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Strategy Letter 1

BEN & JERRY'S VS. AMAZON *continued* ▸

by Joel Spolsky

Building a company? You've got one very important decision to make, because it affects everything else you do. No matter what else you do, you absolutely must figure out which camp you're in, and gear everything you do accordingly, or you're going to have a disaster on your hands.

The decision? Whether to grow slowly, organically, and profitably, or whether to have a big bang with very fast growth and lots of capital.

The organic model is to start small, with limited goals, and slowly build a business over a long period of time. I'm going to call this the Ben & Jerry's model, because Ben & Jerry's fits this model pretty well.

The other model, popularly called "Get Big Fast" (a.k.a. "Land Grab"), requires you to raise a lot of capital, and work as quickly as possible to get big fast without concern for profitability. I'm going to call this the Amazon model, because Jeff Bezos, the founder of Amazon, has practically become the celebrity spokesmodel for Get Big Fast.

Let's look at some of the differences between these models. The first thing to ask is: are you going into a business that has competition, or not?

BEN & JERRY'S	AMAZON
Lots of established competitors	New technology, no competition at first

If you don't have any real competition, like Amazon, there is a chance that you can succeed at a "land grab", that is, get as many customers as quickly as possible, so that later competitors will have a serious barrier to entry. But if you're going into an industry where there is already a well-established set of competitors, the land-grab idea doesn't make sense. You need to create your customer base by getting customers to switch over from competitors.

In general, venture capitalists aren't too enthusiastic about the idea of going into a market with pesky competitors. Personally, I'm not so scared of established competition; perhaps because I worked on Microsoft Excel during a period when it almost completely took over Lotus 123, which virtually had the market to themselves. The number one word processor, Word, displaced WordPerfect, which displaced WordStar, all of which had been near monopolies at one time or another. And Ben & Jerry's grew to be a fabulous business, even though it's not like you couldn't get ice cream before they came along. It's not impossible to displace a competitor, if that's what you want to do. (I'll talk about how to do that in a future Strategy Letter).

Another question about displacing competitors has to do with network effects and lock-in:

BEN & JERRY'S	AMAZON
No network effect; weak customer lock-in	Strong network effect, strong customer lock-in

A "network effect" is a situation where the more customers you have, the more customers you will get. It's based on Metcalfe's Law: the value of a network is equal to the number of users squared.

A good example is eBay. If you want to sell your old Patek Philippe watch, you're going to get a better price on eBay, because there are more buyers there. If you want to buy a Patek Philippe watch, you're going to look on eBay, because there are more sellers there.

Grow slowly, organically, and profitably, or…have a big bang with very fast growth and lots of capital.

Another extremely strong network effect is proprietary chat systems like ICQ or AOL Instant Messenger. If you want to chat with people, you have to go where they are, and ICQ and AOL have the most people by far. Chances are, your friends are using one of those services, not one of the smaller ones like MSN Instant Messenger. With all of Microsoft's muscle, money, and marketing skill, they are just not going to be able to break into auctions or instant messaging, because the network effects there are so strong.

"Lock-in" is where there is something about the business that makes people not want to switch. Nobody wants to switch their Internet provider, even if the service isn't very good, because of the hassle of changing your email address and notifying everyone of the new email address. People don't want to switch word processors if their old files can't be read by the new word processor.

Even better than lock-in is the sneaky version I call stealth lock-in: services which lock you in without your even realizing it. For example, all those new services like

PayMyBills.com which receive your bills for you, scan them in, and show them to you on the Internet. They usually come with three months free service. But when the three months are up, if you don't want to continue with the service, you have no choice but to contact every single bill provider and ask them to change the billing address back to your house. The sheer chore of doing this is likely to prevent you from switching away from PayMyBills.com — better just to let them keep sucking $8.95 out of your bank account every month. Gotcha!

If you don't have any real competition... there is a chance that you can succeed at a "land grab."

If you are going into a business that has natural network effects and lock-in, and there are no established competitors, then you better use the Amazon model, or somebody else will, and you simply won't be able to get a toehold.

Quick case study. In 1998, AOL was spending massively to grow at a rate of a million customers every five weeks. AOL has nice features like chat rooms and instant messaging that provide stealth lock-in. Once you've found a group of friends you like to chat with, you are simply not going to switch Internet providers. That's like trying to get all new friends. In my mind that's the key reason that AOL can charge around $22 a month when there are plenty of $10 a month Internet providers.

While I was working at Juno, management just failed to understand this point, and they missed their best opportunity to overtake AOL during a land rush when everyone was coming online: they didn't spend strongly enough on customer acquisition because they didn't want to dilute existing shareholders by raising more capital, and they didn't think strategically about chat and IM, so they never developed any software features to provide the kind of stealth lock-in that AOL has. Now Juno has around 3 million people paying them an average of $5.50 a month, while AOL has around 21 million people paying them an average of $17 a month. "Oops."

BEN & JERRY'S	AMAZON
Little capital required; break even fast	Outrageous amounts of capital required; profitability can take years

Ben & Jerry's companies start on somebody's credit card. In their early months and years, they have to use a business model that becomes profitable extremely quickly, which may not be the ultimate business model that they want to achieve. For example, you may want to become a giant ice cream company with $200,000,000 in annual sales, but for now, you're going to have to settle for opening a little ice cream shop in Vermont, hope that it's profitable, and, if it is, reinvest the profits to expand business steadily. The Ben & Jerry's corporate history says they started with a $12,000 investment. ArsDigita says that they started with an $11,000 investment. These numbers sound like a typical MasterCard credit limit. Hmmm.

Amazon companies raise money practically as fast as anyone can spend it. There's a reason for this. They are in a terrible rush. If they are in a business with no competitors and network effects, they better get big super-fast. Every day matters. And there are lots of ways to substitute money for time (see table). Nearly all of them are fun.

Ways to substitute money for time:

- » Use prebuilt, furnished executive offices instead of traditional office space. Cost: about 3 times as much. Time saved: several months to a year, depending on market.
- » Pay outrageous salaries or offer programmers BMWs as starting bonuses. Cost: about 25% extra for technical staff. Time saved: you can fill openings in 3 weeks instead of the more typical 6 months.
- » Hire consultants instead of employees. Cost: about 3 times as much. Time saved: you can get consultants up and running right away.
- » Having trouble getting your consultants to give you the time and attention you need? Bribe them with cash until they only want to work for you.
- » Spend cash freely to spot-solve problems. If your new star programmer isn't getting a lot of work done because they are busy setting up their new house and relocating, hire a high class relocation service to do it for them. If it's taking forever to get phones installed in your new offices, buy a couple of dozen cellular phones. Internet access problems slowing people down? Just get two redundant providers. Provide a concierge available to all employees for picking up dry cleaning, getting reservations, arranging for limos to the airport, etc.

Ben & Jerry's companies just can't afford to do this, so they have to settle for growing slowly.

BEN & JERRY'S	AMAZON
Corporate culture is important	Corporate culture is impossible

When you are growing faster than about 100% per year, it is simply impossible for mentors to transmit corporate values to new hires. If a programmer is promoted to manager and suddenly has 5 new reports, hired just yesterday, it is simply impossible for there to be very much mentoring. Netscape is the most egregious example of this, growing from 5 to about 2000 programmers in one year. As a result, their culture was a mishmash of different people with different values about the company, all tugging in different directions.

For some companies, this might be OK. For other companies, the corporate culture is an important part of the raison-d'être of the company. Ben & Jerry's exists because of the values of the founders, who would not accept growing faster than the rate at which that culture can be promulgated.

Let's take a hypothetical software example. Suppose you want to break into the market for word processors. Now, this market seems to be pretty sewn up by Microsoft, but you see a niche for people who, for whatever reason, absolutely cannot have their word processors crashing on them. You are going to make a super-robust, industrial strength word processor that just won't go down and sell it at a premium to people who simply depend on word processors for their lives. (OK, it's a stretch. I said this was a hypothetical example).

Now, your corporate culture probably includes all kinds of techniques for writing highly-robust code: unit testing, formal code reviews, coding conventions, large QA departments, and so on. These techniques are not trivial; they must be learned over a period of time. While a new programmer is learning how to write robust code, they need to be mentored and coached by someone more experienced.

As soon as you try to grow so fast that mentoring and coaching is impossible, you are simply going to stop transmitting those values. New hires won't know better and will write unreliable code. They won't check the return value from malloc(), and their code will fail in some bizarre case that they never thought about, and nobody will have time to review their code and teach them the right way to do it, and your entire competitive advantage over Microsoft Word has been squandered.

BEN & JERRY'S	AMAZON
Mistakes become visible lessons	Mistakes are not really noticed

A company that is growing too fast will simply not notice when it makes a big mistake, especially of the spend-too-much-money kind. Amazon buys Junglee, a comparison shopping service, for around $180,000,000 in stock, and then suddenly realizes that comparison shopping services are not very good for their business, so they just shut it down. Having piles and piles of cash makes stupid mistakes easy to cover up.

BEN & JERRY'S	AMAZON
It takes a long time to get big	You get big very fast

Getting big fast gives the impression (if not the reality) of being successful. When prospective employees see that you're hiring 30 new people a week, they will feel like they are part of something big and exciting and successful which will IPO. They may not be as impressed by a "sleepy little company" with 12 employees and a dog, even if the sleepy company is profitable and is building a better long-term company.

As a rule of thumb, you can make a nice place to work, or you can promise people they'll get rich quick. But you have to do one of those, or you won't be able to hire.

Some of your employees will be impressed by a company with a high chance of an IPO that gives out lots of stock options. Such people will be willing to put in three or four years at a company like this, even if they hate every minute of their working days, because they see the pot at the end of the rainbow.

If you're growing slowly and organically, the pot may be farther off. In that case, you have no choice but to make a work environment where the journey is the reward. It can't be hectic 80 hour workweeks. The office can't be a big noisy loft jammed full of folding tables and hard wooden chairs. You have to give people decent vacations. People have to be friends with their co-workers, not just co-workers. Sociology and community at work matter. Managers have to be enlightened and get off people's backs, they can't be Dilbertesque micromanagers. If you do all this, you'll attract plenty of people who have been fooled too many times by dreams of becoming a millionaire in the next IPO; now they are just looking for something sustainable.

BEN & JERRY'S	AMAZON
You'll probably succeed. You certainly won't lose too much money.	You have a tiny chance of being a billionaire, and a chance of just failing.

With the Ben & Jerry's model, if you're even reasonably smart, you're going to succeed. It may be a bit of a struggle, there may be good years and bad years, but unless we have another depression, you're certainly not going to lose too much money, because you didn't put in too much to begin with.

The trouble with the Amazon model is that all anybody thinks about is Amazon. And there's only one Amazon. You have to think of the other 95% of companies which spend an astonishing amount of venture capital and then simply fail because nobody wants to buy their product. At least, if you follow the Ben & Jerry's model, you'll know that nobody wants your product long before you spend more than one MasterCard's worth of credit limit on it.

THE WORST THING YOU CAN DO

The worst thing you can do is fail to decide whether you're going to be a Ben & Jerry's company or an Amazon company.

If you're going into a market with no existing competition, lock-in, and network effects, you better use the Amazon model, or you're going the way of Wordsworth.com, which started two years before Amazon, and nobody's ever heard of them. Or even worse, you're going to be a ghost site like MSN Auctions with virtually no chance of ever overcoming ebay. (Read Wordsworth's reply.)

There's only one Amazon. You have to think of the other 95% of companies…[that] simply fail because nobody wants to buy their product.

If you're going into an established market, getting big fast is a fabulous way of wasting tons of money, as did BarnesandNoble.com (http://www.barnesandnoble.com/). Your best hope is to do something sustainable and profitable, so that you have years to slowly take over your competition.

Still can't decide? There are other things to consider. Think of your personal values. Would you rather have a company like Amazon or a company like Ben & Jerry's? Read a couple of corporate histories — Amazon and Ben & Jerry's for starters, even though they are blatant hagiographies, and see which one jibes more with your set of core values. Actually, an even better model for a Ben & Jerry's company is Microsoft, and there are lots of histories of Microsoft. Microsoft was, in a sense, "lucky" to land the PC-DOS deal, but the company was profitable and growing all along, so they could have hung around indefinitely waiting for their big break.

Think of your risk/reward profile. Do you want to take a shot at being a billionaire by the time you're 35, even if the chances of doing that make the lottery look like a good deal? Ben & Jerry's companies are not going to do that for you.

Probably the worst thing you can do is to decide that you have to be an Amazon company, and then act like a Ben & Jerry's company (while in denial all the time). Amazon companies absolutely must substitute cash for time whenever they can. You may think you're smart and frugal by insisting on finding programmers who will work at market rates. But you're not so smart, because that's going to take you six months, not two months, and those 4 months might mean you miss the Christmas shopping season, so now it cost you a year, and probably made your whole business plan unviable. You may think that it's smart to have a Mac version of your software, as well as a Windows version, but if it takes you twice as long to ship while your programmers build a compatibility layer, and you only get 15% more customers, well, you're not going to look so smart, then, are you?

Both models work, but you've got to pick one and stick to it, or you'll find things mysteriously going wrong and you won't quite know why.

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