Walmart, avoiding the middleman allowed Biyani to pass savings along to his customers. Discounts in the Big Bazaar ranged from 5 to 60 percent. And just like Walmart, Biyani was focused on merchandising. He practiced the concept of category management both in his Big Bazaar and Food Bazaar stores, as well as in his growing chain of apparel stores, Pantaloon. He explained, "We have over 150 product categories and each is looked after by a manager who is responsible for its growth and profit."[24] According to Damodar Mall, president of Pantaloon's food business, "By undertaking these activities, the category leader along with the retailer undertakes marketing and promotional activities for the particular category."[25]

Pantaloon Borrows from Marks & Spencer and Zara

Biyani wasn't done gathering his analogs. Marks & Spencer, the U.K.-based food and general merchandise retailer, had sold private labels—goods made exclusively for its stores—almost since its inception in 1893.[26] Its in-house labels provided higher margins than did other brands. To gain the benefits of higher-margin goods, Biyani followed suit, offering private branded products both for his Big Bazaar and Food Bazaar retail stores. The Pantaloon apparel stores carried both branded apparel and vertically integrated private label items for the entire family, including casual, ethnic, formal, sports, and winter wear. The private label items were generally less expensive than the name brands, but delivered high margins. As Biyani explained, "Someone who is unable to afford the premium brand will opt for our brands, which are not exorbitantly priced."[27]

The Spanish apparel retailer Zara provided Biyani with yet another analog, this one for inventory management. Zara's lesson (explained further in chapter 8) was that customers were fickle and that fashion preferences changed with the wind. To ensure that Zara never had an abundance of unwanted inventory, the company utilized an inventive product-design and production process called fast fashion. Most Western retailers took half a year to design a line of clothing, get it produced in a low-wage country, and bring it to market. Zara's fashions moved from drawing board to store in as little as fifteen days.

The benefits were considerable. The faster you could bring a design to market, the better the chance customers' preferences would be the same as when the product was designed. This minimized the risk of launching a product that was already passé, forcing the retailer to mark down its obsolete inventory. And under this system, there was far less money tied up in inventory, freeing up cash for other uses—like opening more stores. "The aim . . . is to respond to the demand of the market rather than try to forecast it months in advance," said Biyani. "This will be the key differentiator between the winners and losers because it reduces working capital requirements and improves return on capital."[28]

Pantaloon's Leap of Faith: Getting the Shopping Experience Right

Biyani knew, however, that all these Western analogs would apply largely to the back end of his retail operation. How his stores should be organized and his merchandise presented was an entirely different matter.

He thought about Walmart, whose stores were orderly, with long, straight aisles and systematically shelved products. Walmart stores were often located in busy suburban areas with plenty of parking. The purpose of Walmart's design and location was to make the shopping experience as convenient as possible for time-constrained American customers. Time and convenience were simply not the driving concerns of Biyani's target market, however. Was the typical clean and orderly Walmart store layout an analog, too? Or was it an antilog that would be rejected by Indian consumers, who were used to spending hours each day haggling in Indian markets?

Biyani's leap of faith—that Walmart's orderly layout would appeal to his customers in India—would be resolved when he launched his first Big Bazaars. Alas, he found that, "The customers never stopped. They kept on walking."[29] And Biyani needed them to stop to pick up goods to buy!

Pantaloon Opts for Some Disorder in Its Plan B

For inspiration, Biyani looked no further than the traditional Indian bazaar. Bazaars, common throughout the country, provided Indians a place to buy just about everything. They were hardly an organized or sophisticated shopping experience. Quarters were cramped, with one vendor bumping up against the next. Customers had to pick through both dirty and clean items to find what they wanted. And, of course, there was

no such thing as fixed prices. Bargaining and haggling were the modus operandi for the Indian bazaar, and this was the experience Indian shoppers were used to.

So, Biyani created a totally chaotic front-of-house shopping experience to mimic the Indian bazaar, while keeping his back-of-house efficiencies, unseen by the customer, in place. Letting the buyers choose the vegetables they wanted gave them "a sense of victory," Biyani said. To keep the noise level up, employees announced deals on bullhorns. "The shouting, the untidiness, the chaos is part of the design," Biyani explained.[30]

Biyani was learning that Western analogs could only take his ideas so far. Companies like Walmart, Marks & Spencer, and Zara taught him how to operate his retail stores efficiently and cost-effectively. But none of these chains were targeting this new and still highly diverse market, comprising more than two thousand ethnic groups and four major languages, plus a dozen more languages spoken less widely. It was Biyani's opportunity to put their lessons to use. At a certain point, Biyani had to address some crucial questions, of which orderliness versus chaos was only the first.

He had to experiment where best to locate his stores, how to merchandise his products, and how to design the layout of the stores. He did so systematically and iterated rapidly, continually improving his results. Not everything worked at the outset, but the back-end fundamentals were sound thanks to tips taken from his Western analogs. Biyani's attitude helped his business, too: he was nothing if not adaptable.

Is Pantaloon's Plan B Working?

By 2008, eleven years after Biyani's retailing company was founded, Pantaloon was India's largest retailer, with some one thousand stores—including Pantaloon apparel stores, Food Bazaars, Big Bazaars, and more. And the National Retail Federation in the United States named Pantaloon the International Retailer of the Year for 2007.[31] But the best news was this. Even with $350 billion in revenue, organized retailers accounted for only 3 percent of retail sales in India. There was still plenty of room to grow![32]

Lessons from Pantaloon

All is not lost when your leaps of faith don't all work out. Instead, Biyani's experimental mind-set paid Pantaloon huge dividends, as he tested hypothesis after hypothesis about what his analogs could not convincingly

tell him. As is often the case in emerging economies, many of the analogs and antilogs turned out to be U.S. and European companies. Biyani shrewdly realized that while some of the best-in-class paradigms applied to his emerging market, others did not. For those situations where there was no applicable model, or where the analogs seemed not to fit, he had to take a leap of faith and try something totally new. Who knows? If Biyani had not introduced some noise and Indian chaos into his stores, his customers might still be walking rather than buying!

In our next case, you'll meet two inspiring entrepreneurs who put analogs, antilogs, and leaps of faith together to pursue their dream: to provide a world-class education for some of Africa's brightest young students. As we'll see, this methodology is equally helpful to for-benefit ventures as it is to for-profit businesses.

Case 3: The African Leadership Academy Develops Tomorrow's Leaders for Africa

It was the summer of 2004, and Fred Swaniker, a native of Ghana whose family ran a primary school in Botswana, and Chris Bradford, a former brand manager with Procter & Gamble, had just completed their MBAs at Stanford's Graduate School of Business. While living in Nigeria, Swaniker had come to realize the urgent need for effective and ethical leaders in Africa. "I was struck by the disproportionate impact that just a few individuals [like Nelson Mandela and Desmond Tutu] could have and started to envision a way to develop a critical mass of the kind of leaders that could transform African society."[33] Bradford had done a short stint teaching economics and physical science to African boarding school students in the United Kingdom and, on a study tour to South Africa, had also seen firsthand the limited opportunities available to most African youth.

The intrepid pair thought a leadership academy was needed. But before they attempted it, they would need to address five key beliefs that Swaniker and Bradford thought lay at the heart of the African continent's numerous challenges:

- The root cause of many of Africa's problems is an undersupply of leadership across all sectors.

- Individual leaders can catalyze the actions of large groups of people and unleash massive positive change in society.
- It is necessary to invest in Africa's leaders when they are young and dreaming and give them the confidence they need to bring their ideas to the world.
- A pan-African approach is required to catalyze growth and development.
- Africa needs entrepreneurial leaders across all sectors who will throw off the constraints of existing institutions to change the paradigm and create value.

Together, Swaniker and Bradford set out to build an innovative institution that would bring together top students from countries across Africa and inspire and equip them to be ethical, entrepreneurial leaders committed to creating a bright future for the continent. Their Plan A was based on analogs: to build a boarding school that would emulate the elite American and European boarding schools like Phillips Academy Andover, Eton College, and Philips Exeter Academy, which attracted diverse groups of top students and prepared them well for top universities.

These schools nurtured capability and confidence as well as lifelong connections between their often-powerful alumni—all goals of the ALA. Swaniker had met many wealthy African parents who were paying $50,000 per year to send their kids to prep schools in Europe, an indication that a portion of the top African students they were targeting for the ALA could afford to pay substantial tuition.

Analogs and Antilogs Define the ALA's Parameters

As Swaniker and Bradford talked about their concept with a wide range of people globally, they were pointed to another somewhat different analog that neither of them had heard of: Raffles Junior College (RJC). Raffles, a prestigious school in Singapore, offered a two-year course for graduating high school students. On average, 95 percent of RJC graduates attended university, many on scholarships. In recognition of its sterling academic accolades, Raffles had been described by the *Wall Street Journal* as the Southeast Asian "Gateway to the Ivy League." Even more impressive was the fact that numerous Raffles alumni had gone on to assume very

significant positions of power in the country, including two former presidents. It seemed to Swaniker and Bradford that Raffles had achieved in Singapore much of what they were setting out to do in Africa. They visited the campus and quickly learned as much as they could about the school and its programs.

The duo then looked to United World Colleges (UWC). At the time, UWC ran eleven two-year, pre-university residential schools worldwide (as of 2008, they counted twelve), offering the International Baccalaureate Diploma curriculum. Their mission was to make education a force to unite people, nations, and cultures for peace and a sustainable future. UWC brought together students from all over the world selected on personal merit—irrespective of race, religion, politics, or the ability to pay—with the explicit aim of fostering peace and international understanding. High academic standards, a strong emphasis on community service, and a wide range of cultural and outdoor activities were all part of a UWC education.

Raffles demonstrated success in building a world-class institution producing extraordinary leaders for a single country. UWC suggested that it was possible to recruit students from many countries and put them through a two-year program that resulted in significant leaps in international understanding.

Swaniker and Bradford also looked to their Stanford MBA experience. Several weeks into his first quarter at Stanford, Swaniker was one of seven students sitting at breakfast with Carlos Ghosn, the CEO of Nissan and Renault. "I realized that if an ordinary person could lead such a successful global organization, so could I." Meeting top executives regularly in courses and extracurricular events at the school helped demystify the process of leadership for Swaniker. "It gave me the gall to think big," he says. If he and Bradford were going to build a new generation of leaders for Africa, the opportunity to meet and interact with high-level business and government leaders would be a critical component of what the ALA had to offer to its students.

Swaniker and Bradford were also mindful of some antilogs. Many of the historically white elite African boarding schools had changed their messaging to a focus on building a new generation of African leaders, but the curriculum and recruiting practices had not been revamped to deliver on that promise. They provided a reasonably good educational experience but did not excel at cultivating leadership capability, in Swaniker's view.

Finally, there were also several short-term African leadership development programs, mostly targeting established leaders and engaging them in community service. While these provided good networking opportunities and some positive outcomes in terms of community focus, they were not really expanding the pool of African leaders or significantly increasing entrepreneurial leadership capacity.

The ALA's Leaps of Faith

Swaniker and Bradford felt building a school was clearly doable. But they had five key questions for which their analogs and antilogs had provided insights, perhaps, but no clear answers:

- Could they successfully recruit the best students from multiple African countries?
- Could they establish sufficient credibility to attract top-notch faculty and administrative staff from across Africa?
- Could they raise the philanthropic capital necessary to launch the school?
- Could they attract high-profile business and government leaders to teach and mentor the students?
- Could they have a self-sustaining financial model for the school's ongoing operations? In other words, was there a business model that would work?

Intuitively, as is almost always the case for committed, passionate entrepreneurs, they felt that the answers to all five questions were yes. In their hearts, though, they knew they had scant evidence to support any of these beliefs. All were huge leaps of faith.

Short of building and launching the school they ultimately envisioned, Swaniker and Bradford needed an expedient way to examine their most critical leaps of faith with some hypothesis testing. They hit on the idea of developing a one-month summer youth program in Cape Town, South Africa, to serve as a small-scale trial for the ALA. They recruited Stanford classmate Ronalee Bayani, the former head of a summer program that prepared minority high school students to enroll at the University of California.

The Summer Academy launched in 2005 in Cape Town. The program featured a robust African studies curriculum, twelve teachers from around the world, and seventy students from thirteen countries. "The impact of the program was tremendous," said Bradford. "Our students gained confidence and recognized their power to positively affect the world, and they became passionate about their community and continent." Through the Summer Academy, Swaniker and Bradford gained credibility and experience while validating some key leaps of faith. What did they learn? There were three points of very good news:

- They had no problem recruiting students from multiple geographies.
- They attracted excellent teachers for the program.
- There was the potential for a financial model mixing traditional philanthropy with fees.

Furthermore, they were extremely pleased with the positive relationships that quickly developed between students from different countries and different socioeconomic backgrounds. Perhaps most importantly, the hands-on leadership curriculum seemed to have a big impact on the students.

Difficult Decisions for the ALA

It was time for Swaniker and Bradford to finalize their plans for the real ALA. Would it be the Plan A already established in elite African education, building a boarding school along the lines of the similarly elite European and American schools, as they had originally contemplated? Or would it be a Plan B along the lines of the RJC model? It was beginning to appear that Plan B was better-aligned with what they were trying to accomplish in Africa.

An early decision to locate the school in Cape Town was also reversed. The Summer Academy taught them that it was difficult to recruit the government and business leaders who were central to the ALA experience because a special trip was required. Bradford explained, "Johannesburg is the business and government hub with a much larger pan-African population of prospective mentors and role models and consequently is a more suitable location. We made the difficult decision to walk away from a scenic part of the country to a less idyllic but more practical location."

So were they ready to forge ahead? The summer experiment had proved some key leaps of faith: it seemed that great students and faculty would sign on. They had also nailed down decisions about the program's format and location. They were feeling confident, thanks to the successful Summer Academy experience that they could show to philanthropic investors. They were ready to dive into deeper water, securing an initial campus and recruiting a dean.

Is the ALA's Plan B Working?

Dive they did, and by autumn 2008 several milestones had already been met. A beautiful campus in Johannesburg had been leased. And more than fourteen-hundred students from thirty-four countries applied to the first class, including the top performers on the national exams in Rwanda, Senegal, and Cameroon. In September 2008, the ALA admitted ninety-seven students from twenty-nine countries.[34] Christopher Khaemba, a Kenyan known for his ability to inspire and develop students from a wide variety of socioeconomic backgrounds, signed on as the inaugural dean. A new generation of African leaders was beginning to come together!

Lessons from the African Leadership Academy

We've seen how drawing lessons from various analogs helps to shape your own unique model. For the ALA, the business and governmental involvement that Raffles Junior College was able to obtain in its Singapore location, as well as the multicountry student body that United World Colleges attracted, served as good indications of what the ALA might achieve. Your dreams are crucially important, but blind copying of analogs in me-too fashion is not what we're prescribing. Instead, choose a little of this and a pinch of that until you've got a recipe that serves up what your customers want and what your business model can support. Crucially, this recipe must respond directly to the market and the industry circumstances you encounter.

From the ALA, we've also seen that ingenious means can sometimes be found to test key leaps of faith—live, in the marketplace—in ways that cost far less than going full speed ahead with your ambitious Plan A. These tests, if they pan out, not only build your own confidence in the path you are following, but they provide tangible evidence to financial backers and others—top students and faculty, in the ALA's case—that you are onto something worth being a part of.

Lessons Learned About Analogs, Antilogs, and Leaps of Faith

We hope that at least some of these key messages have hit home for you:

- Analogs and antilogs have varied roles in developing your new business or transforming your existing one.
- Mixing and matching—not simple copying—is the best way forward.
- Oh, it's a process—and a systematic one, at that!

Let's examine each of these themes in some detail to be certain that these messages sink in.

The Varied Roles of Analogs, Antilogs, and Leaps of Faith

Analogs, antilogs, and the testing of hypotheses to prove or refute your most crucial leaps of faith can inform all kinds of decisions, including operational and marketing plans, without breaking your piggy bank. And they can provide insights into issues much broader than whether your customer will buy.

There's another role, too, that's probably even more important, because walking before you decide to run is a very good idea. Testing your leaps of faith early and often helps safeguard your company against risk. Thus, doing so deserves focused managerial attention until the questions you pose and the untested beliefs you hold are convincingly resolved, either proved or refuted.

Mixing and Matching, Not Simple Copying

Mixing and matching snippets of one analog here, an antilog there, provides a creative melting pot out of which can stew new strategies and business models that can enable your company to stand out in your industry. Each of the companies in this chapter drew lessons from companies that had gone before them, and each of them applied those lessons in new and creative ways. New twists on old models, as we saw from Apple, rather than blind copying, is what you are after. That is what many successful entrepreneurs do. Had Apple tried to replicate the razor and razor blades model faithfully, with low-priced iPods and high-priced tunes, we doubt they would have been nearly as successful.

Starting an Innovative Business Is a Systematic Process

The process of uncovering and critically examining analogs and antilogs, and identifying leaps of faith to be examined, is a systematic one, and one you can learn. By exposing the strengths and limitations of your initial strategy, the process often leads to changes in Plan A. These changes can be a series of subtle adjustments, as seen with Pantaloon and the African Leadership Academy, or far more dramatic ones, as with Apple's assault on the consumer electronics and music industries.

Though it doesn't always feel that way at the moment, change is good news, not bad. Refining your plan will make your business more successful. Blind adherence to your original plan is a path to disaster.

In the end, it's often the gaps in the analogs and antilogs, the leaps of faith—and the testing thereof—that are crucial, that make the difference between failure, mediocrity, or slam-bang success. As we'll see in later chapters, some of the most noteworthy successes in business history have arisen when a new kind of business model—mixing lessons from an analog here, an antilog there, and some insightful leaps of faith that turn out favorably—is concocted.

Sometimes, these new recipes create a Plan B not just for the company, as was the case for Apple, but for the industry. Will Apple's digital onslaught on consumer electronics and the music industry turn out that way for the legacy players? What about for artists? And will the iPhone do the same for the cell phone makers like Nokia and Samsung? Time will tell, but we suspect that Steve Jobs and his musical and consumer electronics adventures have only just begun to hum.

Q&A with John and Randy

We've jumped into the deep end in this chapter. There are probably at least a few questions that you cannot yet let go of:

- Aside from this book, where else should I look to find analogs and antilogs?
- How do I know which analogs are "right" or most useful (and which antilogs are "wrong")?
- When is an analog or antilog good enough, and when do I need to test what it tells me as yet another leap of faith?

Where Might You Find Analogs and Antilogs of Your Own?

As the Apple story suggests, the most useful and revolutionary analogs and antilogs may be those from industries other than your own. That's in part because your lead-footed or narrow-minded competitors aren't as likely to notice, examine, or understand them. The razor and razor blades analog can probably be applied in many more industries than it is today. Steve Jobs proved that it can be turned on its head with surprising success. Can you do it in your business? Would it help you break through to a better business model?

So where should you start looking? With reams of data, annual reports, books, and articles on the world's publicly traded companies, there is certainly no shortage of analogs and antilogs. You can start in the pages of the business sections of your local, national, and international newspapers and magazines.

Even better, strong social networks, which are among the most useful assets of most successful entrepreneurs, are a great place to look. Why? Because building a network can help you not only find relevant analogs and antilogs for your business model, but also provide you with trusted insight into how those analogs and antilogs really work. Insights shared among friends can provide the clarity and depth that newspaper articles or financial statements lack. And perhaps most important, a strong social network might help to lift you from an emotional rut if a leap of faith doesn't pan out as you had hoped!

Which Analogs Are "Right" or "Wrong?"

At the end of the day, there are neither "right" nor "wrong" analogs—or antilogs—until they are proved in the marketplace. Thus, in most cases, the customer—as well as the cash flow—is the final arbiter of whether you have chosen them well and followed their advice appropriately for your situation. It's a hard, cold world out there, and you won't always be right. But being "wrong"—whether about an analog, an antilog, or a leap of faith you test—is OK, as we've noted above, as you can then move forward more knowledgeably to Plan B. So, don't worry too much about what's right and what's wrong. Get on with the process and let your learning begin.

When Is an Analog or Antilog Good Enough to Move Forward?

If you are in the throes of starting a new venture, whether a raw start-up or a new venture within your established company, you simply cannot test everything with an experiment. There are not enough hours in the day or—most likely—money in the till. Using your best judgment, if an analog or antilog looks like a close enough parallel to your situation, if you and your investors gain comfort from what it tells you, and if you're happy to assume an element of risk, then you'll have to simply trust some of your analogs and antilogs. That will free you up to focus your attention on other more critical issues—your leaps of faith—where the advice you get from analogs and antilogs isn't so clear.

What's Next?

Leaps of faith are pivotal to the innovation process. They emerge from a thorough understanding of what has come before—analogs and antilogs—and they should be the focus of the scarce time and resources necessary to arrive at the ultimate plan, whether it remains Plan A or evolves into Plan B. The process is systematic and continual, with new questions and hypotheses at each and every critical juncture. But the process is neither dumb luck nor black art. On the contrary, embarking on the journey from Plan A to Plan B requires methodical, experimental thinking and requires a different kind of tool, one we call the dashboard. Building dashboards and using them to guide your journey toward a fruitful and viable Plan B is the topic of chapter 2.

CHAPTER 2

Guiding Your Flight Progress

The Power of Dashboards

AT THE RIPE AGE OF ELEVEN, Johnny Tart experienced his first summer heat wave. Temperatures maxed out at a sticky 104°F. As he sat lazily at his front window one Friday afternoon, he noticed how miserable the commuters looked walking home from the train station. His Chicago suburb was a sleepy one. There was nowhere to stop for a cold drink. Johnny leapt from his perch as an idea took shape in his mind. He would quench the thirst of the local commuters! He would set up a lemonade stand.

Johnny was not the first person in his neighborhood to sell lemonade. The previous summer, his neighbor Jennifer had set up a stand at the end of her driveway, but Johnny had the sense that he could do a better job. For starters, she ran her stand in the early afternoon, long before the commuter rush. She didn't open for business every day, as he planned to. And if he was honest, her lemonade, made from a sugary packet, didn't taste very nice. Jennifer's lemonade stand was more antilog than analog. Johnny assumed that his homemade lemonade, offered every afternoon to commuters, would combine for a great little business. But he had two lingering, unanswered questions—Will commuters stop and buy?, and How much will they pay?—which led to two leaps of faith:

- LOF 1: Commuters, eager to get home, will take a few minutes to stop in front of my house to buy a refreshing drink.

- LOF 2: People will happily pay a premium for a glass of my ice-cold homemade lemonade.

Without realizing it, Johnny was starting a process that we prescribe to data-starved entrepreneurs: dashboarding. Johnny had just accomplished the first task of dashboarding, asking the right questions about his venture. He also had two hunches (hypotheses) about the answers to these questions:

- H1: At least ten people per day will stop and buy my lemonade, if they are not in a rush.
- H2: With a bottle of Coke priced around $1 at the convenience store on the other side of the tracks, they will gladly pay $1.50 per cup.

He believed these hunches, but he had no evidence that they were true.

Let's take a break from Johnny's learning for a moment, because this is where many entrepreneurs make the mistake of stopping. They take their assumptions (Johnny's hypotheses) as fact. Some reckless entrepreneurs embrace this naïveté, having heard that "entrepreneurship is all about tenacity, so I'm going to barrel down this highway at one hundred miles per hour, because my Plan A is wonderful!" Their ventures are the wrecked cars you spot on the side of the road.

If either of Johnny's hypotheses were untrue—if few people stopped to buy his lemonade, and if shoppers thought his lemonade was extortionate at $1.50 a glass—and he failed to respond swiftly, he would probably go out of business. When you leave stones unturned, you run the same risk. We prefer that you reach your destination.

Dashboards Defined

Let's revisit our analog and antilog process. At some point, we exhausted our ability to learn from other companies. Their examples would have given us "good enough" answers to some of our questions, and we could move on. But when analogs and antilogs reach the limit of what they can tell us, we are left with leaps of faith, each driven by a burning question that we cannot answer without some real-world data. So, as we saw in chapter 1, we draw from our leaps of faith a few hypotheses that state what we hope and believe to be true, and we then test them in some way, as quickly and cheaply as possible, and we measure the results. This

process—systematically recording our leaps of faith, the hypotheses that grow out of them, and the results of our hypothesis tests—is what we call dashboarding. Scientists do this in their sleep. They begin with a small set of critical leaps of faith, generate hypotheses with which to address them, and determine metrics to measure the results.

A dashboard—the systematic record you keep to guide and track this process—is a flexible tool for addressing your leaps of faith. It forces you to keep track of the questions you have about your venture, while keeping your assumptions (often guesses, really) in mind. It focuses your attention on the critical issues and more efficiently deploys your precious time and resources to removing the critical risks. And it provides a way to respond to the real-life data you generate.

Moving into the dashboarding stage in developing your business model means moving from *spectator*—observing others as you gathered analogs and antilogs, as Johnny did by recalling his neighbor's limited success—to *doer*.

Johnny Dashboards His Way to Plan B

As we know, Johnny had hunches as to how his questions would be answered in practice. So he put into place some metrics to gauge his success (or not!):

- Number of customers and glasses per day that he sells
- The price at which customers most readily buy

On Monday, Johnny placed his family's old card table at the end of his driveway and formally entered the lemonade business. He jotted down some interesting results:

- He only sold two glasses of lemonade at $1.50 per glass.
- Several people stopped to chat without buying, and one grandfatherly gentleman told him that $1.50 was too pricey; the lemonade stand he'd had in his youth had only charged five cents per glass.

Alas, Johnny's hunches were wrong. He needed to make some changes if he wanted to make money. Armed with the data from Monday's experiment, he made two improvements. First, he posted signs at the end of the street to advertise "Fresh Lemonade." Second, he lowered his price to 50 cents for a small glass and $1 for a large. Unfortunately, on Tuesday it

rained, but on Wednesday, business picked up, with six glasses sold—and $5.50 in revenue. By dashboarding, Johnny spared himself from the hard lessons of failure and saved his customers from a thirsty walk home!

If Johnny was as systematic as we hope you will be as you dashboard your way to a better Plan B, he would have kept careful records so that he could make midcourse corrections if necessary. His record might have looked something like the one shown in figure 2-1.

Johnny's is a simple but prototypical dashboard that illustrates the key building blocks of the dashboarding process that we hope you will follow:

- Your leaps of faith
- The hypotheses you will test
- The metrics you will use to measure your results
- The results of your hypothesis tests over one or more periods
- The insights you draw for decision-making, based on the results you've obtained

FIGURE 2-1

A prototype dashboard for Johnny

Hypotheses	Metrics	Actual Monday	Actual Tuesday	Actual Wednesday	Insights obtained, course corrections needed
Leap of faith 1: Commuters will stop and buy a refreshing drink					
H1: At least 10 customers per day	Customer count	2 customers	No one stopped in the rain	6 customers	High pricing deters sales, they look, don't buy; no point in setting up if it rains; seems like demand is somewhat less than Johnny thought.
Leap of faith 2: People will pay a premium price					
H2: $1.50 per glass will be acceptable	Total sales, price paid	$3.00 total sales, $1.50 per glass	—	$5.50 in sales (1@ 50 cents, 5@ $1)	$1.50 too high, $1 looks about right.

A dashboard is much more than routine paperwork to complete. It is a tool to help you to frame and respond to the lingering questions your venture faces. As you'll see in our examples in this chapter, dashboards must reflect the nature of your business, the management team, and your questions. In other words, one company's dashboard will look different from another's. And the dashboard you build before your venture takes off will be quite a different beast from the one you create two years into the business!

Why Should You Dashboard?

In business, we love to measure things. In an era where established companies suffer from data *overload*, it is rightly considered good business practice to keep a close eye on a much smaller set of metrics to focus everyone's attention on how the business is operating. After all, if it gets measured, it will get done, as the saying goes. Managers like to know how their sales teams are performing. A CEO appreciates quick snapshots of everything from employee turnover to sales results to bank balances.

In a growing number of companies large and small, these metrics are captured and reported each day, week, or month, using a dashboard that's not all that different in concept from the one Johnny would have prepared. Like the dashboard in your car or in a Boeing 777, these companies' dashboards keep track of the most critical indicators of how they are proceeding on their journey. The good news is that, in most established companies, crunching the numbers might take time, but at least the numbers exist to crunch!

Entrepreneurs, on the other hand, tend to suffer from the flipside: data *underload*. Most nascent ventures lack sufficient experience or enough solid information to launch their businesses outright. Based on only a wild guess, doing so would be as ill advised as flying in bad weather with no instrumentation. Pantaloon's Kishore Biyani (from chapter 1) wasn't sure that his Indian customers would respond well to his orderly store. After a small test, he saw that they never stopped walking the aisles to shop! He quickly refashioned his stores to mimic the chaos and racket found in traditional Indian markets, and sales shot up.

Entrepreneurs such as Biyani have a healthy respect for the fact that their business is toast if their assumptions are incorrect. And in case you missed this little point, initial assumptions—whether about a raw start-up or a new venture in a larger organization—are usually wrong. Testing and

measuring is excellent business practice in the start-up world. It's a process that you cannot afford to ignore.

Goal for Chapter 2: Learn to Iterate with Dashboards

A key theme of this book is that, most often, it is necessary to constantly iterate to find a path that will work—for your would-be customers, for you, and for your prospective investors. If all goes well as you iterate, identifying still more leaps of faith and testing hypotheses to address them, you'll eventually find your way to a Plan B or C or Z that will deliver you the kind of success you seek.

Doing this does not mean flying by the seat of your pants—nor without instrumentation. Both flexibility and methodical iteration are the keys to finding entrepreneurial nirvana. Dashboards will record the results of the tests of your hypotheses as they occur. But mere record-keeping isn't why dashboards are so important. More crucially, they will signal the mid-course corrections necessary to reach a viable Plan B. And they have some other tricks, too, as we'll see.

In this chapter, we examine two inspiring case histories. The first is a nonprofit where the analog-antilog-leaps of faith-dashboarding process is every bit as applicable as it is in the for-profit world. The other story is one of those rare cases where Plan A initially worked, though continued dashboarding ultimately revealed the need for a Plan B.

- In the GlobalGiving story, we see how analogs, antilogs, and leaps of faith lead directly to dashboards to interpret what is learned from real-world evidence, and how that learning—whether about initial plans or unanticipated market shifts—brings into crystal-clear focus the need for changing from Plan A to Plan B.
- Aggregate Knowledge's first dashboards confirmed that its Plan A was, remarkably, on track. But the founder kept dashboarding, uncovering some interesting challenges and opportunities for his business.

There are also three common themes that permeate these two stories. The first is their founders' laserlike focus on the biggest risks on the table

at each point in time. Second, we see how their dashboards changed over time, and how the founders used them to evolve their businesses. Third, there was a clear emphasis on quantitative measures, even though some hypotheses were more qualitative in nature. At the end of the day, though qualitative issues are important, getting the numbers nailed down is the only way to know whether you've got a business model that will work.

Case 1: GlobalGiving: Inspired by an Antilog

It was late 1998, and Dennis Whittle had just spent a year developing new processes that would help The World Bank, where he was a senior executive, fight poverty.[1] He had a $5 million budget and the services of a top consulting firm. He, his colleague Mari Kuraishi, and their team of development professionals were running a program that had funneled billions of dollars to the Russian Federation for economic development.

Their efforts were deemed innovative and successful. Yet the *results* were disappointing and unsettling: Whittle and Kuraishi were not confident that the large amounts of money they were injecting into the country had had the impact they were seeking or that it had reached the people on the ground who needed the most help.

Theirs was a familiar problem: funds targeted at urgent human needs didn't always end up where they were intended to go. All too often, the funds wound up in the personal Swiss bank accounts of government officials. In Whittle's view, a radical new approach was needed. He asked Kuraishi to join him and help shake things up.

Kuraishi quickly pulled together strategy staffers and personal friends from other parts of the bank for an all-day brainstorming session. They divided a whiteboard into two sections. The left side was labeled "Existing World Bank Processes" and the right, "What Is the Opposite?" On the left, they wrote things like "top-down loans; $100 million; and two-year processing time; two hundred pages of documentation," and on the right, "bottoms-up grants; $100,000 loans or grants; two-day processing time; two pages of documentation."

The outcome of this antilog-driven process was nothing like what constituted business as usual at The World Bank. Tagged The World Bank Development Marketplace, the resulting program would prove to be an important analog for GlobalGiving.

The First Development Marketplace Sparks an Idea for Whittle and Kuraishi

In February 2000, seven hundred people crowded around 270 cramped booths in the usually pristine atrium of The World Bank. Each was intent on pitching an idea for alleviating poverty in the first-ever Development Marketplace. These finalists were selected from 1,130 applications from more than one hundred organizations based in more than eighty countries. The proposals were limited to four pages, and a fifteen-minute presentation.

At the end of this two-day carnival of ideas, James Wolfensohn, the president of The World Bank, stood on the stage and made awards totaling $5 million to forty-four teams. The event was an overwhelming success. As Whittle explained, "The Development Marketplace not only surfaced exceptionally innovative ideas and projects, but it enabled funding decisions to get made in two days, lightning speed by World Bank standards. This was a radical and eye-opening innovation."

When the awards ended, a South African woman approached Whittle and Kuraishi. In a strong voice, she said, "I did not win." Whittle replied, "Well I am sorry, but this is a competition, and not everyone can win." She retorted, "I am telling you that my idea is a good one, and just because The World Bank did not finance it does not mean that there are not others out there who will finance it."

Whittle was haunted by the truth of the woman's words. Several months later, he and Kuraishi walked away from successful careers in the development establishment. They were committed to building a true marketplace for development project funding where there could be more winners than losers. It would prove to be a challenging journey.

Whittle and Kuraishi Assemble Their Analogs

Whittle and Kuraishi felt strongly that the discipline and rigor of a for-profit business would be critical to the success of their new venture. That would mean raising capital, something neither of them had done. They were encouraged, however, by an analog—eBay—which by matching buyers and sellers for all kinds of goods had grown to more than 20 million users, a dazzling success in the dot-com world. Was an Internet marketplace the right vehicle for their noble venture?

The pair wondered if there were other organizations from which they could learn. Heifer International had been very successful with a charity model, using traditional marketing techniques like direct mail to raise upward of $100 million a year for projects promoting economic self-reliance for individuals in developing countries. But the marketing cost was significant, reducing the funding that actually reached projects. And there was no direct connection between donors and projects. Heifer would be both an analog—demonstrating the possibility of engaging large numbers of donors—and an antilog, for the costly manner in which it raised its money.

GlobalGiving Builds a Dashboard and Takes Crucial Leaps of Faith

With very little effort, Whittle and Kuraishi identified more than one thousand compelling projects in developing countries that could make a significant impact with a small to moderate infusion of funding. It seemed logical that if projects like these could be made visible to a large community of potential funders, money would flow. But their business was far from proven, and it felt too early to establish a foundation to channel charitable contributions to their favorite projects. So the pair established a partnership with the nonprofit Calvert Foundation. The Calvert Foundation had the necessary apparatus for accepting tax deductible donations under the U.S. tax system, an important incentive for U.S. donors.

But the crucial issue, a real leap of faith, was whether Whittle and Kuraishi could harness the Internet to generate direct philanthropic contributions to global development projects in an economically sustainable manner. In particular, there were three key questions:

1. Will attractive, high quality, legitimate projects participate over the Internet?

2. Will sufficient numbers of donors contribute directly over the Internet?

3. How can we fund and structure the marketplace to achieve financial sustainability? In other words, is there a business model that would work?

Though the analogs and antilogs were informative, there was only one way to answer these questions: launch a pilot site and test some hypotheses.

The pair's network in California's Silicon Valley helped to hook them up with a development team in India to create a barebones Web site. In 2002, their new venture, Development Space, came to life with twenty-five projects. Their initial dashboard is shown in figure 2-2.[2]

Though their dashboard does not look just like Johnny's prototype, the same elements—leaps of faith, hypotheses, metrics, results, and insights—are there. Unlike Johnny's, some of Whittle and Kuraishi's hypotheses—the quality of the business plans submitted, for example—are qualitative in nature. Dashboards can be used to gain insights into qualitative issues, too. Like Johnny's, though, a clear focus on the most critical issues that would determine the survival of the business is apparent.

The Data Speak

Happily, there was an immediate and positive response to the Development Space concept. Donations began to trickle in. The news media gave the venture positive coverage as well. But the challenges outweighed the good news. Development Space's results showed that customers needed an assurance as to the quality—indeed, the legitimacy—of the projects listed on their Web site. Based on the eBay analogy, Whittle and Kuraishi envisioned the same kind of user rating system that was so powerful for eBay. Why couldn't donors rely on the ratings of other donors to gain comfort about project quality?

Two things made this clearly unworkable. First, the Patriot Act, introduced after September 11, 2001, required significant vetting of charitable contributions to ensure that they were not going to organizations with terrorist ties. Second, before making a charitable contribution, donors wanted assurance from a credible third party that the project was sound. As Whittle explained, "People were comfortable buying things on the basis of the opinions of other consumers, but they wanted reliable expertise involved in helping them find legitimate projects to fund with their philanthropic dollars." The model would have to be adapted to identify projects through credible sponsor organizations who could conduct due diligence on the ground.

Another problematic hypothesis involved donors. Again, based on the eBay experience, the hypothesis was that if the marketplace existed, donors would come. But the marketplace for "used stuff" that eBay brought to the Web already existed in the form of classified ads and garage sales. The same wasn't true of the marketplace for global development.

FIGURE 2-2

Development Space start-up dashboard

Leap of faith question	Hypothesis	Metrics	Finding	Insight/response
1. Will attractive, high-quality, legitimate projects participate in the marketplace?	Projects will self-identify with minimal guidance. Business plans will be a good proxy for project quality. Due diligence can be conducted after projects apply.	• Number of projects submitted • Size of projects • Type of projects/descriptions • Existence and quality of business plans • Value of business plans to prospective donors • Cost and reliability of due diligence	100 projects submitted; 25 qualified. Size range: $1,000–$250,000. Some too conceptual to appeal to donors (e.g., Argentina fiscal adjustment). Most projects had no business plans or needed extensive technical assistance to create them. Donors didn't care about business plans. Due diligence after the fact was unaffordable and unreliable.	Need to find projects by mining relationships in the field. We need a Plan B! Smaller, community-based projects most attractive to donors. Compelling project descriptions key to marketplace success. Solid relationships with sponsor organizations and a "chain of trust" are needed to ensure project quality and legitimacy, particularly post-Patriot Act. We need a Plan B!
2. Will sufficient number of donors participate in the marketplace?	As with eBay, if the marketplace exists, donors will come.	• Number of donors in first 8 months	<100	Marketing to prospective donors is required. We need a Plan B!
3. How can the marketplace be funded and structured to achieve financial sustainability?	Social and strategic investors will be the best sources of capital.	• $ raised	$3 million investment from HP and World Bank's IFC seemed almost certain, but fell through. $100,000 raised in relatively small increments.	After the dot-com bubble burst, investment capital unavailable. Are philanthropic grants the answer? We need a Plan B!
	A for-profit structure paired with a foundation partner could work.		Having an online marketplace branded "Development Space" and directing donors to a nonprofit partner to make the contribution was a problem in terms of brand identity and credibility.	A structure is needed that would allow for a unified brand. We need a Plan B!

Source: GlobalGiving.

Total spending on foreign aid programs was running close to $100 billion per year, with roughly one-quarter to one-third of the funds coming from private individuals, companies, and foundations. But there were few vehicles other than Heifer International that allowed donors to contribute directly to international development projects. And even Heifer made no clear link between individual donors and specific recipients.

Whittle and Kuraishi's idea was based on a new paradigm. Development Space would connect individual donors with specific projects. As was the case for Heifer, they would have to spend a significant amount of time and money educating and marketing to potential donors. Heifer, the hoped-for antilog, was looking like an analog after all, though a disappointingly expensive one.

Finally, the team found that relying on the Calvert Web site to process donations created a disjointed customer experience. In fact, donors felt as if they didn't know where their cash was going once they were sent to the Calvert Web site.

Development Space Faces a Funding Drought

To make matters worse, the dot-com bubble had burst. Financial investors weren't lining up to put money into an Internet marketplace for global development. And unfortunately, Whittle and Kuraishi needed a small infusion of cash to stay true to the pleas of the South African woman, as well as many other worthy projects. It had been more than two years since her words had kick-started their entrepreneurial journey.

Taken alone, their difficulties might have caused them to give up. But Whittle and Kuraishi were determined to keep going. As Whittle recalled, "Even though the marketplace was not taking off as quickly as we had expected, we could see that the potential was there. We were learning at a rapid pace and needed to adapt our approach based on what we learned." The data, as reflected in the initial dashboard shown in figure 2-2, were speaking loudly and clearly. It was time for Plan B.

Plan B: Development Space Becomes GlobalGiving

Whittle and Kuraishi created a Plan B that was markedly different from their first set of ideas. On the project side, new emphasis was placed on building a sponsor network and relying on sponsors to identify and help position suitable projects for the marketplace. Ashoka, a highly credible organization

that identifies and builds networks among promising social entrepreneurs in the developing world, signed up as the first project sponsor. With Ashoka came a chain of relationships, as well as trust, giving projects credibility.

But the venture was desperate for new donors. This was the area where the initial hypotheses were furthest from the reality that unfolded. Hewlett-Packard (HP) had been interested in Development Space from the start. As a technology company committed to innovation and social responsibility, HP was looking for ways that technology could accelerate economic development beyond the then popular "bridging the digital divide" concept of giving everyone access to the Internet. Excited by the possibility of using the Internet to transform global development funding, HP invited Development Space to be a part of its employee giving campaign. This was a big "Aha," a way to aggregate donors in a potentially much more efficient fashion, without spending scarce resources on marketing.

The time was ripe for Development Space to establish a foundation of its own, to clear up the confusion created when donors were directed to the Calvert Foundation. At the same time, the company changed its name from Development Space to GlobalGiving, a name that the new foundation took as well. A separate board was set up for the foundation. Appropriate mechanisms were put in place to provide the level of independence needed to ensure legal compliance.

GlobalGiving had evolved a financial model that depended on many components, one of which was philanthropic support of the foundation. About the same time, Whittle and Kuraishi launched a major fundraising campaign, targeting foundations and high net worth individuals. Despite the drought, they attracted enough money to take the next steps.

Finally, the original, barebones technology platform needed work. Whittle and Kuraishi needed better tools for tracking and analyzing traffic and user behavior, and they needed a new-look Web site to improve usability and the overall donor experience.

With all of these changes, it was time for a new dashboard to affirm or refute their new leaps of faith (see figure 2-3). The three initial leaps of faith remained unchanged, as neither the company's ability to attract enough good projects, enough donors, nor build a business model that would work had been proved in the first iteration. Based on the learning from the earlier dashboard, however, the hypotheses were changed to reflect the decisions that embodied GlobalGiving's Plan B.

FIGURE 2-3

GlobalGiving second dashboard

Leap of faith question	Revised hypothesis	Metrics	Finding	Insight/response
1. Will attractive, high-quality, legitimate projects participate in the marketplace?	A network of trusted sponsor organizations will identify attractive, quality projects.	• Number of projects submitted • Size of projects • Type of projects/descriptions	300 qualified projects <$100,000 in size. Community-based projects.	Project sponsors (first was Ashoka) created credibility; floodgate opened. Hypothesis confirmed! Must limit number of projects to maintain balance with donor volumes.
	Project sponsors will validate quality and legitimacy, create a chain of relationships and trust.	• Number of trusted project sponsor organizations • Cost and reliability of due diligence	Ashoka signed on first, four others followed. Projects are donor-ready.	Sponsorship is the way to go. No follow-on due diligence necessary. Hypothesis confirmed!
2. Will sufficient number of donors participate in the marketplace?	Donors can be aggregated through companies/corporate partnerships.	• Number of corporate relationships • Number of donors achieved through relationships $ in donations	3–4 key corporate partnerships/sponsorships to build credibility and momentum.	Good vehicle for getting started, but expense of doing customization and servicing relationships is too high for this to be a viable long-term strategy. We need a Plan C as a donor strategy!
3. How can the marketplace be funded and structured to achieve financial sustainability?	Corporations and foundations are the best targets.	• $ raised	Less than the $5 million in corporation and foundation money sought.	The sale cycle is long. Time to breakeven will be significantly longer than originally expected. Major time and energy will have to be invested in raising money for an extended period of time. Plan C needed here, too.
	Need to create a foundation to collaborate with for-profit organization under a coherent brand.	• Structure acceptable to funders? • Ability to accept private investment maintained? • Flexibility to reinvest earnings in foundation?	All foundation funders OK with hybrid structure. YES YES	Hybrid structure provides flexibility but governance is complex.

Source: GlobalGiving.

When the new site was launched, things started to pop. With Ashoka as a project sponsor, the floodgates opened, in part due to the credibility that Ashoka lent. Three hundred projects came so fast and furiously that the team temporarily stopped adding projects to avoid an untenable imbalance between the number of projects listed and the volume of contributions coming in. Once HP's employee giving campaign got under way, the almost immediate uptick in the number of donors and dollars provided an all-important psychological boost for the team. Perhaps Heifer's aggressive marketing spending could remain an antilog, after all!

HP also helped promote this idea to other companies. Partnerships with several other companies, including Visa, Advanced Micro Devices, and The North Face soon followed, augmenting the original open marketplace model with customized sites for specific organizations.

Is GlobalGiving's Plan B Working?

As we write, more than five years after Development Space was launched, the company has funded more than a thousand projects, and GlobalGiving has established a strong sponsor network, as well as robust mechanisms to ensure project legitimacy. While these numbers are not on track with early projections, momentum continues to accelerate and the team remains committed and optimistic. Whittle and Kuraishi now laugh about some of their early hypotheses and how much they have learned. Importantly, they continue to learn not only from their own experiences but from new analogs as well.

What lies ahead for GlobalGiving? Building its growing base of donors is the highest priority. The focus here is on providing such a compelling experience that visitors can't wait to tell everyone they know. Whittle and Kuraishi believe this is possible, in part based on the experience of another analog, Kiva, which delivers microloans by donors in the West to individuals in the developing world. There are two elements in the Kiva analog from which GlobalGiving has learned. First, donors giving through Kiva have felt a connection to the people they are helping, and they've spread the word. Kiva's adeptness at telling the stories of the individuals seeking loans—from the baker in Kabul who needed a new oven to the fish seller in Kenya who needed additional supplies—made each loan request a compelling human interest story. For Kiva, effective storytelling has been a key ingredient in getting donors to open their hearts and their wallets.

Second, offering projects at a sufficiently small size lets donors have a direct impact—a key element to opening wallets. GlobalGiving, as it enters its third phase, is determined to leverage as much as it can on Kiva's successful approach.

By 2008 GlobalGiving had successfully facilitated a reported $14 million in donations from 41,500 people to more than 1,300 projects worldwide. In the process it managed to create a viable business model.[3] The philanthropic support it receives is its most important source of cash. But it also derives revenues from small transaction fees and from the corporations whose employees it services. A very innovative way to fuel a venture endeavoring to change the world.

Lessons from GlobalGiving

The GlobalGiving experience demonstrates the power of the analog-antilog-leap of faith-dashboard process in launching a bold social venture that faced many unknowns at the outset and breaks new ground. By remaining focused on their leaps of faith while making major changes to key strategies—all based on the insights revealed through their dashboards—Whittle and Kuraishi have overcome seemingly insurmountable obstacles and moved ever closer to their goal of making their operation a financially sustainable one.

We now turn to another pair of entrepreneurs. They shared an equally bold vision, one focused on an entirely different problem and a different set of customers. And they are the lucky ones—their Plan A met early success! Read on to see how their dashboards took them further still.

Case 2: Aggregate Knowledge Does Online Discovery

In Paul Martino's view, search engines can't solve every Web user's needs, especially when users do not know quite what they're looking for. Martino's discovery engine was developed for just such instances.[4] He reasoned that individuals' affinity to certain topics (what someone likes to read, for example) provided a better indication of their interests than what they *said* they were looking for.

His concept was a "formative" one: what you read online "formed" and informed a clearer view of what kind of person you might like to date—someone who reads similar things, listens to similar music, likes the same sorts of food, and so on. Martino's insight was that technology could suggest areas or items of interest to users based on the behaviors of other like-minded people. Add to this affinity idea the concept of the wisdom of the crowds en masse and voilá, his vision of "online discovery" was born.

AK's Analogs and Antilogs

In 2005, Martino and Chris Law, his good friend and colleague, cofounded Aggregate Knowledge (AK). Their goal was ambitious: to provide users with information about events, media, and commerce that was deemed relevant based on each person's previous decisions. For example, if you searched for the score of the latest Chicago Bulls game, AK's discovery engine might provide you with upcoming Bulls game times and locations and the ability to purchase courtside tickets. Or, if you were looking at buying a red dress online, the AK engine would suggest other items that people who bought the same red dress had ordered. How about a flashy pair of red heels? The top-selling salsa CD?

Unlike existing online recommendation systems, however, Martino's system would employ the wisdom of crowds across the entire Internet, not just the commonalities of a discrete group on a particular site.

The genesis of Martino's idea for AK was simple. He and Law were working at Tribe.net, an online classified service that combined social networks with groups and listings. Tribe could provide information for finding San Francisco's most recommended orthodontist, but it didn't do a good job helping users find dating partners. Martino figured that the key to finding good dating partners online was to connect individuals based on the news and message boards they read, something Tribe didn't do.

Personify Inc., another start-up, was both an analog and an antilog. The company provided analytics software to help companies gain insight from their customers' behavior, and Personify's idea and its team had attracted substantial venture capital.[5] Personify's value proposition was compelling; however, the company's analytics engine was not scaling sufficiently. It could only process and provide suggestions when there was a limited amount of data. But with so little data, its discovery results tended to be inadequate. Thus, in Martino's view, Personify didn't have the technical

firepower it needed to succeed. The AK engine would have to be vastly more scalable.

Fortunately, searching for things on the Internet was not a new concept in 2005. So when Martino and Law considered their company's revenue model, they looked to a number of analogs for lessons. Google topped their list. Google's technology and reach proved that it was feasible to search from hundreds of millions of sources of data and provide almost instantaneous results. And the bigger its dataset the more useful Google was to its users. Google had become the paradigm of choice for how users found things on the Web. And fortunately for Google's founders and investors, Google had become a targeting tool for paying advertisers who used keywords to offer relevant marketing messaging to online searchers. "Can we be another Google?" Martino wondered.

There was an antilog, too. Epiphany Inc. helped companies keep track of and support their customers. It was proving that its customers had little tolerance for long and complicated software deployment cycles. The fact that it took Epiphany months to deploy its tool to customers instead of days or weeks was proving to be a drag on sales. Martino's tool would have to have short deployment cycles. Clunky architecture simply wouldn't do. Martino reasoned that if he could provide discovery like Personify, make his solution scalable like Google, and make it easy, fast, and inexpensive for customers to deploy, unlike Epiphany, then Aggregate Knowledge would have a winning solution. Easy to say, but was it possible to do?

AK's Leaps of Faith

Three leaps of faith were crucial, as shown on AK's June 2006 dashboard.[6] In keeping with Martino's deep background in science and technology, this first of his dashboards was focused on just the three pressing issues, using simple, pared-down language (see figure 2-4).

> LOF 1: Would B2B customers use AK's technology on their own sites? Martino believed they would—a leap of faith for which, at the outset, Martino had no evidence.
>
> LOF 2: Would the AK research engine really scale, technically speaking? It would, in Martino's view—a second leap of faith.
>
> LOF 3:What was the best route to market? Who knows?

FIGURE 2-4

Aggregate Knowledge dashboard 1

Hypothesis	Metrics	Results
LOF 1: Would B2B customers use AK's discovery technology as part of their sites?		
3 trials	# of trials in development	2 under way, who to do the third?
LOF 2: How well does AKRE 1.0 work?		
1.0 Feature Set compelling	Deliver essential features that exercise core product value	Engineers on board, getting up to speed
Scaling 1 billion/month	# of data hits	Early data is exceeding expectations
LOF 3: How do we go to market?		
Merchants or publishers	Identify subset of potential merchants and publishers that have a strong interest in product value	Initial market segments identified
Fee or revenue share pricing model	Test various pricing scenarios against actual customers	Early discussions, not as important until after-market selection

Source: Aggregate Knowledge.

If these leaps of faith had been left unexamined, Martino would not have been able to confidently say that his technology was on the optimal path, and he would have been running very high risks of failure. Martino used dashboards regularly and relied on them to navigate this early period of AK's development. And as we'll see, he relied on even more granular dashboards following from each successive wave of leaps of faith as his company evolved. "Keeping the multiple moving parts of a nascent business organized and accounted for is always a challenge for a start-up CEO. I used a dashboard to keep track of every point of development because I wanted to make sure that we were spending our time and our investor's money on the things that would be determinative of our ultimate business model and success. If we had it wrong we wanted to know, and quickly, so we could course correct before we ran out of time."

The second leap of faith had to do with the technology. Could the team build a product, Version 1.0, which would operate at Web scale and in real time? If not, Martino would find his idea in the discovery graveyard with the likes of some other infamous antilogs!

The final leap of faith was AK's go-to-market strategy. Which customers should they start with? Were media sites more likely to want what AK offered, or were commerce sites? Who would be willing to pay? How much? And what was the top-line sales potential of each of the potential market segments?

To test his hypothesis that such a system could, indeed, be built and that users could be attracted, Martino needed a couple of well-known B2B clients with millions of unique monthly visitors and hundreds of thousands of transactions. If the technology faltered under stress he would have to rethink his approach. He convinced two pilot customers—one media company, one e-commerce site—to let AK run trials. It was AK's first real test, and his first leap of faith answered!

The Data Speak

Martino kept close tabs on AK's performance. He measured the number of results served, the number of hits, the number of page views, the speed with which the results were delivered, and other metrics. These were the metrics that would indicate whether the technology would work.

From this limited set of data, it seemed as though the company's technology could scale. Good news, both for AK's technology and its ability to attract customers who would pay. Having easily found pilots from each of his target industries, Martino surmised that both media and commerce would make good target segments. But he had some new concerns.

Aggregate Knowledge's Second Dashboard

Martino had two new leaps of faith: First, it was far from clear how much customers would pay. Second, it was not clear what the true market potential really was. Excerpts taken from AK's second dashboard to address these issues are shown in figure 2-5. This second iteration, in January 2007, applied more of a functional lens and additional quantifiable metrics including the number of prospective customers in the sales pipeline, the number testing AK's product, the number of paying customers, and more.

This new dashboard read like a list of critical tasks for key functional leaders in marketing and sales. Instead of dashboard items being strategic leaps of faith, this was more granular, penetrating into the next layer of issues. The metrics assigned to each of these tasks gave functional leaders clear and measurable objectives to shoot for. For the sales team, how many

FIGURE 2-5

Aggregate Knowledge dashboard 2 (+ 6 months)

Sales			
Hypothesis	**Metrics**	**Results**	**Insight**
Pipeline (Y qualified leads)	# of engaged prospects	>Y	Well on the way. Getting correct retail/media mix in the pipe now.
Trials (Z new)	# of trials under way	>Z	Several this month and a few more next month already signed.
Paying customers (W new)	# of customers under contract	<W	Need to figure out right time period for trials to convert

Source: Aggregate Knowledge.

sales meetings were they having? What was the pace of commitment? How many trials were started? If the answers to Martino and Law's leaps of faith proved correct, then the sales team should be able to generate sales, right? In the front office, were the office processes working well enough to keep the product moving forward and customers satisfied?

As a direct result of what Martino and Law had learned from their antilogs, the marketing group closely watched the product's setup wizard, measuring the number of days it took to deploy the solution with a new customer (not shown in the excerpted portion of the AK dashboard that appears in figure 2-5). And, since discovery was all about the quality of the recommendations, the new dashboard closely tracked the percentage of attribution (also not shown). How often could a B2B customer attribute a sale or mouse click to the recommendation provided by Aggregate Knowledge?

While pleased with the level of detail that this new dashboard gave him for managing the growing business, Martino found it somewhat difficult in another way. It covered the key functional questions, but it didn't provide him with focus on the larger priorities for the company. As a result, Martino and Law had to regularly step back and ask themselves whether they were measuring the right things.

Ramping Up: An Audacious Plan B

By July 2007, AK had grown to forty employees. The company had proved that it could generate a positive gross margin on the paying pilots that were

in place. It had proved that the discovery notion resonated with customers across the retail and media spaces—both with users and with the online sites where the AK discovery engine had been deployed. The AK team could work effectively together to upgrade and improve their service. And the technology worked well enough to make their customers more money. A winning proposition, it seemed!

Indeed, Patrick Byrne, CEO of Overstock.com, a pilot customer, said, "Over 20 percent of all products purchased on Overstock during the holiday season were directed through the discovery window that Aggregate Knowledge powers on our site. Our customers love the new choices they are given, and we are thrilled with the results—higher sales conversions, larger shopping cart sizes, and increased customer engagement and satisfaction."[7] Martino, Law, and their team had developed and launched a recommendation engine that helped Overstock more effectively sell its eight hundred thousand SKUs, and had deployed it on Overstock's site in a manner of days, not months. Proven progress, indeed!

With so many proven hypotheses under the company's belt, AK was moving into acceleration mode. No longer did the company simply want to be a discovery tool for individual companies, it aspired to become a discovery platform across multiple online businesses.

It would create a larger network to pool data from and market a new network-based product. It would provide each B2B customer with the benefits of everyone else's experience and a chance for each customer to build new on-site real estate that they could monetize across the network, like online advertising. AK's customers would make money by selling their click-stream assets to one another, with Aggregate Knowledge tending the store.

The key to such a breakthrough was scalability. Martino and Law did not want to settle for good, they wanted to be great. Rather than execute against a plan based solely on the product and value proposition they had already proved, they wanted to see if there was a chance to reach for something much bigger. Growth was their primary concern. Another dashboard, AK's third, was needed to guide this stage of the journey (see figure 2-6).

AK's third dashboard focused on making the business and technology into a scalable network and platform. Functional leaders were assigned larger company priorities—including, for the VP of sales, getting companies with large networks on board—and were responsible for tracking their

FIGURE 2-6

Aggregate Knowledge dashboard 3 (+ 1 year)

Top priorities			
Hypothesis	**Metrics**	**Results**	**(Function head responsibility) insight**
Network product deployed with acceleration	# of installations	On track	(VP Eng) Product plan completed; hiring in place; launch with new small to midsize Discovery Networks; v1 done.
Agreements with X midsize to large discovery networks	# of networks	Trailing	(VP Sales) Trial agreements signed for the basket of Discovery Network tests we need to do.
Competitive assessment completed	Identify strategic partners	On track	(CEO) Determine friends, foes, best/worst partners. This includes the analytics and reporting strategy.

Source: Aggregate Knowledge.

progress toward achieving those priorities. This method allowed leaders to create and manage their own functional dashboards, drilling down to the task level with their own functional teams, while permitting Martino and the executive team to address the critical leaps of faith regarding scale.

Let's focus on the product area again to see how AK's third dashboard tracked its progress at a functional level. As the leader of the product team, Law's priority was to develop and implement a companywide product-management process. This included not just staffing and integrating with the rest of the organization that touched the product, but also driving the product road map and customer feedback process. These major priorities were assigned to leaders in his organization who then managed them as part of the marketing dashboard with specific performance metrics. Take for example the VP of engineering. His dashboard now tracked tasks related to the process flow—including getting the new network product deployed—and integration of the science into the process, in order to test its speed, responsiveness, and flexibility. No longer did Martino need to track every detail. He watched his team's progress on their priorities and let each leadership team manage the nitty gritty. Getting himself out of the

proverbial weeds allowed him to make the big, strategic decisions—based on an updated competitive assessment—more quickly because he could focus on the newly emerging leaps of faith concerning the network and new platform opportunities.

Is Aggregate Knowledge's Plan A Still Working?

By the end of AK's third year, Martino noticed something unusual in its dashboards: the sales team was not acquiring as many new customers as expected and competition was putting pressure on its pricing. He decided to spend ninety days on the road speaking directly to customers. What he found was that few customers had the sophistication to realize the value of Aggregate Knowledge's full power, and competitors were offering a smorgasbord of alternatives that could incrementally address the customer's smaller and more immediate needs. Paul needed a Plan B. He looked for new analogs (advertising networks) and antilogs (Web analytics companies) and determined that Aggregate Knowledge's special sauce had the potential to uniquely address a serious customer pain: targeting the best personalized advertising message to each user. This was his new leap of faith. Fortunately, through dashboarding Martino was quickly alerted to the slowing pace of sales and was able to swiftly refocus his resources. Doing what any smart entrepreneur would do, he began to test his hypotheses using yet another dashboard. Stay tuned.

Lessons from Aggregate Knowledge

The AK example shows how useful a dashboard can be, even when it affirms that Plan A is on the right track. It shows how both quantitative and qualitative data provide insights into progress, and it shows the wider use of a dashboard, as we discuss more fully below. It also shows how AK's dashboards evolved over time, from crucial, high-level strategic questions—huge leaps of faith—to more detailed performance measures as the company matured.

For Aggregate Knowledge, the dashboard was much more than a navigational tool. The company used it to set priorities, provide transparency for the employees, and motivate the right behaviors. Every week, Martino published the dashboard to the entire company. Doing so had positive results. First, it provided all employees with a clear understanding of the company's priorities. Second, it sparked communication among the executive team. Martino also tied his executive team's bonuses to their dashboard results,

motivating his leaders to work on the things that mattered most to the company. While specific objectives were subject to change, getting answers was rewarded regardless.

Finally, the Aggregate Knowledge story shows how fast a company can progress when its hypotheses are spot-on. With a store of analogs and antilogs to draw on, Martino and his team hit the ground running. Similarly, AK's dashboards saved it when the company ran into trouble with its initially successful Plan A. Without benefit of dashboards, the problem could have gone unnoticed or unheeded for too long, making Plan B unachievable.

Lessons Learned About Dashboarding

We opened this chapter on dashboarding with a simple story about Johnny and a simple prototype dashboard to illustrate the basic ideas. Then we pushed you quickly into the deep end, showing you real dashboards for more complicated real organizations. There are three themes that we hope have come through about which we'd like to say a bit more:

- The laser-like focus that dashboards provide
- The way dashboards evolve over time
- An emphasis on numbers, though not exclusively

Dashboarding for Focus

In the GlobalGiving story, we saw how the company's dashboards brought into crystal clear focus the need for changing from Plan A to Plan B. In contrast, AK's dashboards made it clear that, for an extended period, AK's strategy was largely on track. Whichever the outcome, dashboards help entrepreneurs—and managers in established companies, too—focus their time and energy on the crucial issues that matter most at the current moment in the company's development.

Dashboards Evolve over Time

In both of this chapter's cases, we saw how the dashboards evolved based on the learning they uncovered. Thus, there's no simple formula for what a dashboard should look like in one company or another, at a given point in time. There's art in their development, and science in their use.

Focus on Numbers

This book is about breaking through to better business models, about getting to a Plan B that, as we saw for GlobalGiving, is better than Plan A. Doing so is an inherently quantitative task, as the next several chapters will make abundantly clear. While some elements of most dashboards address qualitative issues, you'll be missing the boat if the vast majority of your hypotheses are not quantitative in nature.

Finally, there's one more insight we hope you have gleaned from the cases in this chapter: to get the most out of dashboarding, there are three things that matter most:

- The quality of the questions you ask to identify your leaps of faith
- What you do with the data
- The speed at which you get on with your next steps

In Johnny's trial run, he proved his hypotheses wrong. The next day, he made adjustments, and his lemonade business was stronger for it.

Drawing on what we discussed in this chapter, it should be clear that quality questions are what drive your leaps of faith. Which questions about your company make you feel uneasy and keep you up at night? What would you like to know that you don't? What assumptions have you made that might be wrong? What information would lead you to a different conclusion than the one you are operating under? Your dashboard must address these big questions—your leaps of faith.

The way in which these questions are asked and tested depends on the culture of the company and the context of the situation. If you are in an early stage, like GlobalGiving and Aggregate Knowledge, many of the questions are fundamental. They are about whether your idea will work technologically and whether it holds any value in the marketplace. As you grow and evolve, your questions become foundations for how you refine your plan for greater success. They help you focus on the right market and market segments, customer preferences therein, the right pricing and payment strategy, the right distribution channel, the right financial model, the right partners, and so on. In all of these cases, as leaps of faith are answered or dismissed as no longer relevant, new ones emerge.

Q&A with John and Randy

At this point, you may be harboring a couple of questions about how to apply dashboarding to your new venture—or even to your old one! Here are two that come to our minds:

- How formal must my dashboard be? Must I have all these parts?
- What are the implications of dashboarding for business planning? It seems as if, in these examples, the key figures normally found in a business plan materialize over time.

How Formal Must Your Dashboard Be?

The cases in this chapter relied on dashboards that differed in their formality. GlobalGiving's dashboards were much like the prototype we set out for Johnny in figure 2-1, the textbook example, in a sense. There were specific leap of faith questions, one or more specific hypotheses for each of them, and clearly specified metrics that indicated how progress was to be measured. In addition, in the final two columns there were places to record the results and—importantly—draw conclusions about just what those results meant and what to do next.

Aggregate Knowledge was perhaps less formal, but no less rigorous in identifying what the key questions were at each stage in the company's development. There's no single right answer about how you must do this in your company, but these two examples indicate the range of how dashboards can be effectively employed.

The dashboards shown here also differ in how the leaps of faith were presented. Some companies treat them as questions to be answered and state them accordingly. Others identify them as assumptions or untested beliefs that have been identified and state them declaratively. Either approach works—do what is comfortable for you.

What About Business Planning?

We'll return to this question in more detail in the final chapter, chapter 9. But at this point, it should be clear that a detailed business plan would have been a disservice to companies like GlobalGiving and Aggregate Knowledge. That's because a detailed plan would have obfuscated the burning

questions and lessened the focus on critical priorities. Any revenue projection would have been sheer folly. And without really knowing what shape the business would take, in GlobalGiving's case, any forecast of expenses would have been pie in the sky.

In each of the two cases, dashboarding allowed the teams to identify the leaps of faith that would mean life or death to their companies. As a result, they could focus their scarce time and precious resources on resolving those issues before moving on to tackle the next set of hurdles.

The stories of GlobalGiving and Aggregate Knowledge hint at one more key issue for which dashboards are especially well suited: developing an evidence-based business model whose economics will stack up. We saw how GlobalGiving's conception of the business changed to make its project sourcing much more efficient. We saw how AK's evolving set of dashboards provided real-world, in-the-marketplace evidence of how quickly customers could be acquired and a host of other issues that make the difference between staying in business and running out of cash. This kind of learning translates easily into numbers, and numbers—not words—are the language of every company's business model.

What's Next?

The *process* for developing a viable business model—whether Plan A, Plan B, or Plan Z—is now in place, with analogs, antilogs, leaps of faith, and dashboards laying the foundation.

In the chapters that follow, we turn our attention to the *content* that can make an innovative business model sing and dance. We dive into the five elements of a business model: revenue, gross margin, operating expenses, working capital, and investment. And we check in on Johnny to see how his lemonade stand is faring.

As we shall see, whether in early- or later-stage companies, creating a business model that can turn your idea into the next eBay or Amazon—or turn your long-established company into a juggernaut that disrupts your entire industry—means mixing and matching analogs and antilogs and identifying and addressing leaps of faith, then dashboarding your way to mid-course corrections as you learn.

The content issues are the lifeblood of the business—the arteries through which cash flows—that creates value for customers, shareholders, and others. And—if you apply them well—value for you, too!

CHAPTER 3

Air, Food, and Water

Your Revenue Model

WHEN WE LEFT Johnny Tart in chapter 2, he was sitting confidently behind his lemonade stand, with newly revised prices and better signage. Johnny's family was a source of real support as he navigated the hiccups of entrepreneurship. His mom had graciously made an extra trip to the grocery store to buy lemons, sugar, and paper cups. By Thursday afternoon, with temperatures in the high nineties, commuters knew where to find him. They were certainly thirsty. And on Friday, Johnny tallied his sales: $18.75! That's not bad for four short stretches (remember, it rained on Tuesday!) of daily work!

Revenue Model Defined

In Maslow's well-known hierarchy of needs, air, food, and water sit at the base of the pyramid—signifying mankind's most primitive, most fundamental, most essential needs.[1] Revenue is to any business—and to most other organizations, too—as air, food, and water are to mankind. Without revenue, a business is as lifeless as a plant without water. As management guru Peter Drucker observed, if you don't have customers sending you money, at least eventually, you don't have a business, either.[2]

By *revenue*, we mean money given to you by customers in return for whatever it is that you sell. And by *customer*, we mean the one who pays for whatever it is that you sell.

In the introduction, we briefly identified the five elements of any company's business model that, taken together, determine whether a business or organization can survive and prosper. Chapter 3 is the first of our five chapters that address these key elements.

In our experience, the most likely reason that your Plan A won't work is that there are not enough customers who will send you money—soon enough, often enough, in large enough amounts—to keep your venture afloat. Thus we begin our examination of the five elements of business models by focusing on your revenue model. In particular, we examine six key questions that underlie every revenue model:

1. Who will buy?
2. What will they buy?
3. What pain are you resolving for your customers, or what delight are you offering?
4. How soon, how often, and how much or many will they buy?
5. At what price will they buy, and on what basis will they pay?
6. With what effort and cost on your part?

Examining these questions isn't a simple form-filling exercise. For each of them, you'll need evidence that shows, to you and to others, where your cash from customers will come from and why. But a word to the wise, if your only source of cash is "investors" rather than customers, it's unlikely that you'll actually *get* any investors.

So to answer these questions—with evidence, not hopes—we suggest following the process outlined in chapters 1 and 2. That requires finding relevant analogs and antilogs; identifying your leaps of faith for your revenue model, based on the questions above that are not adequately answered by analogs or antilogs; then dashboarding to test your hypotheses to either prove or refute your assumptions. Why must you do this? Without building an evidence-based foundation for what you plan to do with your venture, you'll have nothing more than a house of cards, a series of leaps of faith, none of which have been proved. If living in a house of cards is the level of risk you are prepared to take, good luck. But most investors won't give you a minute of their time.

What if you've not been able to identify any analogs to jump-start this process? Being rudderless isn't ideal—we don't recommend it. But if that's the situation you find yourself in, then you'll simply have many more leaps of faith to prove or refute than you otherwise would. The questions above will guide you in identifying your leaps of faith and dashboarding will be the process you'll use to resolve them.

Goal for Chapter 3: Develop a Revenue Model That Paying Customers Will Support

Customers are unlikely to part with their hard-earned cash unless what you offer them resolves some sort of pain—a more fuel-efficient car, a squirrelproof bird feeder, a fireproof mask for firefighters, or whatever—or, in consumer markets, what we call customer delight, an experience that transcends what customers have come to expect in the past. The more pressing, urgent, and severe the pain, or the more delightful the experience, the better your chances of developing a revenue model that works. *Your* task is to find a customer pain that you can resolve—or consumer delight to offer—while making money. *Our* task in this chapter is to help you to do just that: build a healthy, working revenue model in which customers pay.

To address this challenge, we examine the stories of three companies. Each addresses one or more of the revenue model questions listed above.

- For Google, a revenue model was actually far from its founders' immediate priority. In fact, there was essentially no revenue in Google's early days. Google counted users aplenty, but it lacked customers—the ones who pay, remember? The Google story shows how the analog-antilog-leaps of faith process eventually uncovered a pressing customer pain—better-targeted ads for advertisers—that turned Google from the world's best search engine into one of the world's best money-making machines.

- Boulder, Colorado–based Silverglide Surgical Technologies had a planned revenue model from the outset. However, Silverglide's Plan A was not attracting customers. The Silverglide story shows how much you can learn by simply focusing on a narrowly defined target

market—not being all things to all people—and then listening to customer feedback. And it shows how one's transition from Plan A to Plan B—by addressing a couple of key leaps of faith through hypothesis testing and dashboarding—can resolve not just one, but several of our revenue model questions.

- Revenue models sometimes get tired and run out of steam, especially when the products on which they are based are easily copied or imitated. The revenue model that served China's interactive gaming leader, Shanda Interactive, began to fail after about four years. Analogs are wonderful to copy, but the copying works both ways. If you can imitate somebody else, so, too, can others imitate you! So, what if this happens and your products no longer excite your customer? The Shanda story shows that offering customers a completely different payment model can reinvigorate a revenue model.

Just as in most start-ups, this trio completed the same painful rite of passage. First, they came to the realization that their first revenue model would not generate enough money to keep them in business. Second, by systematically questioning what was working—and what was not—by applying new analogs and antilogs and by identifying and resolving new leaps of faith, each eventually developed more finely tuned revenue models that worked.

Case 1: Google's Plan A: Who Needs Revenue?

You don't need an exhaustive search to find one of the most impressive Plan A–Plan B stories in recent business history. At its inception, Google's founders wanted nothing to do with advertisers. Tracking the evolution of Google from its Plan A—with no revenue model—to its net income of $4.2 billion in its 2007 fiscal year, uncovers a metamorphosis that every aspiring entrepreneur and every manager who wants to go places in an established organization should study.[3]

With the Internet boom came the advent of the search engine. Search engines were (and continue to be) to the Internet what the Dewey decimal system was to turn-of-the-twentieth-century American libraries. In the mid-1990s, there were plenty of search engines—Magellan, Infoseek, AltaVista,

Yahoo!, Excite, and HotBot, to name just a few—each boasting a slightly different way to find information on the Web. These search engines were good enough for most users. However, Sergey Brin and Larry Page were not fans.

In 1997, Brin and Page were pursuing PhDs at Stanford University. They lived in the heart of Silicon Valley during the hottest period in California economic history since the gold rush. Page and Brin set out to create a better search engine, more of an academic exercise than an entrepreneurial venture. It reflected their passion for organizing and delivering to Web users relevant and useful information on any topic in an easily accessible manner. Theirs was no small undertaking!

For the next year, along with a few Stanford buddies, they developed a new search engine to replace then-popular AltaVista. "We had to solve several problems. One was relevance: How do we determine if a web page relates to what you ask? Next, although many results may be relevant, which are the most relevant and the most useful?" Brin recalled.[4] Their search engine differed because it used a new algorithm called "PageRank," a word play on Larry Page's last name. This algorithm weighted the importance or relevance of search results and displayed the results in their rank order. With PageRank, the "best answers" found their way to the top of the page. Page and his team also added brief summaries for each search result, plus bold fonts for key words and terms, and *voilá*, Google was born. "They didn't set out to build a company," Stanford professor Terry Winograd recalled, "but they did set out to do a better search."[5] In so doing, they solved a pain—finding all kinds of information with far more ease and speed—that customers didn't know they had.

The result was a great search engine, initially available to a limited set of individuals, mostly Stanford graduate students. Through word of mouth and a bit of free publicity, the Google search engine became more widely used. By early 1999, Google was handling about one hundred thousand searches per day. But, as with anything else, there were costs associated with a search engine. As their engine gained popularity, Brin and Page had to continue to build and maintain a hardware infrastructure. Some serious cash was required.

Google's Plan A was a great academic feat. It was award-winning, and was nurtured by some talented individuals. But it wasn't making a penny. There were users galore, but paying customers were another story. No

venture—for profit or not-for-profit—can live for long without bringing in cash from somewhere.

Google's Plan B

Fortunately for Brin and Page, two venture capital firms in the San Francisco Bay Area saw a glimmer of brilliance in Google. Each invested $12.5 million. Even though $25 million is a sizeable chunk of change, the Google founders knew this funding wouldn't last forever. And the investors were banking on the hope that Brin and Page would devise a plan to generate, in the short term, at least enough revenue to cover their costs and hopefully—in the long term—much more.

Internet search had long been established as a free good, for which the user was not asked to pay. If not the searcher, who would be Google's paying customer? Answering the question became an urgent priority.

Google's answer, its first attempt at Plan B, was to license its search engine to other Internet businesses. Believing such companies would pay, and pay enough, for superior search, was a crucial leap of faith. Google targeted Internet companies such as Yahoo! and Red Hat, which licensed the Google search engine for their own sites. In 1999, Google would generate only $220,000 in revenue and $6.1 million in losses.[6] While the Google guys had begun to turn the corner by finally making a bit of revenue, they did not have a revenue model that could support the costs of running their growing business. Their leap of faith had not really panned out, and all six of the revenue model points remained very much up in the air.

A Villainous Plan C?

Realizing that their licensing model was only marginally effective, the Google team set out to find a better customer. Who else might pay? What about advertisers, who had a problem that Google's technology could solve: namely, finding a way to serve up targeted ads to online consumers? Perhaps here was a set of customers with acute pain that Google could serve!

This new leap of faith, if it worked out, would be music to investors' ears. However, to Google's founders, it felt like marching to the dark side and dealing with the devil. From the outset, "advertising" had been considered evil by Google (see "Was 'Plan C' Evil?"). Brin and Page had been adamant not to include advertisements in their search. But with a rising cash flow shortfall, they finally acknowledged that advertising was potentially the

best way to attract customers' cash to support the growing costs of maintaining the world's fastest-growing search engine. It was another leap of faith that might lead to a more cash-rich Plan C.

Was "Plan C" Evil?

The Google board appointed the company's first CEO, Eric Schmidt, in late 2001. In an interview with *CNN Money* in 2005, Schmidt recounted his first run-in with the "Don't Be Evil" mantra: "I was in a meeting where an engineer said, 'That would be evil.' The whole conversation stopped, but then people challenged his assumptions. We ultimately decided not to do what was proposed, because it was evil." Similar conversations occur regularly in all corners of Google, where "Don't be evil" serves as as an organizing principle about values.[a]

In 2004, Sergey Brin and Larry Page expanded on the topic of being evil in their "Letter from The Founders":

> *Don't be evil. We believe strongly that in the long term, we will be better served, as shareholders and in all other ways, by a company that does good things for the world even if we forgo some short-term gains. This is an important aspect of our culture and is broadly shared within the company.*
>
> *Google users trust our systems to help them with important decisions: medical, financial, and many others. Our search results are the best we know how to produce. They are unbiased and objective, and we do not accept payment for them or for inclusion or more frequent updating. We also display advertising, which we work hard to make relevant, and we label it clearly. This is similar to a newspaper, where the advertisements are clear and the articles are not influenced by the advertisers' payments. We believe it is important for everyone to have access to the best information and research, not only to the information people pay for you to see.*[b]

a. "The 70 Percent Solution: Google CEO Eric Schmidt Gives Us His Golden Rules for Managing Innovation," *CNN Money*, November 28, 2005, http://money.cnn.com/2005/11/28/news/newsmakers/schmidt_biz20_1205/.

b. http://investor.google.com/ipo_letter.html.

But Google still needed to determine how to make money from advertisers, so Brin and Page looked to an analog for ideas. Overture Services was providing searches on a paid-listings basis, so inspired by Overture, Google incorporated the concept of paid listings into its search (and later paid Overture to settle a lawsuit in which Overture had charged Google with violating its patents. Using analogs is good, but watch out for patents!). When a user searched for information, relevant ads would show up on the search results page, and advertisers were charged for each ad impression. Later (Plan D) Google would switch to a cost-per-click model.

But unlike Overture, Google's ads appeared in rank order with the most relevant ads appearing at the top of the page. Sticking to their guns, another leap of faith, Google did not allow advertisements on their home page, nor did they allow unsightly, distracting banner ads. They were also careful to make sure that users knew which of their results were sponsored ads versus results that were unsponsored (i.e., purely informational). "There's a clear, large wall between the objective search results and the ads, which have commercial influence," said Brin. "At Google, the search results cannot be bought or paid for."[7]

Google also thought about how to make it quick and easy for advertisers to sign up. It automated the process, which lowered its operating costs. This also made the process more affordable, allowing smaller companies—which make up the bulk of the economy—to get into the Google mix. Once advertisers signed up, their ads appeared almost immediately. By combining the best ingredients from their PageRank algorithm and an analog, Overture, Google finally had iterated its way to a revenue model that popped.

As things turned out, everyone won. Advertisers went gaga over Google's truly targeted, high-traffic medium for their ads. Users benefited from having both the most relevant information and relevant ads displayed prominently, with a transparent source. By the middle of 2000, Google was fielding 15 million searches per day. In 2001, Google had its first profitable year, with $86.4 million in revenue and $7 million in profits. By 2002, revenue had increased to $439.5 million with profits of $99.7 million.[8]

Google Looks for More

In 2002, things looked good for Google. The company's revenue far exceeded its costs. The founders were millionaires. Why not stop there? Is it pure avarice that motivates a company like Google to continue to look

for revenue-making opportunities? Not really. Staying ahead of the pack ensures sustainability. The better you are at what you do, the harder it is for others to replicate your product or surpass your performance. The more reach you have in the marketplace, the tougher it is for your competitors to catch up.

So Google reinvented its revenue model yet again. Who else might pay for Google's knack for searching and its deep pool of advertisers? The company took a close look at some of the companies displayed on their own results pages. These company Web sites often offered searches of their own. Might there be a way to incorporate Google's search technology and advertisers on other companies' Web sites?

TripAdvisor, an online travel community that provides information and customer reviews of hotels and tourist attractions worldwide, was among the first to see the potential. Here's how it worked. Say, for example, we were going to take our spouses to the Greek Islands for a weeklong vacation and some joint work on this book (a great idea in hindsight, but we've thought of it too late!). As we searched the TripAdvisor site for "Santorini," dozens of hotels and reviews would appear, alongside a few targeted, sponsored ads. Google served these ads. And if we chose to click the ad for bed-and-breakfast listings in Greece, then Google would collect payment from the sponsoring advertiser. TripAdvisor and Google would split the payment.

How effective was this new partnership-based revenue model? In 2003, Google grew to $1.5 billion in sales, more than triple the prior year's revenue, with a modest increase in profits to $105.6 million. By 2004, according to Google chronicler David Vise, "Most of the growth and half of sales were coming from a growing network of websites that displayed ads Google provided."[9] Further innovations on the Google model continued, and by 2006, Google surpassed $6 billion in revenue with $1.5 billion in profits.[10]

Lessons from Google

Google's ascendance, achieved in just ten years, is a classic case of not resting on one's laurels, but instead relentlessly searching for even better ways of generating revenue, with whatever new revenue model might apply. The Google story shows how a key analog, Overture, helped Google eventually uncover a pressing customer pain—better-targeted ads for advertisers—that turned Google into something much more than the world's fastest growing search engine.

The Google story also shows us that, if you are really, really fortunate, you can survive for a while without any revenue model at all! Hotmail, MySpace, Facebook, and others would eventually reach similar conclusions. Such a path is a risky one, however, and most who travel it end up in the gutter. When the music stops, if your business does not have a seat at the revenue and cash flow table, the game is over. At some point, revenue from paying customers is essential.

The Google story offers some wider lessons as well. We've seen how its progress was guided every step of the way by a crystal-clear focus on a core purpose: organizing the world's information and making it universally accessible and useful; and core values: don't be evil.[11] Being clear about why your company exists and the values you wish to follow can provide a useful lens through which to examine possible alternatives to your current and future revenue models.

Finally, we note that Google produces many of its breakthroughs by actively embracing innovation throughout its organization, not just at the top or in an out-of-the-way new product development organization. Google engineers are expected to spend 20 percent of their time working on projects of their liking. Many of today's Google offerings stem from this program—Google News, Google.org, which is helping the U.S. Centers for Disease Control and Prevention to monitor outbreaks of the flu, Froogle, and Gmail, to name a few. Finding new ways, new revenue models, for your company to encourage users or customers—advertisers, in Google's case—to send you money is a task that most companies don't delegate widely enough. How many companies have the courage to ask their employees to spend 20 percent of their time working on some innovation that's not really their job? Does yours?

Unlike Google, our next company expected revenue from day one. But would customers send money? Initially, the answer was not encouraging.

Case 2: Silverglide Surgical Technologies: Customers Love You, but Are Not Spending Much Money

Silverglide Surgical Technologies is a story of an entrepreneur, Jonathan Thorne, who did not want venture capital funding and the restrictions that

come with it. He wasn't based in Silicon Valley. And in the late 1990s, he wasn't focused on the Internet craze. Thorne's is an instructive story of a typical entrepreneur's journey toward a revenue model that works, and about listening to and acting upon early customer feedback. And his is a story that shows how the various components of a revenue model—bulleted at the outset of this chapter—can come together when your revenue model works.

Like many entrepreneurs, Thorne had tired of working for others. Ready to take his skills and experience out on his own, he founded Silverglide Surgical Technologies based on a patented product he had developed (and had since licensed) while working for his former employer. In this initial leap of faith, Thorne believed that his surgical probe would be particularly attractive to plastic surgeons. His device was reusable. And unlike most electrosurgical instruments, it would not stick to human tissue. As he put it, "Sticking tissue can cause complications that mar the final appearance of the surgical procedure."[12] The probe, with its proprietary nonstick technology, effectively cauterized bleeding at the point of incision, a crucial step in nearly every surgical procedure. And it did so without sticking, a significant source of frustration for plastic surgeons.

In early 1998, with $80,000 worth of backing from family and friends, Thorne, the engineer, and his partner, Kevin Morningside, an expert in regulatory compliance for medical products, launched the company. By December, Silverglide had won approval from the Food and Drug Administration (FDA). In early 1999 Thorne and Morningstar started making sales calls and presenting at surgical trade shows. They made some headway with a few plastic surgeons who raved about Silverglide's nonstick probe. However, they counted just $5,775 in revenue by July of that year. And Silverglide had burned through $54,000 of its initial capital. Plan A was not working.

Thorne's Quest for a Revenue Model That Would Work

Jon Thorne had simply assumed that if he built a better mousetrap, the mice would come. But the mice were not even sniffing the cheese! Why? There were several possible explanations for Silverglide's modest progress. One was that it had targeted the wrong customer. Another was that a reusable product line provided too little motivation—too few repeat sales—to interest surgical product distributors. Perhaps the surgical probe

was to blame: a surgical instrument that few surgeons would use. Thorne and Morningside had been frugal with their cash—they rarely paid themselves that year—so runaway expenses were not the culprit.

Thorne realized that his revenue model was the problem. Revenue of $5,775 might as well have been zero. And hemorrhaging (no pun intended) their friends' and families' investment was not the business model he or they had in mind.

Thorne took a careful look at his target customers, plastic surgeons. To make a sale, Silverglide had to "convince the surgeon that the probe doesn't stick, and that a probe itself is a useful surgical tool."[13] But Thorne realized that the probe was not a tool that most of them had used before. He didn't have a good grasp of who was going to buy his product. What's more, few distributors wanted to flog his limited and reusable product line (only probes, in only five sizes). Thorne was forced to admit that there wasn't a pressing customer pain that his new tool actually resolved.

Time for Plan B, but Which Way to Turn?

Thorne and Morningstar were convinced that nonstick instruments still made sense. A few early customers of the Silverglide probe had told them that forceps were tools for which sticking was also a problem. And forceps, unlike probes, were used in nearly every electrosurgical procedure. Said one surgeon, "If you can make nonstick forceps, I'll buy them."[14] But developing forceps—a leap of faith—would take all of Thorne's and Morningstar's time, as well as their remaining money. And raising more cash based on the meager results to date probably would not be easy.

There were other questions as well. As Thorne noted, "Plastic surgeons use forceps, as most other surgeons do. But there's another target market that could be attractive: neurosurgery. Sticking tissue is a problem in the brain (a few brain cells here and there really matter!) or near the spine, where they do most of their work. Electrosurgical forceps are one of the neurosurgeon's primary instruments."[15] The Silverglide team wondered whether focusing on neurosurgeons would be a more fruitful route. Neurosurgeons did most of their operations in hospitals. In a given day, a busy hospital might see more than a dozen surgeries. And, since forceps were such a fundamental device for neurosurgeons, an average hospital would have to stock a large supply. Thorne and Morningstar were uncertain of which way to go. Probes or forceps? Plastic surgeons or neurosurgeons?

Which strategy would start the revenue flowing? Or were they already on the right path and just being too impatient? After all, Rome wasn't built in a day!

Though Silverglide's founders had numerous analogs and antilogs from a variety of medical instrument makers serving a variety of markets with which to assess their options, at the end of the day their decision would be not one but two huge leaps of faith. There was no way to know whether one surgeon's statement that he would buy forceps was enough to go on. Thorne knew that what customers say is not always what they will do. He did not even know for sure whether he and Morningstar could apply their growing understanding of nonstick technology to surgical forceps in a way that would work. But he knew that Plan B and its revenue model would *have* to work.

Fortunately for Silverglide and for Thorne's investors, Thorne's Plan B—and then his Plan C—found traction. One step at a time, Thorne moved from probes to forceps, from plastic surgeons to neurosurgeons, and on to a wider range of other nonstick surgical instruments for use by an increasing range of surgical specialties. By 2002, with revenues north of $700,000, at sharply higher pricing, Silverglide's cash flow turned positive. Thorne and Morningstar were out of the woods.

It took about four years for Silverglide to develop a healthy revenue model. But once Silverglide got there, surgeons had clear reasons to buy Silverglide's nonstick forceps. Frustration with sticking forceps proved to be a *real* customer pain. Better yet, the pain was sufficient to earn premium pricing. And with the range of sizes that were required, the money generated from each sale was attractive. Suddenly distributors, too, had reason to energetically sell the Silverglide line. Not long thereafter, other companies saw value in what Silverglide's technology offered. In 2006, Thorne and Morningstar sold the company to Stryker, a diversified medical technology company, for a price that could reach fifteen times revenue, assuming its future projections panned out.

Lessons from Silverglide

From Silverglide we've seen the power of focusing on winning a significant share of a very narrowly defined target market, an objective that, most often, is far easier to accomplish than winning a small share of a very large market, at least at the outset. Why? Focusing helps you better understand

your customer, thereby helping you learn what a better Plan B revenue model might look like. What sort of needs does your customer really have? What benefits must you deliver to convince them to buy? Focusing also limits the resources you need, whether people or capital, thereby enabling you, the founder, to do fewer things better and to keep more of your company once you get things figured out. It's far easier to change from Plan A to Plan B if you've not already burned millions of dollars of your investors' money. (If that's what you've done, by the way, your investors may well embrace a change from Plan A to Plan B, but they may decide that you'll no longer be on board for the journey!)

The Silverglide story also shows that there's more than one way to build a multimillion dollar company. Rather than raising venture capital and shooting for the moon, Thorne proceeded carefully and experimentally, hoarding cash until he had a Plan C that worked. This strategy has its risks—a competitor may pass you by, for example, leaving you in the dust—and is not for everyone, but it's often worth considering. The entrepreneur as risk manager rather than risk-taker is much more common than the folklore reveals.

The Silverglide story is a typical one, especially for technology-driven companies. Most of the time, whether in B2B or in consumer markets, the initial application of the technology, the initial product or services, or the initial target market does not turn out to be where the real money is eventually made. We've seen it with PayPal in the introduction, with Pantaloon in chapter 1, with Aggregate Knowledge in chapter 2, and yet again with Silverglide. Iterating your way from Plan A to Plan B to find revenue you can count on is beginning to look like a road well traveled. But once you find willing customers, do they necessarily stay with you? Let's turn to the story of Shanda Interactive, whose revenue model worked for a time, but then lost its fizz.

Case 3: Shanda Interactive Plays Games in China

The Shanda story shows us that in consumer markets, breaking through to a better business model is not always about resolving customer pain. Sometimes providing consumer delight—an experience so captivating that customers can't get enough of it—is an equally attractive path.

Along with his wife and younger brother, Chen Tianqiao founded Shanda Interactive Entertainment in China in December 1999. Shanda's Plan A was Home Valley, an online virtual community that allowed users to enter and explore virtual fantasy worlds.[16] Unfortunately, Home Valley didn't prove to be the colossal success Chen had envisioned. Users just weren't interested. He soon abandoned ship, but remained committed to finding another way to tap into online communities.

Finding Analogs to Uncover a Product That Will Sell

As Chen looked for analogs to learn from, he saw that the online gaming industry showed promise. In September 2001, Chen jumped into the deep end. His humble goal was to emulate the likes of Bill Gates, doing for gaming and entertainment what Gates had done for software. He started by importing three massively multiplayer online role-playing games (MMORPGs, for short) from South Korea. MMORPGs are online environments in which a large number of individuals can interact and compete with one another at the same time. If you want to serve a large market like China, with its population of 1.3 billion, why not serve lots of customers all at once? MMORPGs would be Chen's Plan B.

First, Chen made certain that his new games were suitable for the Chinese market. His team modified the South Korean games, making their look and feel appeal to the Chinese audience. Next, Chen pondered his revenue model. Should he ask users to pay each time they logged on to play? Or would a subscription model be better, so that users could access the game as often as they wanted? Chen chose the latter as his leap of faith. He would sell prepaid, pay-to-play cards online through Internet cafés and at convenience stores. His prepaid model meant that users required only Internet access to play Shanda's games. This was particularly important, he reasoned, as many Chinese gamers didn't have high-speed Internet access at home.[17]

Chen's revenue model worked like a charm, proving his leap of faith in the prepaid pay-to-play model. In 2003, Shanda took in $76 million in revenue, not exactly matching Bill Gates just yet, but off to a very good start. In May 2004, with international interest in the Chinese market surging, Chen took Shanda public in an initial public offering on NASDAQ in the United States. He raised $152 million, enough cash to fuel even more rapid growth. By the end of 2004, Shanda's revenue had more than doubled to

$165.2 million, and 1.9 million users accessed its games in the fourth quarter alone.[18] In 2004, at the age of thirty-one, Chen was named the second-wealthiest man in China, worth just over $1 billion.[19] In 2005, Shanda earned revenue of $245.7 million and a market capitalization of $2.6 billion, the largest of any Chinese Internet company. Chen was on top of the world, right? Not so fast.

A Changing Market Requires a Plan C

Actually, Chen was getting worried. Four years after Shanda's entry into the Chinese gaming market, its games were losing their stickiness. Its number of average concurrent players slid precipitously to 233,000 in the third quarter of 2005, down from 381,000 in the previous quarter. The June entry of *World of Warcraft*, a competitors' MMORPG with fresher graphics, was stealing Chen's customers.[20] The young Chinese gaming population was getting restless, wanting more from their gaming experience.[21]

Chen had wealth on his side but knew that the tide was turning. Should he stay the course and hope that he could continue to collect on his still reasonably popular game? Or, should he do something drastic? The key questions on his mind were around pricing: what and why will customers buy, and on what basis will they continue to pay? Another leap of faith was on the table.

Audaciously, perhaps, Chen decided to turn his revenue model on its head. In late 2005, observing that several top titles in Korea—still a relevant analog—had gone to a free-to-play revenue model, Chen made two of Shanda's most popular role-playing games, *Legend of Mir II* and *The World of Legend*, free.[22] His goal was to shift his revenue model from one dependent on gaming subscriptions to one reliant on the sale of virtual weapons and costumes for virtual characters, or avatars. The new revenue model invited new, less diehard players to play the older games, and it also extended the lifecycle of each game.

In effect, Chen was betting the company on a bold new strategy underpinned by a new revenue model. Chen's Plan C, in essence, was to evolve from a pure online gaming company to an interactive entertainment and media company, to be "China's Disney," as Chen put it.[23] The Bill Gates software analog was out. Walt Disney's entertainment analog was in! Chen would develop new characters like Disney's Mickey Mouse and market them widely, in many ways.

To become this new breed of company, Chen believed that it was in Shanda's best long-term interest to both expand its user base and increase its average revenue per user. Shanda's goal was to attract gamers and then, when they were online, to sell them books, movies, music, and other forms of digital entertainment.[24] Zhou Donglei, Shanda's director of business development, said, "Instead of hanging around and waiting for these older games to lose more and more users, we proactively changed the revenue model."[25]

Following his new Disney analog, Shanda also added another dimension to its revenue model. Chen and his team started selling products such as dolls, action figures, and cartoon books in retail stores. "The revenue coming from the game-character product business is four times more than that from the game itself in mature markets such as America and Japan," Chen said.[26] Observing the hot demand for electronic gaming devices in Western markets, Shanda also started selling a new product, a small set-top box (called the EZ Station) that provided access to games and video content to be played on an owner's TV.[27]

As Chen had warned, however, the effects of these changes on Shanda's performance were not pretty. Revenue continued to slide, and in the fourth quarter of 2005, profits turned to losses and Shanda lost $69 million. The company's shares plummeted to a fifty-two-week low of $12.36 by April 2006.[28]

Shanda's weak results didn't last long. "The move to 'free-to-play' was not easy, but it was the right one," Chen said.[29] In February of 2007, Shanda reported better-than-expected 2006 fourth-quarter earnings of $22 million, with the 2006 year as a whole delivering $67.8 million in earnings, up more than threefold over the company's $21.3 million in 2005.[30] Chen remained optimistic about what the new revenue model would bring: "The (new) model was proven to be successful in 2006, and we will enhance it in 2007."[31] Indeed, Shanda's revenue rose nearly 49 percent to $337.8 million. And in 2008, Shanda's population of registered—and, in many cases, captivated—users hit the 20 million mark.[32] In another move towards its goal to become a more complete media company, Shanda has acquired three literature Web sites since 2002. In June 2008, the company combined these to form Shanda Literature Limited, which tallies more than 20 million registered accounts.[33]

Lessons from Shanda Interactive

From Shanda, we've seen the power of analogs to help an aspiring entrepreneur break through from an initial Plan A that flopped to a better Plan B and to a Plan C that struck NASDAQ gold. Along Shanda's journey, we've seen the power of analogs for building and adapting one's revenue model. Not once, but twice, Chen copied the South Koreans to get his business back on track, and then Walt Disney. There is nothing wrong with emulating or recreating an effective model. Mimicry, as the saying goes, is the sincerest form of flattery.

But we've also seen just how difficult it can be to remain competitive in industries where imitation is easy and competition rampant. Changing how customers pay for their products provides one alternative for staying ahead of the pack, though changing the basis on which customers pay is easily imitated, too. Thus, in industries where differentiation is hard to sustain, long-term success often comes down to superior execution. Will Chen and his team be able to regain the former $2.6 billion market cap that Shanda once enjoyed? Time will tell.

Lessons Learned About Revenue Models

At the outset of this chapter, we identified the key questions that need to be asked to develop or redevelop a revenue model:

1. Who will buy?
2. What will they buy?
3. Why will they buy?
4. How soon, how often, and how many will they buy?
5. With what effort and cost on your part?
6. At what price will they buy, and on what basis will they pay?

For all three of the companies highlighted in this chapter, Plan A generated little or no revenue. But their subsequent plans, with more fruitful revenue models, created breakthroughs. As they evolved, each company found better answers to one or more of these revenue model questions. So what have we learned in this chapter about building a revenue model,

whether for Plan A or Plan Z, that will work for you? We hope two themes will have hit home:

- The importance of resolving customer pain (the Google and Silverglide cases) or providing consumer delight (Shanda)
- The need for actual evidence of how customers are likely to respond

Let's elaborate briefly on each of them.

Painkiller or Delight: Choose One or the Other

At the foundation of almost every business-to-business revenue model that bears fruit—and many revenue models in consumer markets, too—is the notion of resolving some customer's problem or pain. As renowned venture capital investor John Doerr points out, "Great business opportunities emerge from solving big, painful problems."[34] Alternatively, in the case of some consumer-focused businesses, rather than resolving pain, the new venture delivers what we call consumer delight, a new level of consumer satisfaction in a previously boring, perhaps uninspiring, hum-drum category. Think Starbucks and its coffee experience. The Walkman—and later the iPod—for portable music. Or Andrew Lloyd Webber's long-running hit musical, *Phantom of the Opera*, in London's West End.

If your Plan A neither resolves customer pain nor delivers consumer delight, why should the customer divert her precious cash to your company? The good news is that customer pain can be found practically everywhere. Try making a bug list—a list of things you encounter that are not quite right, or not done as well as you think they could be done. Its length will surprise you! Whether you can come up with solutions for which customers will pay is a lengthier task, of course.

Ground Your Revenue Model in Evidence

We've also learned that at every step, evidence is required, to show, with some confidence, that the revenue you foresee will actually materialize. Analogs and antilogs are your best starting point for gathering such evidence, because they—unlike much of what passes for marketing research—are based on actual history of what customers (albeit customers of other companies, most likely, not yours) have done. Talk is cheap; actions are what count.

But, at some point, analogs and antilogs will leave you with one or more crucial leaps of faith. At these junctures, you must build hypotheses and test them, with marketing research if you must, or better yet with real-world, in-the-marketplace experiments, guiding your journey with dashboards and course-correcting as you go. We've already seen how this process works in chapters 1 and 2. In this chapter, we have learned that to develop your revenue model, you'll have to find evidence that responds to some crucial questions. Who will buy? How much will they pay? and so on. (See the checklist at the end of this chapter for a concise reminder of the things for which this evidence is required.)

Q&A with John and Randy

Having come this far on your revenue model there are three questions that probably remain:

- How will you know which customers to target?
- Where should you look for the right analogs and antilogs for your revenue model? How, specifically, should you gauge a company's revenue performance?
- How will you know whether your analogs are likely to hold true?

How Can You Know Which Customers to Target?

It's a matter of insight into their customer pain. Sometimes, customers will tell you what hurts, as one of Silverglide's surgeons eventually did ("If you can make non-stick forceps, I'll buy them"). As we have seen, focusing clearly on a narrowly defined target market can aid in this learning. If the customers respond, great. If not, try another target. Unless you are very insightful—or lucky—iteration and experimentation will probably be necessary.

Where Should You Start to Find Analogs or Antilogs That Will Provide Useful Insights for You?

From all three of the companies profiled in this chapter, we've learned that analogs and antilogs are out there, just waiting to be identified. And in your case, waiting for you to apply them—for free!—to your current plan.

inspiration for Barbara Cassani and her team and a key ingredient in Go's ability to attract and retain its early customers.

We've seen that even in an established company, if you can beg, borrow, or steal what you need, so much the better. Lease, don't buy, at least at the outset, because it saves precious cash. If you can outsource instead of building from scratch, that may get you far enough down the runway to prove whether your plans—or planes—will fly. You can probably revisit such decisions later, after breakeven is achieved. And outsourcing usually saves time, too, getting you into business quicker.

Another lesson Cassani learned about starting a venture inside an established company was to move her operation out of BA's mainstream, so she and her team could do things differently. In an established company, it's hard to build an inherently different business model from the one already in use. Setting up an office that is away from the glare of the corporate floodlights can be very helpful.

Finally, Cassani's team knew that a viable investment model must not only minimize or offload the costs of getting started. It also had to minimize early operating losses until breakeven was reached. All too often, entrepreneurs or those starting ventures inside big companies assume that profits will ensue almost from day one. It's a fantasy, we're sorry to say. You must include in your thinking about your investment model the losses you will incur until you reach cash flow breakeven, your burn rate, as venture capital investors call it. And as any experienced entrepreneur or investor will tell you, it will probably take twice as long, and three times as much money, as you expect!

Lessons Learned About Investment Models

We said at the beginning of this chapter that a key goal of any investment model is to find a way to get the business started and to cash flow breakeven with as little investment as possible, while including some cash cushion for iterating to Plan B. There are exceptions to this rule, such as where network effects are central to the strategy, as for Skype; where economies of scale make it necessary to "get big fast," as we'll see in the Amazon case in chapter 8; and where a competitive footrace must be won. In such cases, raising more capital may be in order. But generally, whether it's your money or others', leaner is usually better. So, since

money doesn't grow on trees, what are the lessons for building your investment model?

- Counterintuitively, when it comes to raising capital, less can be more.
- There are trade-offs involved in taking institutional venture capital that it's wise to understand before pursuing that route.

Less Capital, or Later Capital, Can Be Better

Most of the time, identifying your leaps of faith and testing hypotheses to prove or refute them is best done on less cash invested, wherever possible, rather than more. You may view disconfirming results of your hypothesis tests as good progress. But not all your investors are likely to agree! If you've burned a lot of their money on hypothesis testing, they may not be happy.

Thus, for entrepreneurs, asking for £25 million up front, as Cassani did, is usually a bad idea. Why? All the risks lie ahead of you, and your investors will want to be compensated for those risks through a larger stake in your company. Staging your investment so that more capital comes in after key leaps of faith are tested and milestones met will probably leave you and your team with a larger share of the company than if you ask for too much cash too early. Perhaps more important, if Plan A does not work and you must move on to Plan B, you'll have a better chance of raising more capital if you've not already burned too much of it. Who wants to give money to someone who goes through capital like it's water?

So identify your analogs and antilogs, develop your leaps of faith and a plan to test the hypotheses that grow out of them. Then raise just enough funding to get through enough tests so that risk drops significantly, after which you can raise more capital on much better terms. Knowing the size of the stash you'll need to cover hypothesis tests that don't pan out isn't easy, of course. It's an approach that's not for the faint of heart, but it will help you remain frugal and keep your eye on the ball.

The Trade-offs Involved in Taking Venture Capital

As John tells his students, "The day you take a dollar or pound or rupee from most venture capital investors is the day you have agreed to sell your business." Why? Investors, perhaps unlike you, aren't in it for the ride. They are in it for the liquidity, most commonly achieved by selling your

(and their) company, as happened in both of the cases in this chapter. They sold Skype to eBay and Go to easyJet. The little-known secret is that nowadays the vast majority of venture capital exits are the sale of the company to another, larger company. Initial public offerings happen—think Amazon or Google—but not very commonly.

So, if you have a start-up in mind and you are developing your investment model, think carefully about what your entrepreneurial dream holds for your future. Do you want to run your company for a long time, at the risk of undercapitalizing it, or do you want to accelerate it with venture capital at the risk of harvesting it with a sale, and, like Skype's Niklas Zennström and Janus Friis, do it all over again?

As Randy points out to his students and to the companies that his fund invests in, the best venture capitalists add significant value through their networks and their experience, alongside their capital. They also reduce risk by having learned how to build companies from scratch. It's their everyday job. They've seen numerous analogs and antilogs and they've known some of them intimately. What they offer you is a smaller slice of what may become, with their capital and assistance, a much larger pie. These are real pluses. But because it's their money, what comes along with their capital is their significant participation in your company's destiny, for better or worse, and in your role therein. And if you and they don't agree? Well, their money bought them a seat at the table and they are entitled to their say.

If you need lots of capital to prove or refute your leaps of faith or to cover the investment required, venture capital investors are about the only sources from which you can raise it. So if you build an investment model that requires venture capital, do so thoughtfully and deliberately, not just because venture capital is the "cool" thing to do.

Q&A with John and Randy

By now we hope we have convinced you to think carefully about building your investment model and how much cash you really need—or don't need. But there are probably a number of questions about how to really build it still swirling in your head. Among them may be these:

- It's easy to say you should try to get by on less up-front investment. But how can you really do it?

- How should you decide which sort of investor—3Fs, angels, or VCs—is right for your venture?
- How open should you be with prospective investors about your pitfalls so far in getting to Plan B?
- What if you're in a large company? Do the lessons of this chapter still apply?"

Getting By on Less Cash

As you build your investment model, don't let your first draft be your last. Think twice—and then twice more—about the cash you'll need to get started and to get to break-even cash flow. Then consider how you can put a bold red line through each of the items. Can you borrow it? Lease it? Delay it? Outsource it for less cash up front, even if it costs a bit more? Or even get somebody else to pay for it? Can you turn fixed costs (which increase your risk of running out of cash) into variable costs, even though doing so will cut profit margins, at least in the short term? Doing these things to trim your need for cash can give you a longer runway for identifying leaps of faith and testing hypotheses and can transform your risk and your overall business model. Drawing those red lines and then implementing the steps they imply—finding lessors or outsourced suppliers, for example—can let you get started on building your business, rather than spending your precious time beating a trail to investors' doorsteps with little more to show than your still-unproven idea and a slide presentation.

What Sort of Investor Is Right?

Once you are on to an investment model that will enable you to test some key leaps of faith and maybe get a first customer on less money than you had ever thought possible, choose the right sources for your initial funds. Banks? Forget it, unless you care to max out your personal credit cards or mortgage your house, neither of which is likely to make your mom or your spouse very happy. Banks are a waste of time at this point, because they'll usually only lend against collateral or proven cash flow. Your nascent business has neither.

What about seasoned business angels or venture capitalists? There's a time and place for their money and expertise, but, unless you have relationships with VCs or angels, testing your initial leaps of faith is probably

better done with money from two of the three Fs, family and friends. Why? They love you! Tell them up front that Plan A almost certainly won't work, and that they'll probably lose the entire grubstake you've asked for. Then, if Plan A fails, you and they won't feel quite so bad. Keep them informed of your dashboard results, and whatever the outcome, they'll still love you. And maybe, if you are lucky or smart, their modest amount of cash will get you to Plan B.

Once you have iterated your way toward a better business model, though, you may decide that, with some key milestones met and risk correspondingly reduced, professional investors—whether angels or VCs—can provide useful business-building skills and cash to boot, all of which can help you build a successful business for the long term.

How Open Should I Be About My Journey to Plan B?

Ideas, as the saying goes, are a dime a dozen. An idea that has been at least partially proven, with the concept shown workable and a few customers on board, is a whole different animal. Simply put, the farther along you are, the lower the risk.

With a bit of experience filling your sails, investors' worries shift from proving the concept or demonstrating marketability to whether or not you and your team can execute. So talking prospective investors through your dashboarding journey to date—and the next steps in your plan—is a good idea. They'll probably appreciate that you understand the risks and that you're willing to take prudent leaps of faith and test the hypotheses that grow out of them.

What If I'm in a Big Company?

In our experience, the principles in this chapter—minimizing the capital you need, staging its commitment, using analogs from outside your industry, and so on—hold for ventures inside large companies as they do for raw start-ups. The same logic applies.

What's Next?

We have now seen how each of the five elements of your business model can form the bedrock of a Plan A or Plan B that will work, and may, if you're sagacious and a little lucky, wreak havoc with your competitors.

Really, though, as you probably have noticed, it takes more than just one of the five elements to create a winning business model that will stand the test of time. For each of the examples we've seen so far, there were other business model elements that also came into play, though perhaps less prominently or fundamentally than the ones we focused on. Thus, in chapter 8, we bring the business model elements together by examining companies whose business models, by design, were truly multidimensional.

John and Randy's Investment Model Checklist

Building your investment model looks easy on the face of it. Just add up the costs of everything you'll need to get started, and ask for the money! Nothing, really, could be further from the truth. There are two key phases in your investment model, and each has questions you'll need to answer with evidence.

The prelaunch phase

- ✓ What are the hard assets—facilities, equipment, and so on—you'll need prelaunch? What will they cost to buy, rent, or lease?
- ✓ What are the development activities that must be completed before you can launch? What will they cost?
- ✓ What are the leaps of faith you can test prior to launch? What will it cost to test them?

Now think twice, and twice more: which of the above can you delay or find a way to do without, or do more primitively or simply? Fancy can wait.

The postlaunch phase, until you hit cash flow breakeven

- ✓ What revenue and gross margin can you generate to contribute to your ongoing costs?
- ✓ How lean an operating model can you run pre-breakeven?

Finally, every leap of faith tested, every milestone met, reduces risk. The later you can wait to raise each round of money, the better the terms on which you can raise it. Thus:

- ✓ Which key leaps of faith, if proven, will signal stepwise reductions in risk? How much cash—see above—will it take to reach each of them, and how much of your funding can be postponed until later?

CHAPTER 8

Can You Balance a One-Legged Stool?

Multidimensional Business Models

WE HAVE GONE EASY on you in the previous five chapters. Taking the five elements of the business model one step at a time, we've had the luxury of examining each element under a microscope. We've seen little-known newcomers like Silverglide and Shanda, well-known start-ups like eBay and Costco, and long-established companies like Toyota and Dow Jones employ one of these elements as a foundation for their success.

Business is never so straightforward. Metaphorically speaking, what each of these companies built was not a one-legged stool. Their business models were, in reality, multilegged. One leg—the key business model element on which our earlier analyses focused—was made of solid steel, providing rigid, unwavering support. But the other business model elements, to which we gave little attention, were also in place. They provided balance and stability, perhaps even elegance and grace.

What's more, companies are successful when the five elements of their business models work together, like the different instrumental parts—strings, brass, reeds, percussion, and so on—in a Mozart symphony. Toyota's gross margins were impressive, but wouldn't have meant anything had the company not had a revenue model that made customers want to drive Toyotas and an operating model that was as efficient as its gross mar-

gin model was lucrative. Go's investment model worked for two main reasons: (1) because Barbara Cassani and her team soon found their way to Plan B, a better revenue model serving sunny Spanish resorts; and (2) because her focus on costs of all kinds, not just investment, made Go's gross margin and operating models work efficiently, too.

Goal for Chapter 8: Pull your Business Model Thinking Together to Build Economic Viability and Sustainable Competitive Advantage

In this chapter, we examine three highly entrepreneurial companies whose success rested on a combination of the business model elements in chapters 3 through 7, where no single element stood out. Instead, their farsighted founders wove an intricate combination of two or more elements into difficult-to-imitate patterns that made them economically viable and gave them rapid growth and sustainable competitive advantage in three of the most hotly competitive industries on the planet today: apparel retailing, wireless telephony, and Internet retailing. Each of these stories shares three common themes:

- The business model grew out of a customer-focused strategy. The key benefit to be offered to customers—the customer promise—was crystal clear at the outset and remained so.
- The founder created a thoughtful combination of two or more business model elements—a strategy for the business—that was fundamentally different from current industry practices, the industry's existing Plan A.
- The strategy had favorable implications for generating and sustaining positive cash flow thereby enabling the founder to rapidly grow the business, too.

As such, the examples vividly illustrate a key contention we hold: that creating one's business model—considering one element at a time and all of them together—is a fundamentally strategic activity. The strategy, as expressed in the five business model elements, is what drives cash flow, profitability, and growth, as ultimately reflected in the financial statements, whether planned or actual. Thus, in our view, the financial statements,

rather than being a driver or goal of the business creation process, become simply the *by-product* of clear and disciplined strategic thinking. Analogs, antilogs, the leaps of faith that follow from them, and the well thought out dashboards that measure the outcomes of the hypothesis tests are what make this process happen. And the business model that results—a revenue model, gross margin model, and all the rest—is the output of the process.

We will now view three cases through our business model lens, to show how and why their multidimensional business models worked successfully:

- Fast-growing Spanish retailer Zara exemplifies the balanced approach to its business model, bringing success from the outset with its initial Plan A.
- Amazon.com, now much more than a bookseller, has woven its business model together into a more efficient operation as it iterates toward its Plan Z.
- Celtel International, the hugely successful mobile telecom operator serving sub-Saharan Africa, built a strong multidimensional business model that operated beautifully from day one.

We'll also see how each of these companies, like Southwest in the airline industry, broke industry rules to create a disruptive Plan B, a new business model for its industry (apparel retailing, online retailing, and mobile telephony, respectively) that has stood the test of time and that, in Zara's case, defies imitation, even today.

Case 1: Zara Invents Fast Fashion

In 2008, Inditex, the Spanish-based retailer, operated more than one thousand Zara stores and nearly three thousand others in over seventy countries. Its flagship chain, Zara, sold women's, men's, and children's clothing and accessories. Daniel Piette, the fashion director of the French luxury goods group LVMH, described Zara as "possibly the most innovative and devastating retailer in the world."[1] Chic: yes. Profitable: yes. High-priced: no.

Zara's is a story of how a carefully crafted combination of sourcing, merchandising, and distribution strategies created a unique new pattern of revenue, gross margin, and working capital models that enabled Zara to grow like wildfire and take its young fashionista customers by storm.

Early in his life, Amancio Ortega worked in a small retail shop in his hometown of La Coruña, Spain. In the early 1960s he started designing and producing garments on his kitchen table, opening his own store in 1963.[2] His goal was to make and sell garments—housecoats in particular—for "cheaper than anyone else."[3] Twelve years later, espousing the same mission, Ortega opened the first Zara store, offering fashionable clothing at affordable prices. Throughout the 1970s and 1980s Ortega opened Zara stores across Spain. International expansion followed, throughout Europe, the Americas, the Middle East, and Asia in the 1990s. In its public offering in May 2001, Inditex, Zara's parent company, raised $2 billion for 26 percent of the company. By fiscal year 2006, Inditex passed the €5 billion mark in sales and was highly profitable.[4] How did Zara do it? Let's explore its strategy in light of its gross margin model first, in contrast to that of another apparel retailer, Gap.

Zara's Fast Fashion Strategy Boosts Gross Margins

To get a sense of just how dramatic Zara's entrance into the retail market was, consider fashion retailer Gap (founded in 1969). If you have never been to a Gap store, let us describe what you would see. Usually you'd find yourself in a fairly spacious store chock full of clothing for men, women, and sometimes kids. Typically, the back quarter of the store would be reserved for sale racks, and it would seem as though literally 25 percent of the clothing was marked down.

In contrast to its Gap antilog, markdown merchandise will rarely be found at Zara. How does Zara avoid marking down its merchandise? First, it prices its apparel affordably from day one, not at some higher price that will then go on sale. However, what is "affordable" varies by country and city. If Parisian customers are willing to pay higher prices than those in Barcelona, Zara sets its pricing accordingly.

Second, and more importantly, Ortega's fast fashion strategy gets the credit. His company's strategy revolves around four processes, all tailored for speed: design, production, distribution, and sales. These processes run so smoothly that it takes Zara as little as two weeks for a new item of clothing to go from design to the store (as much as twelve times faster than its competition).[5] Inditex CEO José Maria Castellano says, "We can create a new fashion line in days. Our competitors manufacture most of their collections in advance. But that involves guessing what customers will want

six or nine months down the line. Our model minimizes the risk of being saddled with lots of unsold stock, and it maximizes full prices because very little gets remaindered."[6] Adds Zara's Carmen Melon, "We only send our stores what they need. There is no stock that doesn't move; we have no extra inventory."[7]

From the start, as part of its strategy, Zara designed its own fashions, often copying a designer garment that, say, Britney Spears or another celebrity had just worn. It treated each new style as a leap of faith, starting with a small production run, rather than placing a bold bet, and testing this small quantity of merchandise in the marketplace. The small runs that Zara created reduced its exposure to fashion faux pas and kept "margin-stripping markdowns to a minimum," said Kris Miller, a New York-based retail analyst with Bain & Co.[8] If the merchandise sold well, as hypothesized, Zara produced more, but not so much more that it would have an overabundance—just enough to sell through the items quickly. If an item didn't do well immediately, the company halted production. "It is our way of minimizing fashion risk," Castellano said.[9] As a result of its limited production runs, Zara rarely had to mark down its goods. In fact, Zara held but two sales each year.

There was one more piece in the Zara tapestry that completed the pattern. While it bought some staples in the Far East—for instance, black T-shirts, which are unlikely to ever go out of style—Zara didn't use low-cost countries, such as China or Bangladesh, to produce its fast fashion production runs. Doing so would have made it impossible to get new styles—some eleven thousand each year[10]—to stores quickly. Instead, the company contracted the assembly of most of its goods to companies in neighboring Spanish and Portuguese towns. By producing its merchandise in Europe, Zara spent about 15 percent more on labor than its rivals did by manufacturing in low-cost labor markets.[11] But the slightly higher manufacturing cost was more than offset by other benefits. Mike Shearwood, managing director of Zara UK, explained why: "The extra margin is superior because there is no wastage, no markdowns, and no problem of getting a collection wrong."[12]

Zara's Revenue Model Lures Shoppers to Return for More

Fast fashion had implications for Zara's revenue model, too. It meant that some items disappeared within a week of entering a store. For Zara

shoppers, this created a feeling of scarcity, as the shopper knew that the item may not be in the store the next time they shopped. "They've built up an excitement around snapping up new clothes before they go," according to Bain's Miller. Scarcity made shoppers more apt to buy an item when they saw it for the first time and it made them more likely to go back to the store often to see what was new. And, for fashionistas who would die if they saw someone else wearing the same outfit, the chances of that happening were considerably reduced.

Zara's Working Capital Model

Manufacturing close to its principal European market and turning inventories quickly was good for Zara's working capital model too. The processes of the Spanish and Portuguese suppliers Zara used were tightly integrated with Zara's systems.[13] This meant that, in return for predictable high-volume business with Zara, these suppliers gave it favorable sixty-day terms. With customers buying their clothes with cash or credit cards, Zara had its customers' cash in hand in less than a week. Fast-turning inventory paired with quick customer cash and slow pay for its merchandise: an attractive working capital model, indeed!

Fast Fashion Versus Slow Fashion

Let's return to Gap to see what all of this means in a competitive sense. Buying most of its apparel in Asia, Gap buyers placed bold bets on which fashions would sell in the upcoming season, still months away. Bell-bottoms or straight legs? Short skirts or shorter? Fuchsia blouses or tangerine? Leaps of faith, all! These big bets were difficult to test, too. Further, Gap was required to pay some of its vendors in advance, before its inbound merchandise was shipped. It used letters of credit to ensure payment to these vendors, tying up cash. In 2006 Gap showed $55 million in "restricted cash" on its balance sheet, representing the letters of credit it needed to pay its suppliers.[14] And once the garments arrived in the United States or Europe in container-sized lots, some sat in Gap warehouses from which store inventories were then replenished. What a difference! Compared with Zara, Gap had more precious cash tied up in letters of credit. More Gap merchandise was sitting in inventory. As a result, Gap suffered far more exposure to the vicissitudes of always-fickle fashion trends. No wonder the back quarter of a Gap store always seems to be on sale!

Ortega's fast fashion strategy and Zara's results speak for themselves. In 2006, Zara parent Inditex became Europe's largest clothing retailer, overtaking Swedish fashion retailer H&M.[15] Gap, whose performance had steadily slipped since 1999, was left in the dust. John Thorbeck of Supply Change, an Oregon consulting firm, puts it succinctly: "Zara has proven that speed and flexibility matter more than pure price. They've turned the old way of doing business on its head."[16]

Growing fast and profitably when times are good is one thing. Perhaps a more stringent test of a robust business model is how fast-growing companies perform when times get tough. As the global credit crunch hammered many retailers' performance in late 2008, Inditex continued to outperform its competitors. For its year ended January 2009, Zara's revenue was up again, to €10.4 billion ($14 billion), up from €9.4 billion in 2007–2008, though earnings were flat at €1.25 billion. Gap, on the other hand, reported an eight percent decline in its full-year 2008–2009 revenue, to $14.5 billion. While many of its competitors resorted to deep discounting to keep the cash registers ringing, Inditex chose not to. "We prefer to stick to our commercial policy even in the current environment," reported Marcos Lopez, Inditex director of capital markets. "The key driver in our stores is the right fashion. Price is important, but it comes second."[17] And a superb business model sure doesn't hurt!

Lessons from Zara's Strategy and Business Model

Why has Zara's fast fashion strategy worked so well, and caused headaches for its competitors? Ortega's strategy favorably impacted at least three of the five elements of Zara's business model:

- *Revenue model:* The customers wanted the latest fashions, and Zara was best positioned to deliver what was hot: "Buy it today, because it won't be here next week. Oh, and come back next week to see what new things we'll have in store." And it was able to make better fashion judgments in season, rather than in advance. Zara had the latest fashions that its trendy customers wanted to buy.

- *Gross margin model:* Initially, Zara's cost of goods sold (COGS) was slightly higher than the Asia-reliant competition, as the company's fashion assortment was produced in more expensive local European

countries. However Zara made up the difference by yielding better overall gross margins, owing to far fewer markdowns than its competitors.

- *Working capital model:* With customer's cash in the till, fast-turning inventory, and generous payment terms from tightly integrated suppliers, Zara was in an excellent position to grow its business on its customers' and suppliers' cash.

Zara competes very successfully in one of the most brutally competitive industries in the world—apparel retailing—and has extended its model to other fashion categories like home furnishings and decor. Amancio Ortega's business model was so ingeniously designed from the beginning that he did not have to iterate much—if at all—to get to a business model, what we now know as fast fashion, that was a disruptive breakthrough for his industry, making life difficult for Gap and others. Best of all for Zara, the model is complex enough that only a few others have been able to imitate it successfully, thereby putting in place Zara's foundation for sustainable competitive advantage for more than two decades. In our view, Ortega, a true visionary and retailing pioneer, is to apparel retailing as Southwest's Herb Kelleher is to airlines.

We now move from high street fashion to the cash-drenched, mid-1990s in the United States. Thanks to the dot-com boom, just about anyone could raise millions in venture capital with a business plan scrawled on a cocktail napkin, or so it seemed. There, at the same time that Zara was choosing next month's fashions, a hedge fund analyst named Jeff Bezos had a very different idea. On a cross-country trip with his new wife—complete with a just-married sign on the back of the car—Bezos put together a plan for an online bookseller, Amazon.

Case 2: Amazon: A Dot-Com Business Model That Worked (Eventually!)

Arguably, Amazon made it through its first nine years of red ink because its investment model—raising boatloads of money from private, then public, shareholders; then the corporate bond markets, too—was fortuitously timed during the frenzied and exuberant days of the dot-com heyday. All

this cash gave Bezos the runway to identify and examine new leaps of faith, one after another, and gave him the wherewithal to continue to invest in the business following the dot-com bust. The story we want to tell here, however, isn't the story of Amazon's early rise and Bezos' restless brilliance. It's the considerably later story—and less-known tale—that interests us. It took Amazon nearly a decade to finally piece together a business model—its Plan Z—that delivered positive cash flow, thereby assuring its long-term survival and impact. That its early success in raising so much cash gave Amazon the staying power to figure things out is undeniable. Without all that cash, Amazon might well have bitten the dust along with many of its dot-com counterparts. But the step-by-step story of how Bezos and his team iterated beyond the red ink is packed with lessons that apply to companies of all kinds, not just dot-com wonders.

Amazon.com launched as a bookselling Web site in 1995. We fast forward to 1999. By focusing his company on the three things customers wanted from an online retailer—the best selection, the lowest prices, and the cheapest and most convenient delivery—Bezos had led Amazon to astonishing growth.[18] His initial "Get Big Fast" (GBF) strategy had worked, in a sense. Revenue for 1999 was $1.6 billion. Not half bad for a four-year-old company. The product assortment had grown beyond books to consumer electronics, music, toys, tools—practically any consumer product you could think of. To support its growth, Amazon's distribution center space had grown from 300,000 square feet to more than 3 million, thanks to five new automated warehouses built in 1999, at price tags of $60 million each.[19]

But Amazon was also burning cash at an alarming rate. Reported losses had mounted to $720 million. In business model terms, Amazon's gross margin model and its operating model were simply out of sync. Despite the soaring sales curve generated by its ever-expanding GBF revenue model, there wasn't enough gross margin to cover the operating costs—warehouses, staff, information technology, and the like. And cash was tied up in a doubling of inventory from twenty-one to forty-nine days in order to head off the poor service complaints that other dot-commers were hearing from customers. But it created a serious problem for Amazon's bottom line and cash flow.

In 2000 Amazon reported losses of $1.4 billion by its year-end. Under the GBF strategy, while revenues were growing, the company had not

managed its skyrocketing expenses very well (recall Patagonia founder Yvon Chouinard's costly wake-up call from chapter 4). There was no formal budget at all.[20] The question often repeated by the business press, "Will Amazon.com ever make money?" grew from a whisper to a full-throated roar.[21] Amazon's stock price suffered, putting into question its ability to raise more cash in the way it had before.

Amazon Tightens Its Belt and Starts Iterating Its Operating Model

Bezos looked outside Amazon to get serious about managing costs and working capital, as well as revenue growth. Bezos brought in Jeff Wilke from AlliedSignal to be Amazon's vice president of operations. Wilke sang a new tune: "Our operational performance this year will be evaluated on the bottom line. If it doesn't show up on the bottom line, we're not working on the right stuff."[22]

In Wilke's view, Amazon's key challenge for 2000 was to learn: "We have a large distribution center network that we built mostly last year, with a huge amount of information technology and nice automation in the right places. Now, we put people into it for the first time, and . . . people who are just learning how this thing works during the holidays are ramping up to a level that the company—in fact, no one—has ever seen. That creates an enormous opportunity to learn."[23]

Over the next year, by automating everything possible, a huge leap of faith, the company improved efficiency.[24] The devil was in the operational details. "Your order spends several hours in our process," said Wilke. In his view, every time a person could touch or influence an order, that touch point introduced the possibility of a mistake. Making mistakes and checking to catch them was inherently inefficient. "So if we can get picking to be 100 percent perfect, we'll never have to go back later in the process and send that bucket of goods all the way to be repicked."[25] Achieving perfect picking saved time, saved money, and made Amazon people more efficient.

In Wilke's view, a key part of the challenge was to improve Amazon's supply chain. By cutting in half the time it took Amazon to get a toy, a book, a DVD, or any other product, Amazon lowered its inventory. Less inventory meant fewer people to handle it, thus lower operating costs. It meant further growth could be accommodated without adding additional distribution capacity, spreading existing operating costs over a wider revenue base.

As its supply chain improved, its internal processes got smoother, and the Amazon people learned how to operate in an automated environment, Amazon's operating model would get better.

Amazon Shaves Dozens of Days from Its Working Capital Model

Wilke's medicine worked magic with Amazon's working capital model, too, enabling inventory to turn much faster, from forty-nine days of inventory in 1999 to seventeen days in 2001.[26] CFO Warren Jenson joined the party, working on the trade terms with Amazon's suppliers. He was able to extend Amazon's accounts payables days from twenty in 1999 to fifty-two in 2001.[27] The result of all these changes was that Amazon's working capital picture shifted radically. As Jenson put it, "We're driving toward negative working capital as fast as we can, because it is an advantage to our business model."[28]

What's more, as Amazon improved its operations and working capital, it was able to improve its service to customers. In reporting the company's 2001 fourth quarter results, Jenson said, "Our improvements in productivity allowed us to lower book prices and now allow us to offer free shipping" on some orders.[29]

Amazon Iterates Its Revenue Model and Gross Margins Soar

Meantime, other Amazon executives were exploring ways to get out of the red. By taking a giant step back, Bezos and his team realized that they had something to sell that generated far better margins than books, DVDs, or lawn furniture. In fact, they were sitting on an enormous asset that could help other companies do business online. At its roots, Amazon was an extraordinary e-commerce platform; a platform that other companies might pay for to support their own e-commerce. Yet another iteration, and another leap of faith. Bezos explained, "We've been talking about ourselves as a 'platform.' It's a foundation or a workbench from which you can do a lot of things. In our case, it consists of customers, technology, e-commerce expertise, distribution centers, and brand."[30]

Amazon iterated its revenue model from a straight e-tailer to an online service provider, selling platform solutions as well as merchandise. First, the company started accommodating third parties such as used-book sellers, allowing them to sell their own goods on Amazon's site. Amazon collected commissions on sales generated by these third parties. We've

already seen how attractive eBay's gross margin model was, and here Amazon was essentially copying the eBay analog, but in a business-to-business setting.

Next, in its first large-platform deal, Amazon provided an e-commerce backbone for the biggest American toy retailer, Toys "R" Us, taking over responsibility for all of Toys "R" Us's e-commerce activities. A large deal with Target, the large U.S.-based discount chain, soon followed. Amazon provided Target with a similar backbone to Toys "R" Us.[31] In return, Target gave Amazon a small cut of its online sales. In addition to its operating and working capital models, Amazon's gross margin model, as the eBay analog predicted, was starting to look better, too, as COGS on these online platform deals was, like eBay's, very modest.

Mark Stabingas, Amazon's vice president of worldwide business development and services sales, articulated the subtle but crucial change in Amazon's strategy. "We're thinking about ourselves as a technology company and a technology platform. The universe of opportunity is larger than if we just want to think about ourselves as a retail business."[32] By selling its platform, Amazon was no longer reliant on individual customers who spent a few hundred dollars a year on goods. Its new customers—corporations seeking online retailing expertise—were willing to spend millions for a proven e-commerce platform. And, there were far fewer costs associated with selling a platform. Amazon didn't have to worry about inventories or warehouses or book publishers or shipping, though in some cases it agreed to do those things too. Amazon spokesman Bill Curry said, "It's important to acknowledge who has what expertise. We have the expertise in online sales, fulfillment, and customer service. We can get to profitability sooner by playing off those skills."[33]

A *BusinessWeek* article summarized Amazon's improving prospects: "With gross margins of 60 percent and higher—more than double Amazon's total gross margins—these (technology services) deals will deliver the cash that could finally push the company into the black. Even more important, such margin-rich revenues address Amazon's perpetual profitability challenge. In 2001, technology-service deals will total about $200 million. That's only 7 percent of Amazon's $3 billion annual revenues, but the business accounts for 18 percent of its gross margins."[34]

As *BusinessWeek* had predicted, by the end of 2001, things were starting to look up. The company's revenue was still growing, from $2.7 billion in

2000 to $3.1 billion in 2001. It had cut its losses in half. Operating expenses were starting to drop as a percentage of sales. And, due to its new services business, gross margins were finally starting to improve. Amazon had its first profitable quarter in the forth quarter of 2001. The combination of a still-strong revenue model, improved operational efficiency, and the new services business paid off.

In 2003, Amazon had its first fully profitable year, with $35 million in profits on revenue of $5.3 billion. In 2004, the company earned $588 million of net income on revenue of $6.9 billion. Perhaps best of all, Amazon's days of working capital were minus twenty-four, freeing up nearly half a billion dollars of spare cash it could use for other things, like new systems development to support new technology services deals. Soon after, Amazon boosted its working capital model again by adding AmazonPrime, a $79 membership service (recall cash-up-front analogs Dow Jones and Costco from chapter 6) allowing members to access free two-day shipping, as well as overnight shipping for a paltry $3.99, among other perks.[35] By 2007, Amazon accounted for 6 percent of the $136 billion in U.S. online sales, up from 5.1 percent in 2006. And its free cash flow had risen by 140 percent. Says Citigroup Internet analyst Mark Mahany, "That's pretty dramatic."[36]

Lessons from Amazon's Relentless Iteration

In three short years, from 2000 to 2003, Amazon evolved iteratively from a dot-com high-flyer that was burning cash to a well-run, highly efficient provider of online retailing and other services, with positive cash flow and its long-elusive profitability finally in hand. What was it that enabled Amazon to turn the corner?

- *Operating model:* For one, its GBF strategy enabled it to reach sufficient scale that it was worthwhile to automate virtually all of its processes. Automating, in turn, enabled Amazon to improve on its already superb reputation for great customer service while cutting its operating costs at the same time. Too often, companies gain efficiency at the expense of good customer service. With the customer-centric Bezos at Amazon's helm, that simply was not going to happen.

- *Revenue and gross margin models:* Second, Amazon realized that its scale and its skills had given it something other companies

needed—the ability to do business online without incurring years of potentially loss-making learning. Amazon had already learned, and was able to peddle its learning, as high-margin services, to others. By 2008 third-party shipments accounted for a third of its unit sales.

What Amazon has really done, though, is what this book is all about. In that sense, Amazon is our poster child. In the words of *Fortune* magazine's Josh Quittner, Amazon's "rise into *Fortune 500*-dom actually has little to do with innovation and more to do with iteration. If anything, Amazon demonstrates how a cutting-edge Internet company—of all things—can succeed slowly. The trick is taking a million tiny steps—and learning quickly from your missteps."[37]

Bezos freely admits that great lessons are born from leaps of faith: "A lot of decisions around consumers are like that. When you do the math, it's not clear what will happen."[38] We couldn't agree more. Identify your analogs, antilogs, and some leaps of faith. Develop and test hypotheses with a dashboard. And determine the effect of your strategic decisions on the five elements of your business model. If Jeff Bezos can iterate to success, so can you.

But beware the temptation to follow Amazon's "Get Big Fast" strategy. Such a strategy can be effective, provided that a company can raise boatloads of cash and can get big enough, fast enough, to reach economies of scale. But those are two very daunting conditions, so we don't recommend the Amazon model as an analog for just any business. There are hundreds, if not thousands, of failed dot-com companies whose powerful antilogs argue against the GBF approach. In fact, had Amazon not raised so much cash when it could, it would have been exposed to the vagaries of the capital market in the dot-com bust, and who knows where it would be today?

Of course, a lucky few of you will have the pleasure of striking the right balance on your first attempt. Our next case is such an example: In nine short years, Celtel International put cell phones into the hands of 27 million consumers in the farthest corners of the most impoverished continent on the planet, Africa. Celtel's founders and investors earned billions in the process. Unimaginable, perhaps, but true. Let's examine the Celtel story.

Case 3: Celtel International: Where Others Saw Poverty, Mo Ibrahim Saw Opportunity

At the turn of the twenty-first century, there were 800 million people in Africa, some 600 million of them in sub-Saharan Africa. Africa was home to thirty-four of the fifty poorest countries on Earth,[39] where per capita GDP ranged from $180 to $5,000 per year, a far cry from the industrialized nations of North America, Western Europe, and Japan, whose GDPs ranged from $24,000 to $36,000.[40]

With such poverty, it was not surprising that the telecom infrastructure was inadequate. In most of sub-Saharan Africa, less than 1 percent of the population had access to traditional land-based telephone lines, compared to more than sixty-four landlines per one hundred people in the United States.[41] With the exception of South Africa, cellular telephony had barely entered the sub-Saharan marketplace. And a nearby telephone was not all that sub-Saharan Africans lacked. Few citizens of countries like Malawi, Uganda, and Nigeria had bank accounts, credit cards, or mailing addresses. The roads were terrible, often washing away in the monsoon seasons. Governments were unable or unwilling to deliver or maintain these basics, and they were plagued with high levels of corruption, to boot.

In light of that, Africa appeared to be a great place to start a new business, right? Not! Most of us would turn our heads from what looks like a high-risk, low-reward opportunity. But not Dr. Mohamed ("Mo") Ibrahim. Ibrahim, a native of Sudan, saw Africa as ripe for mobile telecom expansion. It was a daunting leap of faith, perhaps. But his experience with the mobile telephone industry in Europe combined with his interest in and connection to Africa propelled him to make a move that would ultimately change the landscape—and potentially the economic situation—of sub-Saharan Africa.

Ibrahim grew up in Egypt and studied to become an engineer in the United Kingdom. He spent the early years of his career in the telecom industry with British Telecom (BT). He left BT in 1989 to set up Mobile Systems International (MSI), his own telecommunication consulting company, helping the growing cellular industry design their networks.[42]

In the late 1990s, his company shifted gears, moving from telecom consulting to mobile telephony operations focused on the sub-Saharan

African marketplace. Ibrahim recalled what it was like. "Mobile communications was like the Wild West in the 1990s. Everybody was fighting over licenses. But no one wanted to go into Africa. There was fear. There was ignorance. There were worries. Some of it was understandable," he recounted.[43] But his view differed: "I realized just how negative the image was of this region of the world. Since I'm African by origin myself, I was obviously well aware of the daily difficulties faced by people in Africa. But I felt that my contacts greatly overexaggerated the risks, that there was an enormous gap between their perceptions and the reality."[44]

Opportunity, Yes—but Can Celtel's Revenue Model Attract Subscribers?

Ibrahim saw enormous potential in the African market. His leap of faith was that there had to be a way to provide cellular telephony to this population in a profitable way. He set out to do just that. The first question Ibrahim and his team had to answer was about his revenue model. "How can I get this population to give up some of their very meager disposable income?"[45] He found an interesting analog. In Kenya, working men found a way to purchase a beer at the end of each work week. They afforded themselves this luxury without regard for their income. Ibrahim thought, "If someone is willing to pay for a beer at the end of the week, then an individual with similar wages would likely be willing to shell out a small amount of money to communicate by telephone."[46]

Ibrahim set out to capitalize on the beer-money phenomenon, making telephony as accessible and inexpensive as a bottle of Tusker lager. Rather than offering the fixed-rate monthly call plans common in most of the world, all antilogs, Ibrahim opted for a prepaid, pay-as-you-go strategy. His leap of faith was that customers would buy, along with a simple but adequate low-priced handset (another antilog here, as handsets in the West were frequently subsidized and provided for "free" with a monthly calling plan and fixed-term contract), prepaid scratch cards good for minutes of usage, whatever they could afford at the end of the week. When the minutes were gone and they had earned some more money, they would buy another scratch card.

Let's put Celtel's revenue model story aside for a moment to consider the company's operating model. After all, its operating model was heavily dependent on a cellular system that Celtel would have to build from scratch.

Celtel's Operating Model

Besides being customer-friendly, the prepaid, no-subsidized-handset, no long-term contract strategy had wider implications. It cut the costs of the operating model, as no expensive billing system was needed and there would be no telephone bills to mail—not that the postal systems in sub-Saharan Africa worked, anyway! And it meant that even customers who had little to spend would be profitable, unlike those in the West, for whom the cost of subsidized handsets had raised the bar to reach profitability.

To further strengthen his operating model—in the same way that analogs Southwest Airlines, Ryanair, and Go had decided to fly all their routes with Boeing 737 aircraft—Ibrahim decided to use a single wireless technology, GSM (Global System for Mobile), the one used throughout Europe. Doing so would ensure interoperability among customers and countries and kept operating costs down.

But difficult challenges remained. Licenses to operate cellular systems were granted by governments, which expected cash in return. And subscribers couldn't place calls until the cellular network—cell towers, switches, a network operating center, and so on—was in place. Ibrahim's investment model would have to raise cash to buy the licenses and put the wireless system in place. Thus, there were two huge leaps of faith. First, could sufficient investment capital be raised to start and scale an infrastructure-heavy business in such an unlikely market? Second, would African consumers part with enough of their beer money to make the business model work?

Celtel's Investment Model

At the time of Ibrahim's entrée into Africa, many sub-Saharan governments were beginning to open up their telephony markets, offering licenses to operators at far lower prices than licenses in more developed countries. Jonathan Newman, an executive at another African cellular operator, said, "Governments realized that because returns here are lower, the business model just doesn't stack up if they charge big license fees."[47] Ibrahim convinced Western-funded backers to invest in his company to take advantage of these deals, notwithstanding the risks.

With investment cash in hand, MSI started grabbing as many licenses as it could.[48] In 1998, Ibrahim and his team purchased licenses to operate in Zambia, Congo-Brazzaville, and Sierra Leone. By 2000, they had added

Malawi, Gabon, Chad, the Democratic Republic of Congo, Burkina Faso, Niger, and Uganda. Kamiel Koot, the company's CFO, summarized, "We are doing now what Vodafone was doing in the early 1990s, no different, picking up licenses, building businesses greenfield."[49] In 2004, the company rebranded itself Celtel, and acquired a license to operate in Kenya, east Africa's largest economy. By 2006 the company had licenses in more than a dozen countries, adding Tanzania, Nigeria, and Madagascar to its sub-Saharan portfolio.

Some of the risk that Celtel undertook by acquiring so many licenses so quickly, long before the beer money hypothesis had even been tested, was mitigated by the value of the assets that these licenses—the right to do business in each country—represented. This asset-based analog is a classic, developed originally by the nineteenth-century railroad barons, and copied in other industries as well, including cable and satellite television. Private developers and redevelopers of airports in India are doing exactly the same thing today: building new airports for the right to the revenues they will generate in the future—everything from passenger and gate fees to duty-free shopping.

The Beer Money Model Pans Out

"What about the beer money?", you ask. "Would African customers living on a few dollars a day spend their hard-earned cash on cell phone calls?" Starved for a way to communicate with one another, the African population jumped at Celtel's offerings.

Marten Pieters, Celtel's CEO, recalls, "What people often don't realize is that in Africa there is hardly any alternative to mobile telephony apart from traveling, which can be dangerous. So even for those with lower incomes, mobile telephony can be a very cost-effective solution."[50] Just like the men in Kenya who afforded themselves a beer, sub-Saharans proved willing to pay for the ability to communicate. Pieters continued, "People are willing to spend more of their disposable income on mobiles than in other countries because they do not have access to many other services."[51]

As surprising as it may seem, Celtel's African customers were just as hungry for mobile phones as their European counterparts. They were spending their beer money and then some.[52] In 2002, the average monthly revenue per user (ARPU) for Celtel's sub-Saharan customers was around $300 per year, similar (perhaps shockingly) to European levels.[53] As Celtel

started expanding into less urban areas with even poorer populations, its ARPU did decline. In 2005, ARPU was down to $21 per month, around $250 per year.[54] But while ARPU declined over the years, the number of subscribers increased, enough to offset the smaller payment per user. Pieters said, "We don't subsidize handsets, and operate a pay-as-you-go model. A new customer of ours, more or less from day one, covers his marginal cost and very quickly becomes profitable. That's why we can live with lower ARPUs."[55]

Celtel's Working Capital Model

The Celtel strategy, with prepaid scratch cards and no subsidized handsets, had even more power. Let's look more carefully at Celtel's working capital model. While Celtel was generating strong revenue and posting profits, the company was also driving a very healthy balance sheet. In 2003, for example, 95 percent of Celtel's customers used prepaid methods.[56] As a result, Celtel's deferred revenue (revenue it collected from customers prior to services rendered) totaled $40 million. At the same time, the company's accounts payable to its suppliers for new towers and switches to grow its network totaled $33 million. And Celtel held virtually no inventories—it was a service business. Celtel had more than $70 million of its customers' and suppliers' cash to invest into growing the business!

Further, Celtel's gross margin model was inherently attractive. Once the network was in place, the cost of placing a subscriber's call—Celtel's cost of goods sold—was essentially zero. Moving electrons from Nairobi to Dar es Salaam cost virtually nothing.

Though raising capital to buy the licenses had not been easy, once the initial cell-phone systems were in place, the rest of the business model took over, helping to fuel incredible growth. By 2007, just nine years after entering the mobile marketplace in Africa, Celtel counted more than 27 million customers in fourteen countries, and had reported 2006 revenue of $2.5 billion.[57] The company had been profitable since 2003. In 2005 Celtel was acquired for $3.4 billion by MTC, a fast-growing Kuwaiti operator serving the Middle East and other emerging markets. Ibrahim earned close to $1 billion, and many of his employees—hundreds of them, including many Africans—became millionaires. And with only a 5 percent penetration rate in its markets, Celtel had plenty of room to grow its business even more.[58]

Lessons from Celtel's Balanced Approach

Celtel crafted a business model that worked pretty much as planned, right from the outset. What were the legs to Celtel's multilegged stool?

- *Revenue model:* With its customer-friendly pre-paid scratch cards and no long-term contracts, Celtel made it easy for its always cash-strapped customers to buy airtime when they needed it. And paying cash for the phone to get started was an expense that an extended family, or even a community, could share.
- *Gross margin model:* Celtel's inherently attractive gross margin model—with negligible COGS entailed in transmitting its customers' calls—was a huge benefit. Attractive gross margin models like Celtel's are one of the hallmarks of most service businesses.
- *Operating model:* Without a pricey billing system, nor bills to mail, and with its single GSM technology, Celtel's operating model was very efficient.
- *Working capital model:* The prepaid strategy and generous supplier terms provided a continuously renewable supply of working capital from customers and suppliers for growing the business.

With these four elements—the revenue, gross margin, operating, and working capital models—set to work so well together, it's no wonder that Ibrahim was able to convince investors that the huge sums for acquiring licenses and installing the initial networks would be sums well spent. Once each country was up and running and the electrons started flowing, the system would be a cash machine. Thus, with four legs supporting it, the stool looked stable and well balanced, in investors' eyes. The fifth leg of the stool—the investment model—looked far less risky and made the stool virtually untippable.

Lessons Learned About Multidimensional Models

Business models—like stools—are not built one leg at a time. And the analogs and antilogs that underlie the companies featured in this chapter

did not have to come from within the industry to prove effective. We've found three common themes underlying each of the featured models:

- Each company delivered, at the heart of its revenue model, something that was crystal clear and that customers valued.
- Each company's business model was fundamentally different from what prevailed in its industry at the time.
- The five elements of the business models did not stand alone; the implications of one element for the company's economic viability were meaningful for another element, and all were interlinked in such a manner that made the business viable from a cash flow perspective and easy to grow.

Let's briefly address each of these points in a bit more detail.

A Clear Customer Promise That Customers Value

Each of our examples began with a customer promise, something the business would stand for, in customer terms, that customers valued. For Zara, it was customer delight, the very latest fashion apparel at affordable prices. Amazon promised its consumers an online, one-stop shopping experience that was incredibly customer focused. It offered its business customers the benefit of Amazon's finely tuned e-tailing know-how and infrastructure to resolve the pain they were experiencing in taking their bricks-and-mortar businesses online. Celtel, too, resolved customer pain, offering sub-Saharan Africans widespread and affordable telecommunication, where essentially none had existed before, and where real time communication other than face-to-face had been nigh on impossible. But making customer promises is easy. Delivering on them, in a way that generates cash so the business is cash flow viable and can grow, is the hard part. And that's why thinking strategically about your business model, whether before or after you get started in business, is so important.

Doing Things Differently

None of the examples in this chapter represents "business as usual" in its industry. There were antilogs aplenty. Zara rewrote the rules of slow fashion

retailing that were based on long lead times from low-cost Asian factories to distant Western markets, and created its fast fashion model. Amazon, once it got serious about managing cash flow, got serious about getting to negative working capital—working capital nirvana, as we noted in chapter 6—and about rooting out inefficiency. It became the provider of choice for others—from Toys "R" Us to Target to mom-and-pop sellers of all kinds—who wanted to sell things online. It was, by then, a far cry from its online bookseller roots and the rest of its competitors. Celtel boldly asked its impoverished customers to pay for their phones—no subsidies up front—and used a prepaid pay-as-you-go revenue model in contrast to the prevailing European practice of subsidized handsets, monthly calling plans, and lengthy customer contracts.

The Five Business Model Elements Work Together to Create Cash for Growth

Too often aspiring entrepreneurs and managers in established firms confine their focus to only one part of their company's business model. The sales force worries about the revenue model, or if they are incentivized on gross margin, about the gross margin model as well. The procurement team focuses on the gross margin and operating models, by keeping costs down, whether for COGS or operations. And so on. But, ultimately, if everyone thinks about the business in business model terms, decisions are made differently.

Zara's Amancio Ortega saw the big picture of how his fast fashion strategy had favorable implications for the various elements of his company's business model and for his ability to grow Zara quickly. Jim Wilke, Amazon's operations guru, understood how his efforts would improve his company's working capital model, not just its operating model. Others on the Amazon team saw how Amazon's growing capabilities could be leveraged into higher-margin services revenue. Celtel's Mo Ibrahim saw that if he could just raise enough capital to get his cellular systems in place, the rest of the business model would take over, enabling his business to grow exponentially. None of these patterns was simple. As a result, they probably looked strange—even untenable—to others in their industries. As a result, they went largely uncopied and thereby provided lasting sources of competitive advantage and rapid growth.

Q&A with John and Randy

Now that we've brought the business model elements together, you may be wondering where you should start in thinking about your own business model, whether it's for a start-up you are contemplating or a new and better Plan B that might take your existing company to new heights—or even disrupt your industry. This question is important, so we've devoted part of chapter 9 to an organizing framework and a process that help you get started on your journey to a new and better business model. As you might imagine from having stayed with us this far, that process begins with analogs and antilogs, out of which grow leaps of faith and hypotheses to test to prove or refute them, all driven by a dashboarding process that evolves over time.

But before we move on to our final chapter, we'd like to answer the question about *where* to get started. We tackle it by addressing it in terms of cash and cash flow, and point out two explicit connections among the five business model elements we'd like you to make.

- Your revenue model, gross margin model, and operating model directly affect your working capital model.
- In turn, these four models directly affect your investment model.

Let's take these two issues one at a time.

The Implications of Your Revenue, Gross Margin, and Operating Models for Your Working Capital Model: Timing Is Key

By now it should be clear that the timing with which you ask your customers to pay for whatever it is that you sell them lies at the heart of your working capital model. So, as you think about what you will sell, to whom, why and how much or how many they will buy, and on what basis (your key revenue model questions from chapter 3) the question of *when* they will pay—compared to when you will deliver what they buy—is an all-important question that needs to be at the forefront of your thinking. The *timing* is crucial, in working capital terms, if you wish to create or grow your company using your customers' cash. Thus, as you develop your revenue model, don't forget to think about it in working capital terms.

Second, your gross margin model is crucial. It should ensure that the cash that your revenue model generates is not all consumed by COGS. It should also leave enough cash flow on the table to cover what your operating model—and perhaps your investment model, too—require, while also feeding your working capital model. If your gross margin model doesn't work, getting paid up front won't do you much good. Equally important, though, is the timing with which your COGS will be paid for. As we have seen from Amazon in this chapter and Costco in chapter 6, growing your company using your suppliers' cash is a good way to go.

Third, the timing with which you pay the operating expenses in your operating model is every bit as important as the timing of your supplier payments for COGS and the timing of your customer cash. Don't overlook timing considerations when you plan your operating model and their implications for the days of working capital you'll have at your disposal.

The relationships we've just described are illustrated in figure 8-1.

The Implications of Your Revenue, Gross Margin, Operating, and Working Capital Models for Your Investment Model

As we've seen in the Celtel story, a favorable working capital model—in tandem with thoughtful decisions about your revenue, gross margin, and operating models—can take lots of pressure off your investment model. In some

FIGURE 8-1

Implications of the business model elements on one another

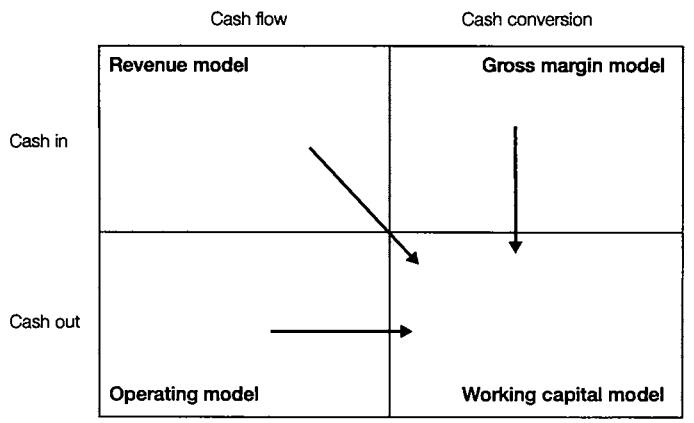
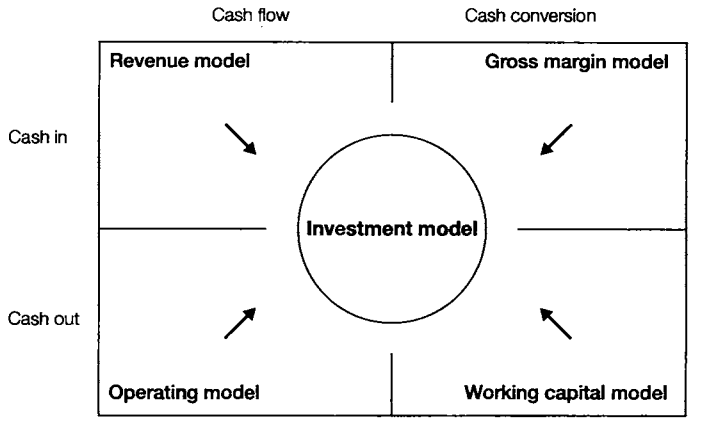


FIGURE 8-2

Driving your investment model with the rest of your business model



cases, it can sharply reduce the investment you'll need, or even eliminate it entirely. The relationship we've just described is illustrated in figure 8-2. If you can get by without investment, at least for some time until you've met some milestones and reduced risk, any capital you eventually raise will come on much better terms.

What's Next?

In chapters 1 and 2, we covered the *process* of getting to a better business model in our chapters on analogs, antilogs, leaps of faith, and dashboards. In chapters 3 to 8, we fleshed out the *content* of your successful business model organized by the five elements in our business model framework. It's time to weave it all together.

In chapter 9, our final chapter, we explore the reasons that many new ventures never reach their own Plan Bs. We address the three sources of cash for starting or growing your business—investors are but one—that this book has uncovered. We address some final questions you may still have. We direct some attention to your entrepreneurial dream. And, most important of all, we get you started on putting the lessons of this book to work, using a business model grid that, together with your dashboards, will give you a more structured learning path—a path we hope leads you to a successful Plan B or Plan Z!

John and Randy's Multidimensional Business Model Checklist

Business models are not built in stovepipe fashion, one element at a time. In order to build a business model that works, you'll need to consider all of the five elements as a package, and determine how each influences the others.

Thus, with your future cash flow in mind, as you develop your business model elements consider these questions, all with evidence to answer them—from your analogs, antilogs, and the hypothesis tests that seek to prove your leaps of faith:

- ✓ As you consider your revenue model, consider the timing with which revenue will come in. How will your revenue model decisions affect your working capital model?
- ✓ As you consider your gross margin model, consider the timing of your COGS payments, as well as the adequacy of your gross margin. How much cash will your gross margin model leave on the table and how will your gross margin model affect your working capital model?
- ✓ As you consider your operating model, consider the timing of your various expense payments. How will your operating model affect your working capital model?
- ✓ As you consider the working capital model that grows out of your revenue, gross margin, and operating models, consider the extent to which it can fund the investment you require. How will your working capital model affect your investment model?

CHAPTER 9

Getting Started on Discovering *Your* Plan B

AS YOU KNOW BY NOW, this is not a book about "business planning." It's a book about, in a sense, "business discovering." *Getting to Plan B* is about a process of *discovering*, over time, a fluid pattern among the five business model elements that, working together, will make the economics work, so you don't run out of money along the way.

Like learning, discovery rarely occurs in a single eureka moment, though there may well be a few such moments along the way. Discovery takes discipline, patience, and the right tools for the job. What tools?

- Some analogs and antilogs from which you will learn
- A few leaps of faith together with hypotheses to prove or refute them
- A sequence of dashboards to guide your journey and mark the need for midcourse corrections
- And a mind-set that embraces the five business model elements as a framework for organizing what you discover

As for any journey into the unknown, planning is absolutely essential, not least because your port of departure is your Plan A. You need a stake in the ground, a starting point—an entrepreneurial dream, perhaps, that captures the essence of your Plan A—from which to embark on your journey to Plan B and its better business model that will actually work. But useful as your stake in the ground is, we are reminded of the words of General Dwight D. Eisenhower, on the merits and limitations of planning for the

D-day landings: "Plans are useless, but planning is indispensable."[1] We don't believe that your Plan A is useless, actually. But it's probably off target in more ways than one, as many of the examples in this book attest.

Essential though planning is, it is not sufficient in entrepreneurial settings, whether for raw start-ups or for new ventures hatched within established companies. It's nearly impossible to plan reliably for an unknown future, especially when the planning concerns an innovative new venture, like many of those we've seen in this book, or a radical, new-to-the-world product. Worse, too much planning, conducted in too much detail, can distract you from the most crucial tasks at hand—testing your most important leaps of faith. Too much planning can blind you to a more attractive opportunity whose name is Plan B or, like PayPal's Max Levchin, Plan G. What, then, are the implications of this book and the process it articulates for the time-honored culture and practice of business planning? This is the first of a handful of remaining issues that we address in this closing chapter:

- We share some lessons we've learned about many of the business plans we've seen and why so many of them simply don't deliver.
- We examine how best to get started on putting the lessons of this book to work on your business.
- We explore the lessons learned about the three best sources of the cash you will need to embark on or continue your journey.
- We answer a few final questions about getting on with your journey toward Plan B.
- And we explore the crucial importance of your entrepreneurial dream.

Most Business Plans Don't Deliver

That's an audacious statement, perhaps. But unfortunately, it's true. Let's consider the business planning culture that pervades all things entrepreneurial today. There are dozens of best-selling books on business planning; Web sites, too; plus software packages, business planning consultants, university courses, and more. So, amid all this good advice, why do most

business plans fail to deliver? Why do so many plans, with their fancy graphics and impassioned cover letters attached, go unanswered, straight into the trash? In short, why do most business plans attract few customers, generate little revenue, and raise no money?

To begin to answer these questions, let's consider what a typical business plan seeks to do. It articulates in a hopefully convincing way, in words, numbers, graphs with hockey-stick projections, and so on, why the idea—the lovingly articulated Plan A, though it's never called that—will work, and how much money everyone will make when it does. Whether it's been prepared to raise venture capital or to win the support of the corporate investment committee, the message is nearly always the same.

What the evidence—the cold, hard facts—tells us, however, is that most often what ultimately works, if anything works at all, is not the Plan A that was so persuasively articulated in the original plan. Instead, it's Plan B. Or, as we have seen in this book, the plan that finds traction has a letter even farther down the alphabetical queue.

Some Common Threads of Clueless Business Plans

Why don't most business plans deliver? Over the years, the business plans we have seen share some common—and unfortunate—traits. First, far too many business plans are written in the first burst of enthusiasm without a shred of real evidence to support their assertions. Simply put, most business plans are written too soon. Analogs, antilogs, tested hypotheses? Few or none. A telltale sign makes it easy to spot this problem. Sentences that begin with the phrase "We believe . . ." are dead giveaways. What the phrase "We believe . . ." most often means, in actuality, is "We haven't a shred of real evidence about this, because we've been too busy writing this business plan to actually gather any evidence, but we hope that . . ." The unfortunate consequence is that most plans lack any tangible evidence in support of the most of the assertions they make. Assumptions, sometimes. Evidence, rarely. Most are built, like a house of cards, on unproven foundations.

Second, rarely is there anything like a plan to discover and learn. The plans assume that most everything is already known up front—not the case, as the company histories that comprise this book have shown. Third, and related to the second point, the rampant uncertainty about what lies ahead goes entirely unacknowledged. As General Douglas MacArthur is

reputed to have once said, "No plan ever survives its first encounter with the enemy."

The process we've articulated in this book exists to counter such disastrous practices—to enable you to anticipate and move beyond a failing Plan A. It is a process designed for learning and discovering, rather than for pitching and selling. It addresses the harsh reality that most of the time we know much less than we think we know about our proposed new ventures.

Putting This Book's Lessons to Work

If you've read this far, you now know the answer to what you should do next, no matter what the stage of your venture or idea or the shape it's now in. And you already know what the building blocks are:

- An identified customer pain and a solution that you believe resolves it, or an opportunity to offer consumer delight where it is absent today
- Next, some relevant analogs and antilogs, building on what others have done before
- Which lead to some as-yet-untested leaps of faith, clearly prioritized, so you know which to prove—or refute—first
- Which lead to a set of hypotheses to test them
- A dashboard to focus your and your people's attention on what's most important right now and to provide the signals for your mid-course corrections
- All comprehensively organized, in just the right sequence, to inform and create the five elements of your business model

So how do you put these building blocks to work? Figure I-1, the business model grid with which we organized this book way back in the introduction and repeat here for your convenience, is your organizing framework (see figure 9-1). Your dashboards are your guide for your discovery journey

Your task to begin putting flesh on the bones of your entrepreneurial dream, without writing a business plan just yet, is to fill in at least one or

FIGURE 9-1

The business model grid

Your current idea and the customer pain that it resolves or the consumer delight it offers:

Business model element	Relevant analogs and the numbers they give you	Relevant antilogs	Leaps of faith around which you will build your current dashboard	Hypotheses that will prove or refute your leaps of faith
Revenue model	A1		C1	D1
Gross margin model				
Operating model				
Working capital model				
Investment model	A5			D5

more of the cells in each row of the grid. For your revenue model, for example, you might have an analog or two that can tell you with some confidence just how, from whom, and at what cost your revenue will be generated. If so, that's the detail—a short paragraph to yourself, including numbers, please—that you need for cell A1. Perhaps your analogs and some antilogs lead to a leap of faith that you'll need to examine experimentally about how your revenue model will play out. If so, that is another paragraph to yourself for cell C1, with your hypothesized answer—again, most of the time with numbers, please—to that leap of faith in cell D1. A draft of the dashboard you will use to guide your experimental path and signal any necessary midcourse corrections in developing your revenue model is next (see figure 9-2, repeated here from figure 2-1). With these steps completed, you'll have jump-started your critical thinking about your revenue model.

Next, working a row at a time, repeat the process for your gross margin model, your operating model, your working capital model, and your investment model. Then, prioritize your set of paragraphs and dashboards, not necessarily in the sequence shown in the business model grid. Which are the most crucial to examine first? Which can wait until earlier answers

FIGURE 9-2

A prototype dashboard for discovering *your* better business model

Hypotheses	Metrics	Actual period 1	Actual period 2	Actual period 3	Insights obtained, course corrections needed
Leap of faith 1:					
Hypothesis H1:					
Hypothesis H2:					
Leap of faith 2:					
Hypothesis H3:					
Hypothesis H4:					

are in hand? When you are done, for the first time around, what will you have? You'll have three things:

- A series of short paragraphs to yourself that, collectively, describe your Plan A in considerably more detail than the one-liner at the top of the business model grid
- Some dashboards to both set your planned route toward a possible, but as yet unknown, Plan B and to course-correct as your venture evolves
- All of which, taken together, comprise, in effect, the strategy you initially envision, viewed though a business model lens

More importantly, you'll have a learning plan, rather than a business plan, that will enable you to either discover that your Plan A is viable, if you are both lucky and shrewd, as we saw with eBay and Celtel, or lead you to a more viable Plan B—or Plan Z.

Planning these learning tasks takes work, but it doesn't take much paper. No more than a page for each row—each element of your business model—plus some dashboards attached. Take the time necessary to refine

your thoughts and make them clear and concise. As the old quip goes, "If I had more time, I would have written a shorter letter."

As you know by now, the process will be iterative. Where your path will lead, no one knows, least of all you! As you think though the rows of the business model grid, you will find yourself iterating from one row to another and back again because, as we saw in chapter 8, the elements don't stand alone. A few weeks or months from now, some cells in your business model grid will have changed based on what you have learned from your journey. As you also now know, pretty much everything has been done before. It's just that no one has put the pieces—your analogs and antilogs and leaps of faith—together in the precise way that you plan to do. You'll be standing on the shoulders of giants—those who have gone before you and learned, perhaps even succeeded, as well as others who have been slain.

Three Sources of Cash

"Ah," you're thinking, "When are John and Randy going to tell me how to raise the cash I am so fervently seeking?" Actually, we already have! Though money still doesn't grow on trees, what we've said is that there are three great sources of cash—not just investors—to fund both your discovery journey and your business as it evolves:

- *Chapter 4's gross margin nirvana:* Assuming your revenue model also works, if you can find a way to generate gross margins that approach 100 percent, like eBay, or even Patagonia's more modest but very attractive levels, those margins will go a long way to funding your business. What high-margin goods or services can you sell today or tomorrow to fund the initial stages of your discovery journey?

- *Chapter 6's negative working capital:* If you can develop a working capital model that gives you the customer's cash up front, as we saw with Dow Jones and Costco, you may not need very much investment, perhaps none at all. What customers can you think of that will find your offering so compelling, that they—like Aggregate Knowledge's beta sites that we saw in chapter 2—will pay you now to start your journey with them? Or what suppliers can you find to

bankroll the initial stages of your journey with generous terms for their vendor finance?

- *Chapter 7's investment model:* Not every business will be able to fund the initial stages of its journey from patient suppliers or a high-margin customer that offers cash up front. This is where your investment model comes into play. The lessons of Skype and Go that we saw in chapter 7 are two inspiring analogs of how to get by with less cash, and the lessons at the end of that chapter explore the various ways of raising the rest of the capital you need.

Some Final Questions Answered

Lest we end this book with any known stones still unturned, let's wrap up with a few final questions—some of which we touched on briefly at the start of the book—with answers to help you on your way.

On my journey to Plan B, do I need a contingency plan up front? There's a temptation to think that, since Plan A probably won't work, you should have Plan B in your hip pocket, ready to pull out at a moment's notice. Don't do it. A contingency plan would probably be just as flawed as your Plan A, so you'd have to go through the same steps for it as you will in going from your preferred Plan A to a completely unknown Plan B. Your time and talent are scarce commodities, so we suggest that you not even think about Plan B until your dashboarding process takes you there. Focus on your dashboards and your hypothesis tests, and Plan B or Plan Z will reveal itself soon enough. There's little point in speculating, when you'll have real evidence in due course.

I'm still not sure where to look for my analogs and antilogs. Where should I start? First, read, or watch the business news. Your local, national, and international business news will constantly replenish your source of analogs and antilogs. Business news takes on a new kind of curiosity when you realize that it is a daily source of great analog and antilog stories.

Consider companies that might be your competitors, but dig into other industries, too, for insights that your own industry may be overlooking. That's what Barbara Cassani did as she and Go brought a different kind of customer service ethic to Europe's no-frills airline industry.

Dive into your social network for some insights. Get out from behind your broadband connection and start talking to people who have done something like what you propose to do. Ask them about analogs and antilogs. What companies, in your proposed industry or others, should you emulate, for which elements in your business model? From what companies should you differ, at all costs?

And, not least, as we noted in chapter 1, there are dozens of great analogs and antilogs between the covers of this book. From Africa to China to India to Europe to North America. From numerous raw start-ups, to corporate spinouts like Go, to great work in large organizations like Toyota and Dow Jones. But these are only a start, just enough to whet your appetite.

When do I need my first dashboard? Yesterday! Your real learning doesn't begin until you are dashboarding. Once you have identified your life-or-death leaps of faith and a set of hypotheses to examine them, you can put your first dashboard to work. It will focus your attention and correct your path when you find you are off course. It will challenge your ideas with real-world evidence. It will give you some insights you lack today. Then, with concrete knowledge about your venture growing day by day, you'll be putting the pieces in place for what will be, before long, an evidence-based business plan that carries less risk. If you do this well, you'll encourage the likes of our colleagues to take your business plan—and more importantly, you!—seriously.

What if I'm in a big company, where the impediments to change are high, where reluctance to take risk reigns from on high? Reread the story of Go, and the lessons that Barbara Cassani learned about getting a venture that was truly different up and running inside a large and conservative company. Reread the stories of Apple's onslaught on the music industry and of Toyota's relentless focus on creating the best gross margin model in its industry. One of these analogs may be the ticket to getting your top management—maybe that's you!—to find a way forward.

Follow our process and start gathering some experimental evidence to support your Plan A. Dashboarding is crucial at this stage! If some early, real-world tests can convince the people around you that you've got a viable business model in the works, you may get more support than you expect.

When does the analog-antilog-leap of faith-dashboard process end? We're glad you asked. It doesn't. Stopping this process is the beginning of

complacency, just what your competitors ordered for you. The process of asking questions, building on the learning of others, and seeking real, in-the-marketplace answers will keep your organization nimble. Remember that Aggregate Knowledge (chapter 2) had a real breakthrough regarding its customers' behavior long after its Plan A was humming. Had its dashboard not signaled the need for a midcourse correction, Paul Martino would never have taken the time to understand the change in behavior and get to Plan B. Aggregate Knowledge avoided a potentially fatal mistake by dashboarding!

If you read about the companies we've profiled in this book a year or two from now, we're sure you'll find that most of them are, in at least some parts of their businesses, on to a new and different Plan B or Plan Z. They don't rest. Neither should you.

What if my venture is nonprofit, or even a government entity? What if I'm not in California or London? As you'll have seen in the company histories in the last eight chapters, the principles and tools in this book do not restrict themselves to any one kind of venture or any single setting. We've examined companies large and small, old and new. Start-ups and restarts. Nonprofits and for-profits. In developed economies and emerging ones. The principles and tools herein provide a solid foundation for generating positive cash flow, every start-up's dream, in any kind of venture, anywhere. Ignore them at your peril.

Dreaming *Your* Entrepreneurial Dream

In chapter 1, we introduced you to Fred Swaniker, who along with a Stanford MBA classmate created the African Leadership Academy. One of Swaniker's inspirations—for becoming an entrepreneur, not just starting the ALA—was born when he attended an intimate breakfast with Carlos Ghosn, the CEO of Nissan and Renault. You'll recall he said, "I realized that if an ordinary person could lead such a successful global organization, so could I. It gave me the gall to think big."

The men and women featured in this book are ordinary folk, too. They combined their own skills and mind-sets with their business or philanthropic ambitions. They kept open minds as they iterated toward stronger business models. They created some of the world's most exciting products and services, enriching your life and ours. You can, too.

So think back to the big ideas and noble goals that many of the founders of the companies profiled in this book pursued from the outset. Mo Ibrahim set out to bring accessible and affordable telecommunication to sub-Saharan Africa, where virtually none had existed before. The Google guys set out to organize the world's information and make it immediately accessible to anyone who needed it, anywhere, any time. Mari Kuraishi and Dennis Whittle of GlobalGiving wanted to efficiently funnel charitable contributions directly to the people in the developing world, allowing GlobalGiving to put donations to work efficiently and immediately. As best-selling author Jim Collins says, "When you've built an institution with values and a purpose beyond just making money—when you've built a culture that makes a distinctive contribution while delivering exceptional results—why would you surrender to the forces of mediocrity and succumb to irrelevance?"[2]

After you've massaged your confidence, we suggest you think big. As Danny Rimer, general partner at Index Ventures in London, notes, "The Skype deal with eBay probably has had repercussions in terms of entrepreneurialism, not only in Britain but across Europe. It's had the effect of providing confidence to entrepreneurs to really go after big opportunities."[3] What's your big opportunity?[4] Your entrepreneurial dream?[5] Put your dream to paper. If you don't have an idea just yet, you can always start by making a list of things that bug you—a buglist, we call it. You'll be surprised how many things stand to be improved! As renowned venture capital investor John Doerr points out, "Great business opportunities emerge from solving big problems."[6]

In short, we hope you, too, will make a difference, if you can, in whatever way is meaningful to you; and meaningful to the society—or the small corner thereof—in which you live and work. Perhaps it will be your next venture that will inspire future generations of entrepreneurs to follow in your shoes.

So there you have it. A process for answering the single, simple, life-or-death question about your entrepreneurial dream: How can I break through to a better business model that will actually work? By using a set of tools to help you take off the rose-colored glasses and embark on your own unique learning journey, with your eyes and ears open, your antennae all the way up. Please write home with your travelogue, so we can help make your business an inspiration and an analog for others! We wish you Godspeed. Have an exhilarating ride!

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11. *Gross margin* is accounting lingo for the difference between the revenue you get when you sell something and what that something costs to produce (cost of goods sold, in accounting parlance)—excluding your other costs like keeping the lights on and the doors open.

12. *Operating costs* are the rest of the costs you incur from month to month; everything but the cost of what you sell.

13. *Working capital* is cash you must tie up while you wait for customers to buy and pay for what they buy. It might be inventory on your shelves. It might be the paper invoice you hold while you wait for them to pay what they owe you for what they have bought. On the flip side, it's cash you hold—cash due to a supplier, perhaps, in thirty or sixty days, which you can use as long as you hold it.

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INDEX

Accor and cutting costs, 127
accounts payable, 137
accounts receivable, 134, 146
Advanced Micro Devices, 51
advertisers, 72
advertising networks, 60
Aer Lingus, 116
Africa, 26–28
African Leadership Academy (ALA), 214
  analogs and antilogs, 27–29
  business and government leaders, 29
  defining parameters, 27–29
  difficult decisions, 30–31
  faculty and administrative staff, 29–30
  financial model, 29, 30
  leaps of faith, 15, 29–30, 31
  lessons from, 31
  Plan A, 30
  Plan B, 30–31
  raising capital, 29
  small-scale trial, 29–30
  students, 29–30, 31
  tomorrow's leaders for Africa, 26–31
Aggregate Knowledge (AK), 42, 61, 211, 214
  acceleration mode, 58
  analogs and antilogs, 53–54
  B2B (business-to-business) customers, 54
  customers, 58
  dashboards, 54–55, 58–61, 63
  fundamental questions, 62
  go-to-market strategy, 56
  growth, 58
  leaps of faith, 54–57, 59–60
  lessons from, 60–61
  market potential, 56
  objectives, 56–57
  online discovery, 52–61
  Overstock.com and, 58
  paying customers, 56
  personalized advertising message, 60
  Plan A, 60
  Plan B, 57–60
  process flow, 59
  product area progress, 59
  product-management process, 59
  prospective customers, 56
  quantifiable metrics, 56
  revenue model, 54
  scalability, 58
  search engine, 54
  technology, 55
Air France/KLM, 119
airlines, 92, 168
Air Miles, 169
AlliedSignal, 188
AltaVista, 68
Amazon.com
  AmazonPrime, 191
  automating, 191
  as bookselling Web site, 187
  burning cash, 187
  business model, 181, 187
  cash flow, 191
  customer service, 191
  delivery, 187
  distribution center, 187
  dot-com business model, 186–193
  e-commerce platform, 189
  economies of scale, 172
  efficiency, 188
  GBF (Get Big Fast) strategy, 187, 191–192
  gross margin model, 187, 191–192
  gross margins, 96, 189–191
  growth, 187
  initial public offerings, 174
  inventory, 188
  investment model, 186–187
  leaps of faith, 187
  lessons from iterations, 191
  negative working capital, 200
  online sales, 191
  operating model, 187–189, 191
  Plan Z, 181, 187
  platform solutions, 189
  prices, 187
  profitability, 190–191
  raising cash, 187
  resolving pain, 199
  revenue, 187
  revenue model, 189–192
  service to customers, 189
  supply chain, 188–189

Amazon.com (*continued*)
Target and, 190
as technology company and technology platform, 190
Toys "R" Us and, 190
used-book sellers, 189
working capital, 191
working capital model, 189
AmazonPrime, 191
American and European boarding schools, 27
American Standard and negative working capital, 151
analogs, 6, 8, 14, 208
advertisers, 72
advertising networks, 60
African Leadership Academy, 27–29
Aggregate Knowledge, 53–54
answering questions about, 45
antilogs and, 83–84
Apple, 16–18, 20
cost of goods sold, 109
critically examining, 15, 33
different industries and, 34, 171–172
easyJet, 169
eBay, 44
emerging economics, 26
Ephiphany, Inc., 54
evidence, 83–84
finding, 34
First Direct, 168, 171–172
Go airline, 195
Google, 54
gross margin models, 110–111
Heifer International, 48
identifying, 10, 173
information about, 6–7
insights, 32, 84–85
Kiva, 51
limits, 38
mixing and matching, 16, 32–33
Napster, 19
newspapers and magazines, 34
not appropriate, 26
operating costs, 114–115
panning out, 85
Pantaloon, 22–23
Personify Inc., 53
products that will sell, 79–80
quantifying expectations, 129
relevant, 15
right or wrong, 34
Ryanair, 114–115, 169, 195
social networks, 34
Southwest Airlines, 117, 169, 195
stopping process of, 213–214
themes, 10–11
unique twist, 16
variety of roles, 15–16, 32
where to look for, 212–213
antilogs, 6–8, 14, 208, ix
African Leadership Academy, 27–29
Aggregate Knowledge, 53–54
analogs and, 83–84
answering questions about, 45
Apple, 16–18, 20
cost of goods sold, 109
critically examining, 15, 33
different industries and, 34
emerging economics, 26
failed dot-com companies, 192
finding, 34
Gap, 182
growth-for-growth's-sake pattern, 103
Heifer International, 48, 51
identifying, 10, 173
inefficient, 127
information about, 6–7
insights, 32, 84–85
limits, 38
mixing and matching, 16, 32–33
moving forward with, 35
newspapers and magazines, 34
operating costs, 114–115
Pantaloon, 22–23
pay-for-music sites, 18
Personify Inc., 53
quantifying expectations, 129
relevant, 15
right or wrong, 34
social networks, 34
stopping process of, 213–214
storage and user-interface problems, 18
themes, 10–11
variety of roles, 15–16, 32
vending machines, 123
Walmart store layout, 24
Web analytics companies, 60
where to look for, 212–213
Apple Computer, 213, xii
analogs, 16–18, 20, 110
antilogs, 16–18, 20
computing experience, 16
consumer electronics, 15, 21
digital music Plan B, 21
iPhone, 21
iPod, 16, 19, 21
iTunes Jukebox, 19
iTunes Store, 19–20
leaps of faith, 18–20, 21

lessons from, 20–21
MP3 player, 19
music, 16, 18, 19–20
personal computers, 16–21
"razor and razor blades model" and, 20
record companies, 19
stealing great ideas, 20
vocal evangelists, 16
ARPU (average monthly revenue per user), 196–197
Artega, Amancio, 182
Ashoka, 48–49, 51
asset-based analog, 196
assets, 158
assumptions, 15
as fact, 38
initial, 41
ATMs (automatic teller machines), 125
AuctionWeb, 95–96
Automobile, 100

Bain & Co., 183
balance sheet, 134–135, 154–155
banking, 125
banks, 175
banner ads, 72
Barron, Clarence, 141
Barron's, 141, 143
Barron's Online, 143
Bayani, Ronalee, 29
Benchmark Capital, 96
Bengier, Gary, 97
Bergstresser, Charles Milford, 140
Berkshire Hathaway, 148
Bernstein, Leonard, 14
Bessemer Venture Partners, 164
Bezos, Jeff, 187–193
Big Bazaar, 22–24
big companies and impediments to change, 213
biggest risks, 42–43
big ideas, 215
Bill Gates software analog, 79–80
Biyani, Kishore
designing stores, 25
hypermarkets, 22–23
leap of faith, 26
locating stores, 25
market demands, 24
merchandising products, 25
operating retail stores, 25
refashioning stores for Indian markets, 41
testing hypotheses, 25–26
BJ's, 145
BMW, 100
Body Shop, 2
Bonderman, David, 119
Bradford, Chris, 26–31
Brin, Sergey, 2, 69–74
British Airways (BA), 116
aircraft in the air, 118
Project Hyacinth, 167–168
selling Go airlines, 170
British Telecom (BT), 193
Brotman, Jeffrey, 146
Brower, David, 106
bug list, 83
building blocks, 208
business angels, 175–176
businesses
data overload, 41
incorrect assumptions, 41
pay-as-you-go, 154
qualitative issues, 43
quantitative measures, 43
revenue, 65
source of cash, 66
subscription-based model, 154
business model grid, 208–209, 211
business models
airlines, 92
Amazon, 186–193
better, 62
copying or adapting, 128
customer-focused strategy, 180
economic viability, 180–181
elements working together, 3, 92, 180
evidence-based, 64
grid, 10–11
gross margin model, 9
investment model, 9
key elements, 9, 66
multidimensional, 179
operating model, 9
pattern of economic activity, 4–5
Plan B, 10
revenue model, 9
running out of cash, 3
strategy, 180
sustainable competitive advantage, 180–181
tough times and, 185
uniqueness, 127–128
working, 4–5
working capital linking other elements, 152–154
working capital model, 9

business plans
common threads, 207–208
dashboards and, 63–64
detailed, 63–64
discovery and learning, 207
not delivering results, 206–208
Plan A, 207
refining, 33
what lies ahead, 207–208
without real evidence, 207
Business Traveler, 171
BusinessWeek, 190
Byrne, Patrick, 58

Calvert Foundation, 45
Calvert Web site, 48
capital, raising, 159
Car and Driver, 100
CareerJournal.com, 144
cash, 131, 134–135
accounts payable, 137
customers' money, 140–145
fixed assets and, 138
funding growth, 149
getting by on less, 175
growth and, 200
on hand, 135–136
increasing importance of, 139–140
inventory, 137
new ventures, 3
raising less, 160–161
running out of, 3, 9
sales, 137
someone else's, 136
sources of, 211
cash balance, 135
cash flow, 86, 130
changing timing, 153
generating and sustaining positive, 180
investment model, 202
operating model, 202
timing, 131, 139
understanding, 91–92
Cassani, Barbara, 167–172, 212, 213
Castellaño, Jose Maria, 182–183
cellular systems, 195
Celtel International, 192
African market, 194
ARPU (average monthly revenue per user), 196–197
asset-based analog, 196
attracting subscribers, 194
balance sheet, 197
beer money model, 194, 196–197
cost of goods sold, 198
deferred revenue, 197
gross margin model, 197, 198
growth, 197
GSM (Global System for Mobile), 195
investment model, 195–196
leaps of faith, 194
lessons from balanced approach, 198
licenses, 195–196
MTC, acquisition by, 197
multidimensional business model, 181
operating model, 194–195, 198
poverty and opportunity, 193–198
prepaid pay-as-you-go revenue model, 194, 200
profits, 197
resolving pain, 199
revenue, 197
revenue model, 194, 198
Western-funded backers, 195
wireless system, 195
working capital, 198
working capital model, 197, 198
charitable contributions, 46
chart of accounts, 114, 126, 130
Chen Tianqiao, 79–84
Chouinard, Yvon, 93, 102–106, 188
Chouinard Equipment, 103
classical operating models, 125
climbing equipment, 103
CNN Money, 71
cost of goods sold
airlines, 92
analogs and antilogs, 109
approaching zero, 97
cost of materials, 110
defining, 91
driving down, 109
eBay, 97
excluding other costs, 91
expenses related to product, 90
finding necessary evidence, 109–110
gross margin models, 106
labor, 110
manufacturing, 99
OnSale, 96
percentage of sales, 92
rules and conventions, 91
timing for paying, 202
what's included and what's not, 92
Zara, 185–186
Collins, Jim, 215
companies
cost of goods sold, 94
customers' behavior, 53

initial investments, 162–163
unsuccessful ventures, 6
values, 74
venture capital, 174
competitive advantage, 127
Costco, 145
sustainable, 180–181
working capital model, 145
computers, 162
Condé Nast Traveler, 121
consumer delight, 78, 83, 208
consumer electronics, 21
consumers, wanting very best, 126
content
framework to organize, 9
process and, 10–11
Continental Airlines, 116
contingency plan, 212
Coopers & Lybrand, 167
Costco, 179, 211
accounts receivable, 146
bargains, 148–149
basic items, 148
cash flows, 153
competitive advantage, 145
customer cash, 149
entrepreneurs, 152
fast-changing goods, 149
gross margins, 147–148
immediate cash, 146
impact of, 149
inventory, 150
launch of, 146
lessons from, 150
limited items, 148
lower prices, 147
members, 149
membership fee, 146, 150, 153
negative working capital, 150, 151
packaging in volume, 147
Plan B, 145–150
pre-tax profit, 150
Price Club, 145–146
pricing, 147
profit margins, 147, 150, 153
profits, 146
rapid growth, 150
retailing industry and, 149–150
revenue, 150
targeting small businesses and upscale families, 148
trading up and trading down concept, 148
value, 150
warehouses, 148
working capital, 146–147
working capital model, 139, 149
cost of materials, 110
costs, 69
critical unknowns, 15
crucial beliefs, 15
crucial issues, 8
cryptography software, 4
Crystal Dynamics, xii
current assets and liabilities, 136
Curry, Bill, 190
custom dashboards, 41
customer cash, 144
customer delight, 6, 67
customer feedback, 75
customer-focused strategy, 180
customer pain, 208
customer promise, 199
customers, 66
defining, 65
negative working capital and, 154
paying before product or service is produced, 140–145
revenue models, 67–68
targeting, 84
what he wants and will buy, 3
and WIIFM, 154
Customers' Afternoon Letter, 140
customer services and negative working capital, 152

Daily Telegraph, 171
dashboarding
asking right questions, 38
business planning and, 63–64
hard lessons of failure, 40
lessons learned, 61–62
next steps, 62
Plan B, 39–41
quality of questions, 62
what to do with data, 62
dashboards, 7–8, 35, 159, 208
Aggregate Knowledge, 61, 63
assumptions, 38
business model, 209–210
custom, 41
defining, 38–42
developing, 10
Development Space, 46
emphasis on numbers, 61, 62
evidence-based business model, 64
evolution, 60–61
evolving business, 43
formal, 63

dashboards (*continued*)
getting answers, 61
GlobalGiving, 61, 63
granular, 55
iterating with, 42–43
key indicators, 8, 41
laser-like focus, 61
leaps of faith, 8, 63
modifying, 43
Plan B, 209
prototype, 40, 61
qualitative issues, 46, 62
quantitative hypotheses, 62
reasons to use, 41–42
record-keeping, 42
reflecting nature of business, 41
signaling for corrections, 85
specific objectives, 61
stopping process of, 213–214
strategically thinking, 8
testing hypotheses, 8
themes informed by, 10–11
usefulness, 60
when to create, 213
data, what to do with, 62
data overload, 41
data-starved entrepreneurs, 38
data underload, 41
Debonair, 169
decision making, 14
deferred income, 155
deferred revenue, 155
Dell and cutting costs, 127
Delta Airlines, 116
design process, 182–183
detailed business plan, 63–64
developing world, 51
Development Marketplace, 43–44
Development Space
dashboards, 46
donors, 46, 48
dot-com bubble, 48
foundation for, 49
funding drought, 48
Hewlett-Packard and, 49
name change, 49
Plan B, 48–51
projects, 46
responses to, 46
start-up dashboard, 47
Web site, 46
Diamond Media Systems, 18
digital music, 17
discovery engine, 52
Disney analog, 81
disruptive operating models, 125
distribution process, 182–183
Doerr, John, 215
doing things differently, 199–200
Donglei, Zhou, 81
donors, 46, 48, 51–52
"don't be evil," 71, 74
dot-com bubble, 48
Dow, Charles Henry, 140
Dow Jones & Company, 179, 211, 213
Barron's, 141, 143
Barron's Online, 143
CareerJournal.com, 144
cash flows, 153
customer cash, 141
Customers' Afternoon Letter, 140
digital world, 153
Dow Jones Financial Information Services, 142
Dow Jones Industrial Average, 140
Dow Jones Online News, 143–144
Dowvision, 142
electronic publishing and services, 141–142
entrepreneurs, 152
Factiva, 142
identifying content, 144
individuals and small companies, 142
large enterprises, 142
leaps of faith, 141
lessons from, 144
MarketWatch.com, 142–143
negative working capital, 144, 151
net income, 144
News Corporation and, 144
NewsPlus, 142
OpinionJournal.com, 144
Plan A, 143
Plan B, 141, 143
print media, 140
The Publications Library, 142
RealEstate Journal.com, 144
revenue model, 153
selling community newspapers, 143
subscription-free services, 144
transition to digital age, 144
unearned subscriptions, 155
using customers' money, 140–145
Wall Street Journal, 140–141, 143
Wall Street Journal Interactive Edition, 142
working capital model, 139, 141–144, 153
WSJ.com, 143
Dow Jones Financial Information Services, 142

Dow Jones Industrial Average, 140
Dow Jones Online News, 143–144
Dowvision, 142
Draper Fisher Jurvetson, 164
dreaming entrepreneurial dream, 214–215
Drucker, Peter, 65

EasyJet, 169, 171
eBay, 179, 211
  analogs, 44
  AuctionWeb, 94–96
  cost of goods sold, 94, 97
  eBay Motors, 97
  economic activity, 97
  generating revenue, 97
  gross margin, 96, 97, 151
  gross margin model, 93, 94–98
  growth, 96
  lessons learned from, 97–98
  PayPal, 4
  Plan A, 97
  public stock, 96
  purchasing Skype, 165–166
  revenue, 97
eBay Motors, 97
economic development, 2
economic fundamentals, 9
economic progress, 127
economic viability, 180–181
Eddington, Rod, 171
effective models, 82
Eisenhower, Dwight D., 205–206
emerging economies and analogs and antilogs, 26
entrepreneurial dreams, 2–3, 214–215
entrepreneurs
  assumptions as fact, 38
  data-starved, 38
  data underload, 41
  incorrect assumptions, 41
  leaps of faith, 166
  money up front, 173
  as risk manager, 78
  virtual-goods, 107–108
  what to do when Plan A fails, 2
Entrepreneurship Summer School, vii, xi
Epiphany Inc., 54
erroneous assumptions, 62
established companies, 172
evidence, grounding revenue model in, 83–84
evidence-based business model, 64
Excite, 69
expected revenue, 130
expenses, 92
experimenting, 7
EZ Station, 81

Facebook, 74
Factiva, 142, 143
failed dot-com companies, 192
failure, hard lessons of, 40
fast fashion, 181–186
  versus slow fashion, 184–185
fast-growing companies, 2
Federal Communications Commission, 165
financial statements, 180–181
Financial Times, 142
First Direct, 168, 171–172
fixed assets, 138
fixed costs, 129
  turning into variable costs, 175
flexibility, 42
flimsies, 140
Food and Drug Administration (FDA), 75
Food Bazaar, 23
Ford, 102
formal dashboards, 63
Fortune 500, 150
Fortune magazine, 192
founders of companies, 215
framework to organize content, 9
free calls, 165
Friis, Janus, 162, 174
fundamental questions, 62

Gap, 182, 184–185
General Electric and negative working capital, 151
General Motors, 99, 101–102
Get Big Fast (GBF) strategy, 192
Ghosn, Carlos, 28, 214
global development and donors, 46, 48
global development projects, 45
GlobalGiving, 42, 215
  business model, 52
  dashboards, 50, 61, 63
  Development Space becoming, 48–51
  donations, 52
  donors, 51
  financial model, 49
  foundation board, 49
  fundamental questions, 62
  key strategies, 52
  leaps of faith, 52
  legal compliance, 49
  lessons from, 52

GlobalGiving (*continued*)
philanthropic support, 49, 52
Plan B working, 51
project legitimacy, 51
revenues, 52
small projects, 52
sponsor network, 48–49, 51
tracking and analyzing traffic and user behavior, 49
Go airline, 160, 161, 212
analogs, 195
breakeven, 168–169
capital expenses, 169
cost containment, 169
EasyJet purchasing, 171
European low-cost airlines, 169
inaugural flight, 169
initial routes, 170
investment model, 167–172, 180
leasing aircraft, 169
lessons from, 171–172
low cost but high quality, 169
management buyout of, 170–171
mimicking low-fare carriers, 170
operating expenses, 169
Operation Summer Sun, 170
outsourcing services, 169
Plan A, 170
Plan B, 170
profitability, 170, 171
shoestring budget, 169
small investment in, 168–169
underused airports, 170
ventures inside established company, 161
Google, 2, 10, 215
automating process for advertisers, 72
banner ads, 72
core purpose, 74
cost-per-click model, 72
costs, 69
customer pain, 73
don't be evil, 71, 74
evil advertising, 70–72
finding better customer, 70
finding things on the Web, 54
home pages, 72
initial public offerings, 174
innovation, 74
leaps of faith, 70, 72
lessons from, 73
licensing, 70, 85
organizing and delivering information, 69
PageRank algorithm, 69
paid listings, 72
partnership-based revenue model, 73
paying advertisers, 54
paying customers, 69–70
Plan A, 68–74
Plan B, 2, 70
Plan C, 70–72
profitability, 72
relevance, 69
relevant marketing messaging, 54
revenue, 74
revenue model, 67, 68–74, 85
search technology and advertisers, 73
staying ahead of the pack, 73
technology and reach, 54
users, 69
venture capital firms, 70
Google News, 74
Google.org, 74
go-to-market strategy, 56
government entity, 214
Gozzi, Carlo, 14
granular dashboards, 55
gross margin models, 9, 86
Amazon.com, 187, 191–192
analogs, 110–111
business model grid, 209
cash flow, 130
Celtel International, 197, 198
checklist, 111–112
cost of goods sold, 90–92, 106
competitive advantages, 90
crucial, 202
eBay, 93, 94–98
lessons learned about, 106–108
managing margin mix, 90
operating expenses, 130
Patagonia, 93–94, 102–106
prices, 90, 106
profit, 130
providing delight, 109
resolving customer pain, 109
Toyota, 93, 98–102
value-based pricing, 107
Zara, 185–186
gross margins, 89
Amazon.com, 96, 189–191
approaching 100 percent, 211
AuctionWeb, 96
breathing room, 93–94
calculating, 91, 92
cost of goods sold, 90–92
covering operating expenses, 91
defining, 90–93
earning fatter, 101–102
eBay, 96, 97
efficient processes, 109

evaluating, 135
General Motors, 101
generating, 89–90, 109
higher percentage, 91
improving, 99
insufficient, 90
Kmart, 148
OnSale, 96
Patagonia, 106
rate, 91
Target, 148
Toyota Motor Company, 99, 101, 179
trimming, 109
Zara, 182
gross profit. *See* gross margins
growth-for-growth's-sake pattern, 103
GSM (Global System for Mobile), 195
guiding and tracking journey, 7–8

H&M, 185
Hammerstein, 14
Hartsfield-Jackson Atlanta International Airport, 122
Heifer International, 45, 48
Henley, Don, 19
Hewlett-Packard (HP), 49, 51
Home Valley, 79, 85
HotBot, 69
Hotmail, 74
Hughes, Brian, 123–124
hypotheses
recording results of tests, 42
testing, 85

Ibrahim, Mohamed ("Mo"), 193, 200, 215
ideas, 6
evolving to compelling, 13
not starting from scratch, 14–16
identifying leaps of faith, 173
incentives for payment up front, 154
income statements
focusing time and energy on, 135
working capital model, 155
Index Ventures, 215
India, 21–22
Inditex
Europe's largest clothing retailer, 185
new fashion lines, 182–183
out-performing competitors, 185
public offering, 182
Zara stores, 181
industries
competitive advantage, 127
eliminating operating expenses, 126
inefficient antilogs, 127
overcapacity, 152
totally new, 17
working capital requirements, 152
inefficient antilogs, 127
Infoseek, 68
initial assumptions, 41
initial public offerings, 174
innovative businesses, 33
international development projects, 48
Internet
peer-exchanged data, 162
philanthropic contributions, 45
P2P technology, 163
search engines, 68–69
searching for things on, 54
inventory, 133–134, 137, 189
investment models, 9, 86, 212
Amazon, 186–187
business model grid, 209
capital, 173
capital-raising side, 159
cash, 158, 175
cash flow, 172, 202
cash to start business, 158
Celtel International, 195–196
checklist, 177–178
defining, 158–160
developing, 157
Go airlines, 167–172, 180
leaps of faith, 160
lessons learned about, 172–174
licenses, 195–196
little investment as possible, 158
minimizing early operating losses, 172
minimizing or offloading costs of getting started, 172
network effects, 172
postlaunch phase, 159
prelaunch phase, 159
raising capital, 159
revenue, gross margin, operating, and working capital models, 202–203
right type of investor, 175–176
Skype, 161–167
spending side, 159
venture capital trade-offs, 173–174
wireless systems, 195
investments
assets, 158
competitive footrace, 172
earning return on, 138

investors, 66
  banks, 175
  business angels, 175–176
  dashboarding and, 176
  liquidity, 173–174
  right type of, 175–176
  risk, 157
  venture capitalists, 175–176
iPhone, 21, 33
iPods, 16, 19, 20–21, 83
ISP (Internet service provider), 95
iterating and dashboards, 42–43
iTunes Jukebox, 19
iTunes Store, 19–20

Jackson, Peg, 124
jidoka (built-in quality), 99
Jobs, Steve, 16, 19–21, 33–34, 110
Jones, Edward Davis, 140
Jones, Tim, 119
Joswiak, Greg, 18

kaizen (constant improvement), 100
kanban (just-in-time system), 99
KaZaA, 162
Kelleher, Herb, 116, 128
key indicators, 8
Khaemba, Christopher, 31
Kiplinger Letter, 140
Kiva, 51
Kmart, 148–149
Koot, Kamiel, 196
Kuraishi, Mari, 44–46, 49, 215

labor and cost of goods sold, 110
L'Amoreaux, Claudine, 107
Landes, Faye, 96
leaps of faith, 7, 15, 63, 159, 208
  African Leadership Academy, 29–30
  Apple, 18–21
  AuctionWeb, 95
  breaking even, 168
  Celtel International, 194
  Dow Jones, 141
  erroneous assumptions, 62
  Gap, 184
  global development projects, 45
  Google, 70, 72
  identifying, 10, 15, 33, 62, 64, 85, 173
  innovation process, 35
  insights, 32
  investment model, 160
  lessons from, 192
  metrics, 39
  Pantaloon, 24
  Patagonia, 105
  Price Club, 145
  proving or refuting, 8, 32, 166
  quality questions, 62
  before raising money, 166
  revenue models, 84
  right or wrong, 34
  Shanda Interactive Entertainment, 79, 80
  Silverglide Surgical Technologies, 75, 76
  Skype, 163, 164
  stopping process of, 213–214
  style, 183
  systematically recording, 39
  testing hypotheses, 8, 38–39, 173
  themes, 10–11
  varied roles, 32
  ZoomSystems, 123–124
learning from experiences of others, 14
learning plan, 210–211
legal Plan B, 162
Legend of Mir II, 80
Levchin, Max, 1, 4–5, 7, 206
Lexus, 100–101
liabilities, 135, 140
licenses for cellular systems, 195
Linden Lab, 107
Lonergan, Liam, 116
long-distance telephone industry, 163
Lopez, Marcos, 185
Los Angeles Times, 142
Lufthansa, 119

MacArthur, Douglas, 207–208
Macy's, 22
Magellan, 68
The Magnificent Seven, 14
Mahany, Mark, 191
Mall, Damodar, 23
Mandel, Stephen, Jr., 145
Mandela, Nelson, 26
Mangrove Partners, 164
manufacturing and cost of goods sold, 99
Manz Wear Pvt. Ltd., 21
MarketWatch.com, 142–143
Marks & Spencer, 22–23, 25
Martino, Paul, 52–53, 55, 214
Maslow's hierarchy of needs, 65
massively multiplayer online role-playing games (MMORPGS), 79–80
materials and costs, 110
mechanization productivity gains, 126

Melon, Carmen, 183
Mercedes-Benz, 100, 101
methodical iteration, 42
metrics, 7
Microsoft economic activity, 97
milestones, 173
Miller, Kris, 183, 184
mobile telephony cost-effective solution, 196
Molière, 14
Morita, Akio, 17
Morningside, Kevin, 75
Motorola and ZoomSystems, 124
MP3 player, 18, 19
MSI (Mobile Systems International), 193
muda (eliminating waste), 99
multidimensional business models, 179
  checklist, 204
  lessons learned about, 198–201
multilegged business models, 179
Munger, Charlie, 148
Murdoch, Rupert, 144
music industry, 16–18
MusicNet, 18
MySpace, 74

Napster, 16–17, 19
negative working capital, 137, 138, 211–212
  Amazon, 200
  American Standard, 151
  benefits, 139–140, 151–152
  business growth, 152
  business model, 153
  Costco, 150, 151
  customers and suppliers, 154
  customer services, 152
  Dow Jones, 144, 151
  dramatic changes, 144
  General Electric, 151
  as Holy Grail, 151
  periodicals publishers, 140
  Tesco, 151
  Whirlpool, 151
Neo Carta Ventures, 124
Netflix, 153
net income, evaluating, 135
net profit, 91
Newman, Jonathan, 195
News Corporation purchasing
    Dow Jones, 144
NewsPlus, 142
new ventures, 3, 157
New York Times, 140, 142, 144
New York Times Online, 144
Nissan, 28, 100, 214
noble goals, 215
Nokia, 107
nonprofits, 214
The North Face, 51
Nutter, Eric, 151

Oberoi Cecil, 121
Oberoi Hotels
  adding luxurious amenities, 121
  adding value, 127
  best hotel chain, 121
  lessons from, 122
  Oberoi Cecil, 121
  operating costs, 115
  operating model, 120–122, 128
  trained staff, 121
Ohno, Taiichi, 99
O'Leary, Michael, 117–120, 128
Omidyar, Pierre, 94–97
1% for the Planet, 105
online classified service, 53
OnSale, 96
operating and timing issues, 153
operating costs
  analogs and antilogs, 114–115
  bankrupting company, 114
  comparing to retail stores, 124–125
  competitors, 120
  defining, 113–114
  evaluating, 135
  fixed, 129
  increased, 114
  planning for, 129–130
  reduced or eliminated, 114
  rethinking, 114–115
  variable, 129–130
operating expenses, 91, 92, 126, 130
operating models, 9, 86, 113
  Amazon.com, 187, 191
  amenities, 121
  business model grid, 209
  cash flow, 202
  Celtel International, 194–195, 198
  chart of accounts, 114
  classical, 125
  competitive advantage, 127
  copying or adapting, 128
  customer experiences, 122
  disruptive, 125
  filling in cost structure, 130
  lessons learned, 126–128
  levels of costs, 126
  model checklist, 131–132
  Oberoi Hotels, 120–122

operating models (*continued*)
operating expenses, 126, 202
productivity gains, 127–128
real numbers, 129
Toyota Motor Company, 179–180
uniqueness, 127–128
value, 127
OpinionJournal.com, 144
opportunities, missing, 13
Ortega, Amancio, 200
outsourcing, 172
Overstock.com, 58
Overture analog, 72, 73

Page, Larry, 2, 69–74
PageRank algorithm, 69, 72
Pantaloon
analogs and antilogs, 22–23
category management, 23
founding, 21
India and, 15
International Retailer of the Year, 25
leap of faith, 24
lessons from, 25
Marks & Spencer and Zara, 23–24
Plan B, 24, 25
shopping experience, 24, 25
traditional Indian bazaar, 24–25
trial-and-error process, 15
Walmart, 22–23
Patagonia, 211
bankruptcy, 103
changing packaging, 104
contributing to society, 102
customers paying higher prices, 104
environmental values, 102, 104, 105–106
gross margin model, 93–94, 102–106
gross margins, 106
growth, 103, 104, 106
leaps of faith, 105
lessons from, 105–106
1% for the Planet, 105
Plan B, 103–105, 106
pricing decisions, 106
strong moral code, 102
values, 102–106
Patriot Act, 46
pay-as-you-go, 154
paying customers, 69–70
PayPal, 4
peer-exchanged data, 162
peer-to-peer (P2P) technology, 162–163
periodicals publishers, 140
Personify Inc., 53–54
Peters, Tom, 22
Phantom of the Opera, 83
Pieters, Marten, 196
Piette, Daniel, 181
Plan A
African Leadership Academy, 30
analogs, 27
business plans, 207
changes in, 33
Chouinard Equipment, 103
detailed description, 209
eBay, 97
Go airlines, 170
Google, 68–74
off target, 206
Price Club, 145
Project Hyacinth, 168
revenue models, 68, 82
Ryanair, 116–117
Shanda Interactive Entertainment, 79
Silverglide Surgical Technologies, 67
statistics, 1–2
street-testing, 5–9
Swaniker, Fred, 27
Toyota Motor Company, 100
what you don't know, 7
when it fails, 2
why it won't work, 3
ZoomSystems, 122–123
Plan B
African Leadership Academy, 30
Aggregate Knowledge, 57–60, 60
breaking industry rules, 10, 94, 181
building sponsor network, 48–49
as contingency plan, 212
Costco, 145–150
dashboarding to, 39–41
Development Space, 48–51
Dow Jones, 141, 143
evidence to support, 8
Go airlines, 170
Google, 70
industry, 33
legal, 162
not-fully-successful Plan A, 94
openness about journey to, 176
Pantaloon, 24–25
Patagonia, 103–105, 106
Ryanair, 117–119
Shanda Interactive Entertainment, 79–80
Silverglide Surgical Technologies, 77
Toyota Motor Company, 100–101
unique lessons about, 15–16
ZoomSystems, 123–124

Plan C
  Google, 70–72
  Shanda Interactive Entertainment, 80–81
  Silverglide Surgical Technologies, 77
  Skype, 165
planning
  learning plan, 210–211
  merits and limitations, 205–206
  not delivering results, 206–208
  vagaries of operating costs, 129–130
Plan Z and Amazon.com, 181, 187
Polti, Georges, 14
positive cash flow, 180
poverty, 43
Powell, Michael, 165
predecessors, 14
Pressplay, 18
Price, Sol, 145
Price Club, 145, 148
prices
  customer purchases, 90
  gross margin models, 106
primary market data, 6
process and content, 10–11
Procter & Gamble, 26
production process, 182–183
productivity gains, 126, 127–128
products
  customer delight, 67
  margin mix, 90
  resolving pain, 67
  success and failure, 3
profitability, 135
profits, 130–131, 139
Project Hyacinth, 167–168
prototype dashboards, 40
The Publications Library, 142

qualitative issues, 43, 46
quantitative hypotheses, 62
quantitative measures, 43
questions, 7, 62
Quittner, Josh, 192

Raffles Junior College (RJC), 27–28, 31
raising money, 160–161
RealEstate Journal.com, 144
real opportunities, missing, 13
Red Hat, 70
Re-Imagine!, 22
reinventing the wheel, 6
Renault, 28, 214
rethinking operating costs, 114–115
Reuters, 143
revenue, 65
  adequate gross margin, 89–90
  Amazon iterating, 189–191
  cost of goods sold, 90
  Costco, 150
  defining, 65, 91
  eBay, 97
  expected, 130
  Sam's Club, 150
  timing, 131
revenue models, 9
  adding dimension, 81
  Amazon, 191–192
  analogs or antilogs, 82, 84–85
  AuctionWeb, 95
  bug list, 83
  building and testing hypotheses, 84
  business model grid, 209
  Celtel International, 198
  checklist, 86–87
  cost of goods sold, 202
  customer delight, 67, 83
  customers to target, 84
  defining, 65–67
  evidence, 83–84
  evolution of models, 82
  expected revenue, 130
  generating revenue, 73
  Google, 67, 68–74
  how customers respond, 83
  key questions underlying, 66
  leaps of faith, 84
  lessons learned about, 82–84
  membership fee, 153
  move to free-to-play, 81
  paying customers, 67–68, 153
  Plan A, 82
  resolving customer pain, 67, 83
  Shanda Interactive Entertainment, 68, 78–82
  Silverglide Surgical Technologies, 67–68, 74–78
  timing issues, 153
  Toyota Motor Company, 179
  Zara, 183–185
RIAA (Recording Industry Association of America), 19
Rimer, Danny, 215
Rio, 18
Risk Management Association Annual Statement Studies and BizStats, 129

risks
focusing on, 42–43
investors, 157
needing to resolve, 15
Rivkin, Jan, 116
Roddick, Anita, 2
Rogers, 14
ROI (return on investment), 138
Romeo and Juliet, 14
Rothman, Simon, 97
Russian Federation economic development, 43
Ryan, Christy, 116
Ryan, Tony, 116
Ryanair, 10, 115, 169, 171
aircraft, 117–118
airline policies, 117
analogs, 114–115, 169, 195
Charleroi, Belgium, 118
cutting costs, 127
expanding service and low-price reputation, 117
Internet savvy of customers, 118
leaps of faith, 117–119
lessons from, 120
low-cost airline, 119
operating costs, 115, 116
operating model, 128
passengers paying for extras, 119
Plan A, 116–117
Plan B, 117–119
regional airports, 118
saving commissions and operating costs, 118
as "Wal-Mart of flying," 119

sales, 137
sales process, 182–183
Sam's Club, 145, 148, 150
Sandford C. Berstein & Co., 96
Schmidt, Eric, 71
Schwartz, Bruce, 124
scratch, not starting from, 14–16
Seal, 20
search engines, 52, 68–69
secondary data, 6–7
Second Life, 107
The Seven Samurai, 14
Shakespeare, 14
Shanda Interactive Entertainment, 179
analogs, 79–80, 82
average revenue per user, 81
changing market, 80–81
consumer delight, 78
Disney analog, 81
EZ Station, 81
gross margin, 151
Home Valley, 79, 85
initial public offering, 79
leaps of faith, 79, 80
lessons from, 82
licensing initial product, 85
massively multiplayer online role-playing games (MMORPGS), 79–80
pay-to-play cards, 79
Plan A, 79
Plan B, 79–80
Plan C, 80–81
revenue, 79–81
revenue models, 68, 78–82
Shanda Literature Limited, 81
subscription model, 79
user base, 81
Shanda Literature Limited, 81
Shearwood, Mike, 183
shopping experience, getting right, 24
Sierra Club, 106
Silverglide Surgical Technologies, 179
developing forceps, 76–77
Food and Drug Administration (FDA), 75
leaps of faith, 75–77
lessons from, 77–78
licensing product, 85
narrowly defined target market, 76, 77–78, 84
patented product, 75
Plan A, 67, 75
Plan B, 76–77
Plan C, 77
revenue models, 67–68, 74–78
target market, 67–68, 75–76
transitioning from Plan A to Plan B, 68
venture capital, 74–75
Silverman, Josh, 166
Silverstein, Michael, 148
Sinegal, James, 146–148
Skype, 10, 212
acquiring customers, 166–167
beta version, 163
comparing to Vonage, 165
cut-rate calls, 164
eBay and, 162, 165–166
free calls, 163, 165
gateways and hardware, 164
initial investment, 163
instant messaging, 165
investment model, 161–167
investors, 164–165
journey from Plan A to Plan B, 160

leaps of faith, 163, 164
lessons from, 166–167
marketing, 161, 162
operating costs, 164
Plan C, 165
P2P technology, 160, 163
premium services, 165
registered users, 166
revenue, 165, 166
SkypeIn, 165
SkypeOut, 164, 165
starting, 162–163, 167
telecom industry and, 161–167
text messaging, 165
user base, 163
videoconferencing, 165
voice mail, 165
webcasts, 165
SkypeIn, 165
SkypeOut, 164, 165
Slim, Carlos, 144
Smith, Gower, 122–126
somebody else's cash, 136
Sony and ZoomSystems, 124
Sony Walkman, 17
sources of cash, 211–212
Southwest Airlines, 10, 116, 171
analogs, 117, 169, 195
disciplined growth, 117
good service, 168
unbroken profitability, 120
spot-on hypotheses, 61
Stabingas, Mark, 190
Stanford's Graduate School of Business, 26, 28
Starbucks, 2, 83
starting from scratch, 14–16
staying ahead of the pack, 73
street-testing Plan A
asking right questions, 7
being different, 6–7
framework to organize content, 9
guiding and tracking journey, 7–8
metrics, 7
not reinventing wheel, 6
process, 5–8
Stryker, 77
stuck in a rut, 13
style and leaps of faith, 183
sub-Saharan Africa, 193–194, 215
subscription-based model, 154
subscription-based periodical publishing industry, 140
Summer Academy, 29–30
suppliers and WIIFM, 154
Supply Change, 185
sustainable competitive advantage, 180–181
Suzuki, Ichiro, 100
Swaniker, Fred, 26–31, 214

Target, 200
Amazon, 190
Costco, 149
gross margins, 148
target market, 127–128
technology
Aggregate Knowledge, 55
productivity gains, 126
Tele2, 162
Tesco and negative working capital, 151
testing hypotheses, 208
theater, 14
Thorbeck, John, 185
Thorne, Jonathan, 74–78, 85
Toyoda, Akio, 102
Toyoda, Kiichiro, 98
Toyoda, Sakichi, 98
Toyoda, Shoichiro, 100
Toyota Motor Company, 107, 179, 213
basis for success, 98
boring image, 100
costs, 99, 110
efficiency objectives, 99
gross margin model, 93, 98–102, 102
gross margins, 99, 101, 179
growth, 99–100
high quality, 101
just-in-time supply chain processes, 154
kaizen, 100
lessons from, 101–102
Lexus, 100–101
low cost, 101
measurable results, 99–100
net loss, 102
operating model, 179–180
Plan A, 100
Plan B, 100–101
reliability, 99, 101
revenue model, 179
vigorously competitive, 102
worker productivity, 99
wreaking havoc on industries, 101
Toyota Production System (TPS), 99
Toys "R" Us, 190, 200
trade-offs involved in venture capital, 173–174
Tribe.net, 53
TripAdvisor, 73
Tutu, Desmond, 26

unearned subscriptions, 155
United Airlines, 116
United Kingdom incorporated companies, 129
United States economic development, 2
US Airways, 116
United World Colleges (UWC), 28, 31

value-based pricing, 107
variable operating costs, 129–130
vending machines antilogs, 123
venture capital, 173–174
venture capitalists, 174–176
virtual-goods entrepreneurs, 107–108
Visa, 51
Vise, David, 73
visionaries, 2
Vodafone, 196
VoIP (Voice over Internet Protocol) technology, 160
Vonage, 161, 165

Wabco UK, 151
Walkman, 17, 83
Wall Street Journal, 27, 139–143
Wall Street Journal Interactive Edition, 142
Walmart, 25
  category management, 22
  design and location, 24
  discount goods, 22
  modeling after, 23
  orderly stores, 24
  Pantaloon learning from, 22–23
  removing cost of middleman, 22
  shopping experience convenient, 24
  supercenters, 148
  supplier relationships and merchandising, 22
  thriving, 149
  unbroken profitability, 120
Walt Disney's entertainment analog, 80
Walton, Sam, 22
warehouse clubs, 145, 151
Washington Post, 142
Web analytics companies, 60
Webber, Andrew Lloyd, 14, 83
Web sites, 73
West Side Story, 14
Whirlpool and negative working capital, 151
Whittle, Dennis, 44–46, 49, 215
WIIFM (what's in it for me?), 154
Wilke, Jeff, 188
Wilke, Jim, 200
Winograd, Terry, 69
Wolfensohn, James, 44
working capital, 86, 134
  accounts payable, 137
  assets, 136
  business model elements, 152–154
  checklist, 155–156
  defining, 135–139
  inventory, 137
  liabilities, 136
  measuring in days, 137–139
  negative, 137–138, 211–212
  noncash portion, 136–137
  reducing, 137–138
  ROI (return on investment), 138
  sales, 137
  timing, 153, 201
working capital models, 9, 134
  Amazon, 189
  analogs, 155
  balance sheet, 154
  business model grid, 209
  Celtel International, 197, 198
  competitive advantage, 145
  Costco, 139, 149
  Dow Jones, 139
  favorable, 202
  lessons learned, 150–152
  paying before product or service is produced, 140–145
  revenue, gross margin, and operating models for, 201–202
  stretching too far, 154–155
  timing cash flows, 153, 201–202
  warehouse stores, 145
  Zara, 184, 186
The World Bank, 43, 44
The World of Legend, 80
World of Warcraft, 80
WSJ.com, 143
WSJ Online, 142, 144

Yahoo!, 69, 70

Zannino, Rich, 143
Zara, 10, 25
  affordability, 182
  assembly of goods, 183
  business model, 181
  cash in hand, 184
  clothing and accessories, 181
  cost of goods sold, 185–186
  customer delight, 199

customers, 23
design process, 182–183
distribution process, 182–183
fashionable clothing, 182
fashion preferences, 23
fast fashion, 23–24, 181–186
feeling of scarcity, 184
gross margin model, 185–186
gross margins, 182–183
international expansion, 182
inventory, 183, 184
inventory management, 23
leap of faith, 183
luring shoppers to return, 183–184
markdown merchandise, 182
new products for, 186
Pantaloon borrowing from, 23
pricing apparel, 182
production process, 182–183
retail marketplace, 182
revenue model, 183–184, 185
sales, 183
sales process, 182–183
slow fashion, 184–185, 199–200
strategy and business model, 185–186
suppliers, 184
working capital model, 184, 186
Zennström, Niklas, 162, 174
ZoomSystems, 122
competitive advantage, 127
cost-saving replacement of labor, 115
extending retail experience, 124
labor productivity, 124
leaps of faith, 123–124
lessons from, 125–126
location of stores, 123–124
manufacturers, 124
Motorola, 124
operating costs, 124
optical sensors, 123
Plan A, 122–123
Plan B, 123–124
profit-sharing model, 125
revenues per square foot, 125
robotic store, 122–123
scarce and expensive resources, 115
Sony, 124

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