Introduction

IT WAS THE SUMMER OF 1998, and Max Levchin wasn't quite sure what he was going to do with his life. After finishing his undergraduate education amid the soybean fields of Champaign-Urbana at the University of Illinois, Levchin moved to Silicon Valley to start yet another company, having already started three during his studies.[1]

"I was living in Palo Alto, squatting on the floor of a friend," recalled Levchin. "I had two different ideas that I was considering."[2] After pitching his ideas to a hedge fund manger he had met at a lecture at Stanford University, the two decided to pursue Levchin's idea for security software for such handheld devices as the hot-selling PalmPilot. "I wanted to start a company that would take this scarce skill of implementing crypto on handheld devices and then packaging it into libraries and products. The assumption was that enterprises are going to all go to handheld devices really soon as the primary means of communication. Enterprise requires security; security requires these scarce skills; I have the skills; start a company." Voilà—Levchin's "Plan A" was born! "Any minute now, there'll be millions of people begging for security on their handheld devices," thought Levchin.[3]

The Sad Statistics of Plan A

Every aspiring entrepreneur has a Plan A. And virtually all of these individuals believe, like Levchin, that Plan A will work. They can probably even imagine how they'll look on the cover of *Fortune*, or the comments they'll give when asked, "How did you create the world's best business?"

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!