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FIFTH EDITION

THE NEW BUSINESS ROAD TEST



What entrepreneurs and investors
should do *before* launching
a lean start-up

JOHN MULLINS

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THE NEW BUSINESS ROAD TEST

FIFTH EDITION

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Part 1

Road test your new business idea

1

Our opportunity: why will or won't this work?

You may have capital and a talented management team, but if you are fundamentally in a lousy business, you won't get the kind of results you would in a good business. All businesses aren't created equal.

Long-time venture capitalist William P. Egan II¹

Passion! Conviction! Tenacity! Without these traits, few entrepreneurs could endure the challenges, the setbacks, the twists in the road that lie between their often path-breaking ideas – opportunities, as they call them – and the fulfilment of their entrepreneurial dreams. The very best entrepreneurs, however, possess something even more valuable – a willingness to wake up every morning and ask a simple question about their nascent opportunity: 'Why will this new business work when most will fail?' Or, to put it more realistically, 'What's wrong with my idea, and how can I fix it?'

They ask this simple question for a very simple reason. They understand the odds. They know most business plans never raise money. They know most new ventures fail. Most of all, they don't want to end up starting and running what Bill Egan would call a 'lousy business', one that consumes years of their energy and effort, only to go nowhere in the end. Despite asking this crucial question every day, their passion remains undaunted. So committed are they to showing a reluctant world that their vision is an accurate one that they want to know before bad things can happen why they might be wrong.

If they can find the fatal flaw *before* they write their business plan or *before* it engulfs their new start-up, whether lean or otherwise, they can deal with it in many ways. They can modify their idea – and pivot to a better version – thereby

shaping the opportunity to better fit the hotly competitive world in which it seeks to bear fruit. If the flaw they find appears to be a fatal one, they can even abandon the idea before it's too late – before launch, in some cases, or soon enough thereafter to avoid wasting months or years in pursuit of a dream that simply won't fly.

Better yet, if, after asking their daily question and probing, testing and especially experimenting for answers, the signs remain positive, they can embrace their opportunity with renewed passion and conviction, armed with a new-found confidence that the *evidence* – not just their intuition – confirms their prescience. Their idea really is an opportunity worth pursuing.

Tools to answer the question 'Why will or won't this work?'

Just as most car buyers take a road test before committing to the purchase of a new vehicle, so serious entrepreneurs and street-smart investors run road tests of the opportunities they consider. Each road test resolves a few more questions and eliminates a few more uncertainties lurking in the path of every opportunity.

“serious entrepreneurs run road tests of the opportunities they consider”

This book provides a road test toolkit that any serious entrepreneur or investor can use to resolve these questions and eliminate these uncertainties *before* writing a business plan and *before* getting started on a path to nowhere. It addresses the seven domains that characterise attractive, compelling opportu-

nities. It recounts the vivid case histories of path-breaking entrepreneurs who understood these domains, to their enduring advantage. Perhaps more importantly, the book brings to life the less happy stories of other entrepreneurs whose opportunities ran foul of one or more of the seven domains and who, as a result, failed to achieve their goals. Learning from failure is something most successful entrepreneurs do well. As many entrepreneurs put it, in talking about their battle scars, 'If I can make each mistake only once, I'll be in good shape.' The common as well as some not so common mistakes are here in this book for all to see.

What this book is and what it is not

This book is *not* about how to write a business plan. It's about what to do *before* you write your business plan, and before you embark on a lean start-up and its series of hypothesis tests leading to possible adjustments. If you're

a budding entrepreneur, its purpose is to help ensure that your venture has a better chance to compete for the time and attention – and hopefully the money – of the financiers and other resource providers you will approach, be they the three Fs (family, friends and fools, as the saying goes), angel investors, bankers, venture capitalists or prospective partners or employees. Or even your prospective customers, as we explore in some detail in Chapter 12! If you're one of those investors, my purpose for you is to help you avoid at least some of the errors commonly made in investing in early-stage ventures. You surely don't want those mistakes to offset the gains from the best of your deals.

This book doesn't just tell the story of one entrepreneur's route to glory – there are already plenty of books in that category – for it's grounded in solid research into what characterises attractive opportunities across a wide variety of market and industry settings (see the Appendix). This research brings together insights gleaned from leading venture capital and angel investors and successful serial entrepreneurs. Their insights apply equally to high-potential ventures and to lifestyle businesses that can enable an entrepreneur to be his or her own boss and get out of the corporate rat race.

It's also not a book about the personalities and traits of successful entrepreneurs, for an abundance of research has made clear that successful entrepreneurs come from all walks of life, from all strata of society.² The sources of their opportunities, however, do show some patterns, which we examine later in this chapter.

“this book is not about how to get rich quickly”

Finally, this book is not about how to get rich quickly. And it's not for those who want to start a business – any business – over a weekend. It's about how serious entrepreneurs and their investor partners – whether embarking on a new start-up or building something

new within the confines of an existing organisation – can prepare a solid foundation for the development of an enduring business that creates and delivers value for its customers and owners alike. There's nothing more fun in business than doing this, and the results are well worth the effort, as any successful entrepreneur will attest.

So what *is* this book? It's a map for the opportunity-assessing, opportunity-shaping process. It provides a useful framework – the seven domains – to lay a solid foundation on which to build a business plan or to create a successful entrepreneurial venture.

Opportunity assessment and shaping in today's lean start-up world

The lean start-up movement has burst onto the entrepreneurial scene and is revolutionising the way many entrepreneurs think about starting their ventures. Drawing on the work of Steve Blank, Eric Ries and others,³ the central notion is that before investing lots of money into a venture that's based on numerous untested and highly precarious assumptions, it makes more sense to think flexibly at the outset and invest fewer resources – staying 'lean' as the lean start-up moniker indicates – to begin systematically testing the most crucial assumptions to see whether they make any sense. If the assumptions prove erroneous, then you 'pivot' – altering the strategy, without abandoning your vision, as Eric Ries defines the term – and use what you've learned to work your way toward a better strategy that's more viable.

While the lean approach doesn't work for all kinds of start-ups, it holds great promise for many of today's new ventures, especially for the technology-enabled internet and mobile ventures that many readers of this book are probably contemplating. You'll find several compelling case histories of such ventures – some successful, some not – between the covers of this book. But, as the next section points out, not all markets or industries are equally attractive settings in which to launch a start-up, whether lean or otherwise. And you or your entrepreneurial team are probably better placed to start some kinds of ventures than others, if you're honest about it. Hence there are some crucial steps you should take *before* launching your lean start-up to ensure that the opportunity you plan to pursue – in lean fashion, perhaps – is one that's really worthy of your time and effort.

The seven domains of attractive opportunities

At its heart, successful entrepreneurship comprises three crucial elements: markets, industries and the one or more key people who make up the entrepreneurial team. The seven domains model (Figure 1.1) that drives this book brings these elements together to offer a new and clearer way to answer the crucial question that every aspiring entrepreneur and every early-stage investor must ask themselves every single morning: 'Why will or won't this work?' The model offers a better toolkit for assessing and shaping market opportunities⁴ and a better way for entrepreneurs or entrepreneurial teams – and investors, too – to assess the adequacy of what they themselves bring to the table as individuals and as a group. The model also provides the basis for

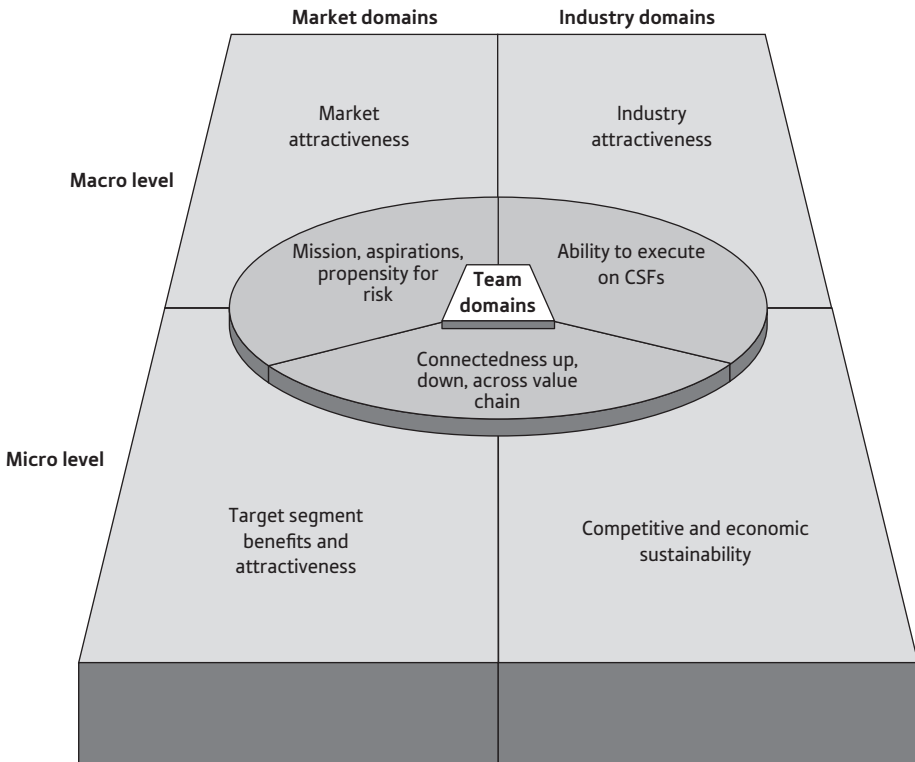


figure 1.1 The seven domains of attractive opportunities

what I call a customer-driven feasibility study that entrepreneurs may use to guide their assessments – *before* they invest the time and effort in writing a business plan or getting started in earnest.

At first glance, the seven domains model appears simply to summarise what everybody already knows about assessing opportunities. So it does. Upon more careful scrutiny, however, the model goes further to bring to light three subtle but crucial distinctions and observations that most entrepreneurs – not to mention many investors – overlook:

- markets and industries are not the same things;
- both macro- and micro-level considerations are necessary: markets and industries must be examined at both levels;
- the keys to assessing entrepreneurs and entrepreneurial teams aren't simply found on their resumés or in assessments of their entrepreneurial character.

Moreover, the model's seven domains are not equally important. Nor are they additive. A simple scoring sheet won't do. Worse still, the wrong combinations of them can kill your venture. On the

“good opportunities can be found in not-so-attractive markets and industries”

other hand, sufficient strength on some factors can mitigate weaknesses on others. Good opportunities *can* be found in not-so-attractive markets and industries.

As the model shows, it is made up of four *market* and *industry* domains, including both *macro* and *micro* levels, and three additional domains related to the entrepreneurial *team*. These seven domains that emerged from my research address the central elements in the assessment of any market opportunity.

- Are the market and the industry attractive?
- Does the opportunity offer compelling customer benefits, an economically sustainable business model as well as a sustainable competitive advantage over other solutions to the customer's needs?
- Can the team deliver the results they seek and promise to others?

Before examining these questions, let's address the first of the three crucial distinctions, that between markets and industries.

Markets and industries: what's the difference?

A market consists of a group of current and/or potential customers having the willingness and ability to buy products – goods or services – to satisfy a particular class of wants or needs. Thus, markets consist of buyers – people or organisations and their needs – not products.

“markets consist of buyers, not products”

One such market, for example, consists of businesspeople who get hungry between meals during their workday. We'll call this the market for workplace snacks.

“an industry consists of sellers”

An industry consists of sellers – typically organisations – that offer products or classes of products that are similar and close substitutes for one another. What industries serve the market for workplace snacks? At the producer level, there is the salty snack industry, the confectionery industry and the fresh produce industry, to name but three. There are also industries providing the distribution of these products to workplaces, including the supermarket industry, the restaurant industry, the coin-operated vending

machine industry, the coffee bar industry and so on. Clearly, these industries offer varying bundles of benefits to hungry workers. Some of these industries are more attractive than others to would-be entrants seeking to serve the workplace snack market.

Why is the market–industry distinction important? Because judgements about the attractiveness of the *market* one proposes to serve may be very different from judgements about the *industry* in which one would compete. This should not be – but often is – surprising, for the questions asked to assess market attractiveness are different from those for industry attractiveness, a point easily obscured when words like ‘sector’ and ‘space’ are used indiscriminately or carelessly in the opportunity assessment process. (Does the user of these terms mean ‘market’ or ‘industry’? See Case Study 1.1.) So, if market and industry attractiveness are both important, how should each be assessed?

case study 1.1

A lesson learned from the dot.com crash

In the late 1990s, entrepreneurs stumbled over one another in a mad race for first-mover advantage in the dot.com space. But what did they mean by ‘space’?

Did they mean the *market* of individuals and organisations who would use the internet for shopping, information, communication and other purposes? In hindsight, we now know that this market was and is extremely attractive: it was growing fast and would soon include most segments of the population, as the so-called digital divide shrunk rapidly.

Or did they mean *industries*: internet service providers, social networks, e-tailers, e-publishers and so on. In hindsight, we now know that some industries on the Web were and still are unattractive, because numerous new competitors can enter easily, differentiation is difficult to establish and competitive advantage is hard to sustain with competitors only a mouse-click away.

As entrepreneurial efforts, business plans and venture capital followed like lemmings from business-to-consumer to business-to-business to peer-to-peer models in the late 1990s, it soon became clear that, while many of these models served potentially attractive *markets*, they were situated in not very attractive *industries* in which to compete. Unfortunately for the many dot.com entrepreneurs whose ventures failed, the recognition of this crucial distinction came too late.

As time has healed some of the internet wounds, significant numbers of attractive internet opportunities have emerged. They share in common many of the attributes – attractive markets and industry settings, clear customer benefits, sustainable competitive advantages, business models that work, all delivered by capable management teams – that characterise many of the pre-dot.com case histories in this book. As we now know, the internet, while perhaps not the change-the-world phenomenon in as many ways as was predicted at the turn of the millennium, is alive and well!

Is the market attractive? Macro and micro considerations

All else being equal, most entrepreneurs and most investors would prefer to serve attractive rather than unattractive markets, of course. How might such market assessments be made? My research showed that assessments must be made at both macro (broad, market-wide) and micro (particular to a specific segment, one customer at a time) levels. The macro/micro distinction is important, for the assessment questions differ.

Macro level

It is actually quite straightforward to conduct a macro-level market assessment. One first assesses – usually by gathering secondary data from trade publications, the business press and so on – how large the market is. Market size can be measured in many ways – the more the better. Measures include:

- number of *customers* in the market, say for workplace snacks;
- the aggregate *money spent* by these customers on the relevant class of goods or services, in this case workplace snacks;
- the number of *units* of relevant products or usage occasions, such as workplace snacks, bought annually.

One also collects recent historical data, to ascertain how fast the market has been growing, together with any available forecasts about how fast it is likely to grow in the future.

The investors and entrepreneurs we interviewed in researching this book concurred with this view:

We want to know the size and growth rate of the market, so that if the product catches on, we should have a substantial upside.⁵

HH, UK

We want to know that the overall market opportunity is big, and we have to be able to demonstrate that the market size of this particular offering is robust.

TP, USA

One then assesses broad macro-environmental (macro for short) trends – demographic, sociocultural, economic, technological, regulatory and natural – to determine whether things are likely to get better or worse in the future.⁶ Do the trends favour the opportunity, or will the entrepreneur be swimming against a powerful tide?

I think that being able to assess, spot, and maybe even create trends is very big – a key to decision making. There are many problems that don't have solutions yet. Just look at the cell phone . . . As you know, in many countries today, the penetration of mobile telephony now surpasses the penetration of desktop or wireline phones.

CM, USA

The broad, macro-level market assessment is important to both entrepreneur and investor, for both take risk in investing years and investment capital in an idea that, in the end, may not be substantial enough to be worth all the time and effort. It's important to know whether the opportunity is a substantial one, serving a large and attractive market, or a niche opportunity with limited potential. Either may be acceptable. It depends on the entrepreneur's and the investor's aspirations. It is also important to know which way the tides are flowing. Thus, reaching a clear conclusion about market attractiveness is critical. But this macro-level assessment – done at the 30,000-foot level, so to speak – is only half the market domains story. It is essential aerial reconnaissance and a good look at the road ahead, but for the full picture you need observers on the ground.

Micro level

No matter how large and fast-growing a market may be, entering it in the face of other competition is likely to be difficult, since customers are probably already satisfying their needs – though perhaps not optimally – in some way. In this sense, there's no such thing as a new market in customer terms. Aspiring entrepreneurs who say 'We have no competition' are simply naïve. Thus, most successful entrepreneurs, rather than targeting the entire

“Aspiring entrepreneurs who say ‘We have no competition’ are simply naïve”

market, identify a much smaller segment of customers *within* the overall market. The micro-level market assessment involves asking four key questions relevant to such a segment.

- Is there a target market segment where we might enter the market in which we offer the customer clear and compelling benefits, or – better yet – resolve their pain at a price he or she is willing to pay?
- Are these benefits, *in the customers' minds*, different from and superior in some way – better, faster, cheaper or whatever – to what's currently offered by other solutions? Differentiation is crucial. With the possible exception of niche markets in which small entrants can safely fly 'below the radar' of competitors, the vast majority of me-too products fail.
- How large is this segment, and how fast is it growing?
- Is it likely that our entry into this segment will create a stable platform that will facilitate entry into other segments that we may wish to target in the future?

This new service concept is turning the existing business model in the market on its head, making it a cost-effective alternative in a market that hasn't been properly serviced in the past. Customers are lining up for it.

JS, UK

How can these questions be answered? Most commonly, a combination of first-hand primary data (gleaned from talking to or surveying prospective customers) and secondary data (data collected previously and available on the internet or in libraries or from other sources, to determine segment size and growth rate) can deliver the understanding that both entrepreneurs and investors need.

“many aspiring entrepreneurs make the mistake of examining only the macro-level”

As we shall see later in this chapter, many aspiring entrepreneurs – not to mention many early stage investors – make the mistake of examining only the macro level. This behaviour appears to be especially common in technologically driven firms. Through failing to identify the first customers who will buy – almost by name – and why they

would benefit,⁷ and in ignoring how entry into this segment might create one or more options for growth into other market segments,⁸ they risk pursuing a dead-end path on two counts:

- without differentiated benefits, most customers won't buy;
- without a pathway to growth, most investors won't invest.

Most market segments are simply too small to sustain a high-growth business for very long, although such segments may be quite attractive to entrepreneurs seeking to establish niche-market or lifestyle businesses that fly 'below the radar' of larger competitors and grow more slowly. The story of Nike's entry and subsequent growth in the athletic footwear market demonstrates the importance of the micro-level assessment of market attractiveness (see Case Study 1.2).

case study 1.2

Nike wins at the micro level

The story of Nike's origins is now a familiar one. Phil Knight, a distance runner, and his track coach Bill Bowerman used Bowerman's wife's waffle iron and some latex to develop a running shoe for distance runners that was lighter (benefit: faster race times), had better cushioning (benefit: fewer shin splints and stress fractures from miles and miles of training) and had superior lateral stability (benefit: reduced chance of ankle sprains caused by running on uneven terrain).

At the macro level, the market for athletic footwear was stagnant at the time. Most people had only one or two pairs of trainers and saw no need for another. From a micro perspective, however, distance runners loved Knight's and Bowerman's new shoes, and the new company's success in the distance running segment led to later successes in tennis, basketball and other sports that have made Nike one of the world's leading brands.

In opportunity terms, what Knight and Bowerman saw initially was a chance to offer a demonstrably superior product that customers – elite distance runners – would prefer and pay for, one that could then lead to similar success in other sharply targeted footwear niches. Their sport-by-sport advance across the formerly stagnant athletic footwear market, accompanied by astute marketing that made high-priced athletic shoes a fashion item, led to that market's stunning growth (how many pairs of different athletic shoes are in *your* wardrobe today?) and to Nike's leading position in today's athletic footwear industry.

Is the industry attractive? Macro and micro considerations

Just as serious entrepreneurs and sensible investors prefer to serve attractive markets, so they also prefer to compete in industries in which most participants are successful and profitable, rather than in industries where many

firms struggle to survive. They also prefer to compete on the basis of some sustainable advantage that their competitors do not enjoy, and with a business model that won't soon run out of cash. How might these crucial judgments be made?

Macro level

Michael Porter, in the late 1970s, identified the forces that determine industry attractiveness.⁹ These forces – five of them – are powerful determinants of the overall profitability of any industry, not a bad thing for an aspiring entrepreneur to know:

- threat of entry;
- buyer power;
- supplier power;
- threat of substitutes;
- competitive rivalry.

Assessing these forces and any ongoing or likely future changes therein lies at the heart of a macro-level assessment of industry attractiveness.

So, how should a five forces analysis be done? What should be its outcome? The aspiring entrepreneur first identifies what industry his or her new business will be in – retailing, food manufacturing, software, or whatever. Doing this is not a trivial exercise. Industries can be defined broadly or narrowly, as we shall see in Chapter 4.

The entrepreneur or investor then asks a series of questions (discussed in detail in Chapters 4 and 14) about each of the five forces to determine whether that force is favourable or unfavourable on balance. The more forces that are favourable, the more attractive the industry, and vice versa. As it turns out, most industries are not very attractive. Would-be entrepreneurs should note that severe problems on just one force can be enough to tip the balance, so the weighing must be done in a thoughtful manner. Identifying such problems in advance enables the entrepreneur to craft plans to deal with them, or to abandon the opportunity altogether, if the problems are too severe.

**“most industries
are not very
attractive”**

Once all five forces have been assessed, the key outcome is to reach a clear conclusion about the attractiveness of one's industry. This step is crucial to the overall assessment of your opportunity, and it is one issue that professional investors always examine. If necessary, admit that your industry just

isn't very attractive. Note, however, that all is not necessarily lost if the verdict is unfavourable. Other factors elsewhere in the seven domains analysis may compensate for these concerns.

As in the case for the macro-level assessment of market attractiveness, gathering secondary data is necessary here, but such data tell only part of the story. Additional, first-hand industry knowledge or primary data are usually required to develop a clear understanding of how the industry works and how it is changing.

We research where the industry is heading and what factors are affecting it. We want to know that the industry is here to stay and that it's not about to be replaced by technology.

JS, UK

One might imagine that a macro-level assessment of industry attractiveness would be sufficient, provided the micro-level market assessment has indicated that customers want to buy what the new entrant offers. For entrepreneurs who seek to build small but stable firms serving narrow market niches, this may sometimes be true. For more growth-oriented entrepreneurs and for most early-stage investors, however, there's another important piece of the puzzle: the micro level.

Micro level

Even if customers like what the prospective new entrant offers and most firms in its industry are successful due to favourable industry structure, a new venture is not likely to grow over the long term if the initial advantage it brings to its customers cannot be sustained in the face of subsequent competitors' entry, or if its business model lacks economic viability. Thus, identifying and assessing the competitive and economic sustainability of the proposed venture is necessary to fill in the micro-level industry piece of the opportunity assessment puzzle.

How might these micro-level industry judgements be made? Assessing the sustainability of the proposed venture requires examining, in relationship to its competitors, the proposed venture itself – whether a new firm or a venture within an existing firm. The goal is to determine whether certain factors are present that would enhance the ability of the venture to sustain any advantage that it might have at the outset, without quickly running out of cash. These competitive and economic factors are the following.

- The presence of proprietary elements – patents, trade secrets and so on – that other firms are unable to duplicate or imitate.

- The likely presence of superior organisational processes, capabilities or resources that others would have difficulty duplicating or imitating.¹⁰
- The presence of an economically viable business model – one that won't quickly run out of cash! This factor, in turn, involves a careful look at some more detailed issues:
 - revenue, in relation to the capital investment required and margins obtainable;
 - customer acquisition and retention costs, and the time it will take to obtain customers;
 - contribution margins and their adequacy to cover the necessary fixed cost structure to operate the business;
 - operating cash cycle characteristics, i.e. how much cash must be tied up in working capital such as inventory, how quickly will customers pay, and how slowly may suppliers and employees be paid, in relation to the margins the business generates.¹¹

Information on the economic structure of most industries can be found from published sources such as the Risk Management Association's *Annual Statement Studies*, available in most business libraries and on the internet, e.g. the Risk Management Association's website, www.rmahq.org

Aspiring entrepreneurs who plan to compete based on price should note that building a business by giving away your products for less than they cost to acquire or produce is not a sustainable strategy in the long run, as numerous dot.com entrepreneurs learned in the turn-of-the-millennium dot.com bust. Another economic viability issue often overlooked is this:

Too often entrepreneurs fail to understand how long it will take (and thus how much capital) to actually close a sale, no matter how good the opportunity looks.

RJ, UK

It's worth noting here that first-hand experience in the industry makes all the difference in addressing these issues. Entrepreneurs who know the territory will have the necessary answers. Those who don't must find people who do. Adequate answers for most of these issues are not likely to be found on the

“first-hand experience in the industry makes all the difference”

internet. If the entrepreneur doesn't have such experience, then they must obtain it from others. Picking up the phone and calling industry experts can help, and it helps build your network, too, a topic we address further later on.

The point addressed by the micro-level assessment on both the market and industry sides is that even in generally attractive markets and industries – such

as financial services and pharmaceuticals – not all new ventures succeed. Favourable industry conditions at the macro level are not a panacea. Positive results from your investigations into these micro-level conditions are typically far more important.

Can the team deliver?

When pressed to name the single most important factor in their investment decisions, many of the investors we interviewed said, simply, 'Management, management and management.' But we learned that assessing 'management' involves more than judging character and reading CVs. Our research identified three domains relating to the entrepreneur or entrepreneurial team itself, and we include any investors therein. Examining these domains is necessary in order to complete the opportunity assessment task.

- Does the opportunity fit the team's business mission, personal aspirations and risk propensity, and does all of that align with that of a prospective investor?
- Does the team have what it takes, in a human sense – in experience and industry know-how – to deliver superior performance for this particular opportunity, *given its critical success factors*, i.e. those factors that, done right, almost guarantee superior performance, even if other things aren't done so well; or done wrong, will have severely negative effects on performance, regardless of doing other things right?
- Is the team well connected up, down and across the value chain so it will be quick to notice any opportunity or need to change its approach if conditions warrant?

Let's take a look at each of these final three domains.

The team's business mission, personal aspirations and risk propensity

For a variety of reasons, individual entrepreneurs and investors come to the opportunity assessment task with certain preconceived preferences, often defined in terms of:

- markets they wish to serve (Nike's founder, Phil Knight, an athlete himself, wanted to market to athletes);
- industries in which they are willing to compete (for Knight, athletic footwear);

- their own aspirations (how big a venture; how soon, if at all, do we wish to exit; are we committed to this opportunity, or are we buying an option to see whether it pans out?);
- risks they are willing to undertake (with how much money; how certain must we be of a successful venture; must we have control, or are we willing to share it?).

Opportunities that do not match these preferences will be seen as unattractive, even though other observers having different sets of preferences and dreams might view them more favourably.

We've turned down opportunities because they didn't meet our criteria for investing, and sometimes they go on to do well with another firm. But when you change your threshold, you let in a lot more false positives. Your level of scrutiny should be exactly proportional to how much risk you are willing to take on in bringing in deals that may actually turn out to be bad. False positives are what you worry about, not false negatives.

TP, USA

The team's ability to execute on the critical success factors

The backgrounds and prior experiences brought to the venture by particular entrepreneurs and investors make them better prepared to execute on some sets of critical success factors than on others. Understanding the critical success factors relevant to a particular opportunity and the industry within which it will compete, and matching them against the team's ability to perform on them, is among the most compelling questions most investors ask in assessing opportunities. Entrepreneurs should do the same.

“Understanding the critical success factors is among the most compelling questions”

We really dig into the management team. We want to be totally confident that this team can deliver on the promises they have made. We do that by looking at their experience, by assessing how well they understand their industry and their customers. We want to know about their leadership in terms of the CEO and the heads of engineering, R&D and marketing. Probably those were the most important functions for this opportunity.

OD, USA

I don't mess with products or markets I don't know how to read.

PB, UK

Entrepreneurs who fail to assess accurately whether they and their team have what it takes to execute on the critical success factors they will face take a huge personal risk – beyond the business risk they already take – if they seek external capital. It is all too common for venture capital investors who like an opportunity to tire of the team they first back and bring in a new one at the first sign of trouble. Losing their companies is not something most entrepreneurs are keen to do.

The team's connectedness up, down and across the value chain

A favourite saying among venture capital investors is: 'I've made more money on Plan B than I ever made on Plan A.'¹² In other words, the ability to combine tenacity with a willingness to change course – sometimes due to changes in the marketplace, fortuitous or otherwise – can make all the difference. Thus,

“I've made more money on plan B than I ever made on plan A”

good luck can help a new venture, but those best prepared to take advantage of good luck are those whose leading-edge information connections enable them to respond to market changes quickly and adroitly. Entrepreneurial teams should ask

how connected they are, both up and down the value chain – with suppliers and customers – and across their industry to address this concern. How can they get connected if they are not? One partial answer: network, network, network.

We had three products when we entered the business, and we thought we knew their order of importance in the marketplace. We lost the market for what we thought would be our biggest product, and things looked really bad. But we had an outstanding board that brought to the team a lot of experience and partnerships and connections. One of our salespeople told a story about a customer's interest in our third product, a network interface card. The board seized upon the story and talked to some people that knew. It turned out that the board had spotted an early trend, and this is where we made all of our money. Without a doubt, the thing that carried us through was the quality of the team and all of its connections.

HH, UK

By assessing themselves with respect to the three *team* domains as part of their broader opportunity assessment efforts, entrepreneurs and entrepreneurial teams gain in three ways.

- If the team needs to be strengthened to better suit an otherwise promising opportunity, the best time to do so is *before* writing a business plan and *before* seeking seed capital. Doing this early enables the venture

to benefit from the talents, insights and perspectives of the team's new members.

- Viewing investors as part of the team also builds trust and can reduce the risk investors perceive in the venture, since many investors like to help build the team. Entrepreneurs who are willing to admit they don't have all the skills required often rate highly with the investor community.
- If external funding is to be sought, then pitching an inadequate team is not only likely to be unsuccessful but also undermines the credibility and reputation of the team members, thereby hampering their ability to raise capital in the future. Get the team right first, then pitch. You'll need to make a convincing case that the team will be able to deliver the results it seeks and those it promises to investors and other stakeholders.

These benefits are important, even for entrepreneurs in emerging industries who may not appreciate the need for well-developed connections. (For more on this topic, see Case Study 1.3.)

case study 1.3

What about entrepreneurs bearing new paradigms?

A visionary entrepreneur can change the world, or at least some part of it. They may be tempted to say, 'Our new paradigm changes everything. The old rules no longer apply.' But is this true?

The not very pretty record of dot.com ventures at the turn of the millennium suggests that entrepreneurs pitching new paradigms must understand clearly the realities of the old ones. Otherwise, they risk being blindsided by market or industry forces they fail to foresee, or facing critical success factors they are ill prepared to address. Including both old- and new-paradigm people and perspectives on the entrepreneurial team is one way to ensure that this does not happen.

Putting the seven domains model into action

Using the seven domains model requires a considerable amount of data. Mere opinions that an opportunity is attractive will not suffice and will destroy the credibility of the aspiring entrepreneur in the eyes of others. How, then, should an entrepreneur or investor obtain and interpret the necessary data?

In Chapter 10, we address this question in some detail. For now, however, let us note that some of the data the model calls for can be obtained quickly from

secondary sources: trade and other business publications in the library or on the internet, government reports and so on. Typically, though, an abundance of primary data – from interviews, observation, surveys of prospective customers and/or industry participants, or market experiments – are necessary for the two micro-level assessments making up the lower row in the model and for understanding the industry's critical success factors. So, build a simple mockup or prototype, pick up the phone or get out of the building and get some feedback! Make the connections up, down and across the value chain that any entrepreneurial team will need to fully assess your opportunity and to run a successful venture.

As for interpretation (and as was noted earlier in this chapter), using the model is not a simple matter of constructing a score sheet that adds scores for the seven domains. The domains are not additive and their relative importance can vary. Thus, a simple checklist will not suffice. The wrong combination of factors can kill your new venture, and enough strength on some factors can mitigate weaknesses on others. We address these situations in Chapter 9. For now, however, if a checklist is not sufficient, then how should anyone who completes a seven domains analysis draw conclusions about what it means?

Why *won't* this work?

Along the seven domains path, concerns inevitably crop up – a risk list, in a sense – that may have potentially fatal flaws that can render one's opportunity a non-starter. The key task in answering the crucial question 'Why won't this work?' is to find that major flaw that cannot be resolved, the opportunity's Achilles' heel. Thus, the crucial things to look for on the downside are elements of the market, industry or team that simply cannot be fixed by pivoting or shaping the opportunity in a different way.

“**find that major flaw that cannot be resolved, the opportunity's Achilles' heel**”

If flaws that cannot be fixed are found, then the best thing to do is to abandon the opportunity at this early stage and move on to something more attractive. Persisting with a fundamentally flawed opportunity is likely to have one of two outcomes, both of which are unpleasant.

- *Best case:* The best and most likely outcome is that experienced investors or other resource providers – suppliers, partners and so on – will identify the flaws that you have ignored and refuse to give you the resources you need, even if you have gone to great lengths to craft a business plan or a pitch deck that papers over these flaws. Fortunately for you, their refusal will save you the agony of investing additional months or years

of your life in actually running a lousy business, though your efforts in preparing and pitching your business plan will have been wasted. The harsh reality is that this is the case with the vast majority of business plans, for the opportunities they seek to pursue are fatally flawed. Most business plans should have been abandoned before they were written. Fortunately, most aspiring entrepreneurs now understand that writing a business plan – which is almost always about a well-loved but unlikely-to-succeed Plan A – is not the first thing they should do.¹³

- *Worst case:* The second, though less likely, outcome of pursuing a fundamentally flawed opportunity is that, in spite of the flaws, you are able to secure the resources you need and actually start the business. At some point, the flaws will rear their ugly heads, and you'll need to scramble to recast the business before it goes under. Some readers of this book may find themselves in this unhappy predicament today. It's not a pretty place to be.

The simple fact is, though, that inherent in virtually every entrepreneurial opportunity are some key flaws or risks that merit considerable attention. The seven domains analysis helps identify such risks wherever they lurk, and makes them salient enough to both entrepreneur and investor so they are not ignored.

So, 'Whose job is it to conduct a seven domains analysis of a prospective opportunity?' you might ask? 'Is this the entrepreneur's job, or is it the investor's?' Actually, unless you're a swashbuckling risk-taker who cares little about outcomes, you'd *both* better do it for the reasons already pointed out in this chapter. Indeed, in all of my own angel investing activities, I always bring a seven domains perspective to the table, front and centre. This allows me to quickly rule out opportunities that are not up to par, and spend my time on opportunities for which the upside looks great and the key risks appear manageable and worth taking.

Why *will* this work? Can the opportunity be shaped?

The good news in all this is that opportunities are not static. They can be shaped and developed in many ways. Potentially fatal flaws are there to be fixed. You can choose a different target market, one more receptive to the proposed offering. The product offering can be adapted to make it better fit what the market needs. Decisions can be made to pursue the opportunity at a different level in the

value chain – as a distributor, rather than as a retailer or a manufacturer, for example – if a different industry setting would be more hospitable. Finding

“potentially fatal flaws are there to be fixed”

additional individuals who can help the team deliver on the critical success factors or who bring appropriate connections up, down or across the value chain can strengthen the entrepreneurial team.

All of these approaches to reshaping but not abandoning your opportunity are what the lean start-up movement calls pivots: changes in strategy *without* a change of vision.¹⁴ If your opportunity turns out to be one you decide merits no further pursuit, however, don't fool yourself by calling this a pivot. Simply abandon it and move on.

Mapping a route to your dreams

Completing the seven domains road test provides the light to see through the fog of uncertainty that surrounds every opportunity. It enables the entrepreneur and investor to make the necessary pivots to reshape the opportunity so that it becomes worth pursuing – *before* writing a business plan and *before* launching a lean start-up. Most likely, your initial conception of your opportunity isn't quite optimal. It can probably be improved. This book provides tools for doing so and for identifying and guiding the initial pivots your venture – whether a lean start-up or otherwise – is likely to require.

In this chapter, I've provided an overview of the seven domains framework and shown how it can protect entrepreneurs and investors against pursuing ill-advised ventures that are fatally flawed, and how it can help entrepreneurs to achieve their dreams. In the next seven chapters, taking each of the seven domains in turn, the book relates the case histories of successful entrepreneurial heroes from around the world whose businesses exemplify 'getting it right' in seven domains terms. Each chapter also examines one or more case histories of entrepreneurs who violated the precepts of that domain – and paid the price. To complete each of these chapters, I draw on the research that underlies this book to outline what investors look for in each of the seven domains. And I summarise the powerful lessons the case histories offer to aspiring entrepreneurs who hope to avoid the mistakes of others who have ventured down the entrepreneurial path before them.

Then, Chapters 9 and 10 bring it all together. Chapter 9 shows how the seven domains can work together to spring traps that wary entrepreneurs should look out for in their own opportunities and shows how and where attractive opportunities can be found in stagnant or otherwise unattractive markets and industries. It also points out the kinds of opportunities that are particularly well suited to niche-market entrepreneurs – those who hope to build a

fly-below-the-radar business that they can operate for many years or pass on to their children.

Chapter 10 examines where the best opportunities usually come from and addresses the practicalities of conducting the necessary market research and preparing the evidence-based forecasts that are so crucial in the development of any new venture. Chapter 10 also outlines the steps that aspiring entrepreneurs should take in writing a customer-driven feasibility study for their own opportunity. Such a study – a short memo to oneself, really – captures and clarifies the conclusions of the seven domains road test. It provides a clear, customer-focused vision about why the proposed venture makes sense (or not!) – from market, industry and team perspectives. Best of all, it takes the entrepreneur halfway home in preparing a compelling business plan or pitch deck, thereby jump-starting either a business planning process or a lean start-up journey and ensuring it rests upon a firm foundation.

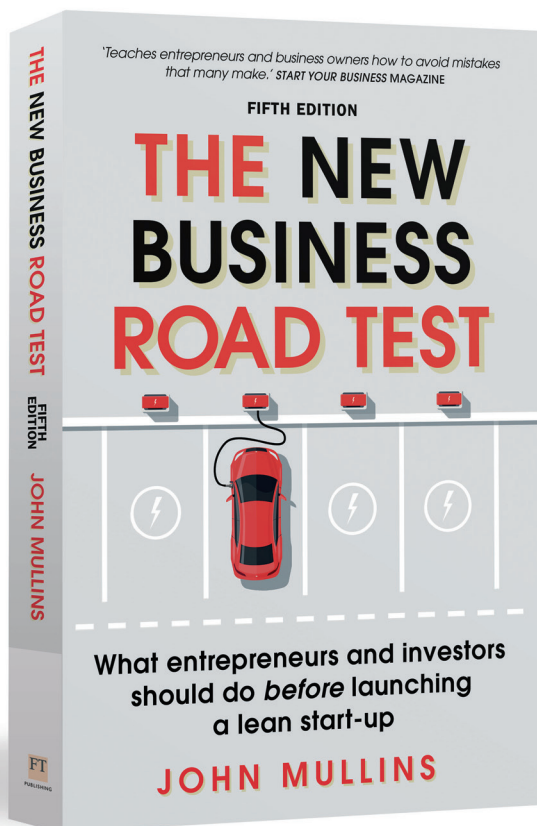
In the second half of the book, in Chapters 11 through 17, we put some of the tools you'll need for your opportunity assessment journey into your toolkit, and we link those tools to the *New Business Road Test* app for your smartphone or tablet, about which there's more information below. So, read on and enjoy the ride!

THE NEW
BUSINESS
ROAD TEST

A tool for when you are out and about: *The New Business Road Test* app

If you're like most entrepreneurs, assessing your opportunity is a day and night effort. You just never know where a crucial morsel of information will come from, and we want you to be ready to record it whenever and wherever that happens. So we've built a dandy little app for your smartphone or tablet that enables you to keep track of your notes, links to pertinent online content, and interviews you conduct as your seven domains research unfolds. It's got places to keep track of the risks you identify ("Why won't my idea work?") and of your judgements of the attractiveness of each of the seven domains as those judgements evolve. Cool! As one well-known marketer of credit cards used to say, 'Don't leave home without it!'

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