The Importance of Discovering Your Plan B

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Today's Startup Process: Seriously Flawed

If the founders of Google, Starbucks, or PayPal had stuck to their original business plans, we'd likely never have heard of them. Instead, they made radical changes to their initial models, became household names, and delivered huge returns for their founders and investors. How did they get from their Plan A to a business model that worked? Why did they succeed when most new ventures crash and burn?

Every aspiring entrepreneur, whether they desire to start a new company or create something new within an existing company, has a Plan A—and virtually all of these individuals believe that *their* Plan A will work. They can probably even imagine how they'll look on the cover of *Fortune* or *Inc.* magazine. Unfortunately, they are usually wrong. But what separates the ultimate successes from the rest is what they do when their first plan fails to catch on. Do they lick their wounds, get back on their feet, and morph their newly found insights into great businesses or do they doggedly stick to their original plan?

Let's face an uncomfortable fact: the typical startup process, largely driven by poorly conceived business plans based on untested assumptions, is seriously flawed. Most new ventures, even those with venture capital backing, share one common characteristic. They fail. But there is a better way to launch new ideas—without wasting years of your time and loads of investors' money. This better way is about *discovering* a business model that really works: a Plan B, like those of Google and Starbucks, which grows out of the original idea, builds on it, and once it's in place, enables the business to grow rapidly and prosper.

Most of the time, breaking through to a better business model takes time. And it takes error, too—error from which you learn. For Max Levchin, who wanted to build a business based on his cryptography expertise, Plans A though F didn't work, but Plan G turned out to be the ubiquitous PayPal we know today.

Getting to Plan B at Apple

Were Sergey Brin and Larry Page of Google, or Howard Schultz of Starbucks, or PayPal's Max Levchin simply lucky? Or is there something systematic about their successes that any entrepreneur can learn? Indeed, there is. Let's let the story of Apple's transition from a creative but struggling maker of personal computers to a consumer electronics and music phenomenon show us the way.

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While the iPod and the iTunes store have no doubt revolutionized how people listen to and approach music—not to mention TV and movies—are they really all that new after all? Consider the Sony Walkman for a moment … it made music personal and portable back in 1979! By 2000 over 300 million Walkman's had been sold. The Walkman analog suggested that demand for personal listening devices was real.

Then there was Napster, another analog, whose 26 million users were downloading music one tune at a time—illegally, as the courts soon decided. But analogs—predecessor companies that are worth mimicking in some way—are only part of the story. For Apple, there were *antilogs*, too: predecessor companies that you explicitly choose to do things *differently* than, perhaps because some of what they did has been unsuccessful. For the iPod and the iTunes store there were several important antilogs. There were MP3 players like the Rio, whose clunky user interfaces were far from user friendly. There were online music stores like MusicNet and Pressplay, whose very limited music selection and limited rights made them not very appealing to music lovers.

For Apple, there was one more analog that put all the pieces together, courtesy of Gillette's razors and razor blades. Gillette sold razors at low break-even prices and made its money selling the blades. Apple's Steve Jobs, ingeniously, flipped the model upside down. That he could do so profitably was, however, an unproven leap of faith. Jobs' hypothesis was that people would pay for easy to use, licensed, downloadable music and that a business model of high gross margins on the iPod with razor-thin margins in the iTunes store would be profitable while keeping the music industry off his back. Jobs showed how well he understands the value of applying an existing idea to his business when he said "Picasso had a saying: he said good artists copy, great artists steal … and we have always been shameless about stealing great ideas."

Apple's revenue on iPod sales in the first year alone was $143 million. When the iTunes store was launched in April 2003, over 1 million songs (at 99 cents each) were downloaded the first day! In 2007, Apple's music business passed $10 billion in annual revenue, and by 2008, 6 billion tunes had been sold to 75 million customers through the iTunes store. Paying for downloaded music had suddenly become cool.

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Getting to Plan B in *Your* Business

How can you break through to a business model that will work for your business? First, you'll need an idea to pursue. The best ideas resolve somebody's pain, some customer problem you've identified for which you have a solution that might work. Alternatively, some good ideas take something in customers' lives that's pretty boring and create something so superior it provides true customer delight, as was the case for the Walkman and the iPod.

Next, you'll need to identify some analogs, portions of which you can borrow or adapt to help you understand the economics and various other facets of your proposed business and its business model. And you'll need antilogs, too. As we have seen from the Apple story, analogs and antilogs don't have to only be from your own industry, though. Sometimes the most valuable insights come from rather unusual sources.

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*. 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.

To address your leaps of faith, you'll have to leap! Identify your key leaps of faith and then test your hypothesis. 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 time and money.

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But, what do you actually need to consider when developing your business model? Every business model needs to *quantitatively* address five key elements:

1 } **Your revenue model:** Who will buy? How often? How soon? At what cost? How much money will you receive each time a customer buys? How often will they send you another check?

2 } **Your gross margin model:** How much of your revenue will be left after you have paid the direct costs of what you have sold?

3 } **Your operating model:** Other than the cost of the goods or services you have sold, what else must you spend money on to keep the lights on?

4 } **Your working capital model:** 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?

5 } **Your investment model:** How much cash must you spend up front before enough customers give you enough business to cover your costs?

Uncovering the right analogs and antilogs, identifying your most important leaps of faith, and testing a series of hypotheses to inform all five elements of your business model doesn't happen in a single "eureka" moment. Getting to a viable Plan B, as PayPal's Max Levchin discovered, is a journey that can take months, and even years.

Like any journey that wants to go somewhere, this journey needs a roadmap to point the way and track your progress, something we call a dashboard. 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 entrepreneurs use them are much more than the dashboard in the family car. A dashboard in this 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 detours 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 are 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.

A dashboard—the systematic record you keep to guide and track this process of establishing your leaps of faith, the hypotheses that grow out of them, and the results of your hypothesis tests—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—to *doer*.

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One Element Can Hold the Key

While all successful business models address each of the five elements, for many great companies just a single element holds the key. The key element for Google was its revenue model because, initially, there wasn't a revenue model at all—just a free search engine. In order to bring money in, Google's Plan B provided paid search listings alongside the "objective" ones. Google's even more successful Plan C built on its proprietary search algorithms to deliver targeted ads to other web-sites—which has generated more than half of Google's revenue since 2004.

For Ryanair, the low-cost European airline, the key was its operating model. The Ryanair operating model utilized only one type of aircraft, no free in-flight meals, direct-to-consumer online ticket booking to cut out ticket agent commissions, and even getting rid of window shades and seat back pockets to significantly decrease the time on the ground between flights. This incredibly efficient operating model has allowed them to surpass all other European airlines in passenger traffic.

There are many more examples of businesses around the world that have revolutionized their industries by hanging their hat on one key element of their business model. Some of these companies include:

- China's Shanda Interactive: Revenue model
- Japan's Toyota and USA's eBay: Gross margin models
- India's Oberoi Hotels: Operating model
- USA's Costco and Dow Jones: Working capital models
- UK's Skype: Investment model

For others, such as Spain's Zara, combining two or more elements has made their business models particularly difficult to imitate, creating sustainable competitive advantage and an ability to grow rapidly even in brutal industries like retailing.

The Cold, Hard Facts

Most business plans assume that most everything is already known up front—not the case, as our examples have now shown. As the famed American general in World War II, Douglas MacArthur, is reputed to have once said, “No plan ever survives its first encounter with the enemy.

The process articulated here is a healthy alternative to the straight-jacket of today’s business planning 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’s a process that recognizes the cold, hard facts—most often, what ultimately works is not the Plan A that was so persuasively articulated in the original plan. Instead, it’s Plan B.

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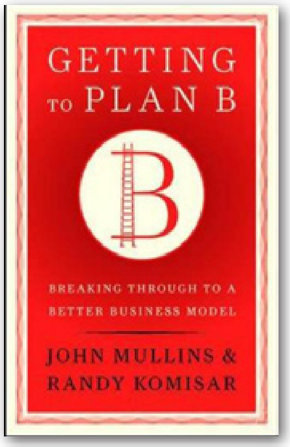

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Get more details or buy a copy of John Mullins and Randy Komisar's *Getting to Plan B*.

ABOUT THE AUTHORS

John Mullins teaches entrepreneurship and venture capital at the London Business School and in regular workshops on four continents. He is also the author of the definitive work on assessing entrepreneurial opportunities, *The New Business Road Test.* **Randy Komisar** is a partner at the esteemed VC firm Kleiner Perkins Caufield & Byers, a lecturer on Entrepreneurship at Stanford University, and the author of the bestseller *The Monk and the Riddle*, which was selected as one of the top 100 business books of all time. Together they are the authors of *Getting to Plan B: Breaking Through to a Better Business Model* (Harvard Business Press, 2009).

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