

# THE NEW

second  
edition



# BUSINESS



# ROAD TEST

What entrepreneurs and executives should do  
*before* writing a business plan



**JOHN W. MULLINS**

**FT**

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FINANCIAL TIMES

# Why read this book?

Right now there are 2 million entrepreneurs in the UK actively engaged in starting a new business. Many of their ventures will never get off the ground. Of those that do, the majority will fail. There are more than 15 million entrepreneurs in the USA doing the same thing. Most of their ventures will fail, too. Of those who submit business plans to business angels or venture capitalists less than 1 per cent will be successful in raising the money.

This picture of entrepreneurship is not a pretty one. The odds are daunting, the road long and difficult. Why, then, are a stunning one of every 19 adults in the UK – and one in ten in the USA – actively pursuing entrepreneurial

**“most opportunities are not what they appear to be, as the business failure statistics demonstrate”**

dreams? In a word – opportunity! Opportunity to develop an idea that seems, at least to its originator, a sure-fire success. Opportunity to be one's own master – no more office politics, no more downsizing, no more working for others. Opportunity for the

thrill, excitement, challenge and just plain fun inherent in the pursuit of entrepreneurial ventures. I know, because I've been there, too.

But there's a problem. Most opportunities are not what they appear to be, as the business failure statistics demonstrate. Most of them have at least one fatal flaw that renders them vulnerable to all sorts of difficulties that can send a precarious, cash-starved new venture to the scrapheap in a heartbeat. An abundance of research makes it clear that the vast majority of new ventures fail for opportunity-related reasons:

- market reasons – perhaps the target market simply won't buy;
- industry reasons – it's too easy for competition to steal your emerging market;

- entrepreneurial team reasons – the team may lack what it takes to cope with the wide array of forces that conspire to bring fledgling entrepreneurial ventures to their knees.

## How can a mere book help you meet this challenge?

The research underlying this book (see the Appendix) suggests that the serious entrepreneur who wants to beat the long odds – who wants to work harder and smarter to beat their competition – should pause in their haste to write that great business plan. Yes, I'm referring to *you*. Before putting pen to paper, you should step back and give your opportunity a road test. Examine the seven crucial domains of attractive opportunities that this book illuminates. Find, if you can, the fatal flaw lurking in what looks like an attractive opportunity. Your prospective investors will be looking for it, so you'd better have looked first.

## Why bother?

But why shouldn't a would-be entrepreneur simply skip the seven-domains road test this book advocates and proceed directly to preparing a business plan? There are two key reasons.

- First, this book enables entrepreneurs to avoid impending disaster. For most entrepreneurs, that's the likely outcome – sad to say – according to the business failure data. Preparing a customer-driven feasibility study based on the seven domains – a concise memo addressed to one's self, really – affords the entrepreneur a chance to opt out early in the process, before investing the time and energy in preparing a complete business plan. Identifying the critical flaw early can save weeks or months of time that might be wasted on a fundamentally flawed opportunity.
- For opportunities that do look promising, the feasibility study jump-starts the business planning process and provides a clear, customer-focused vision of why the proposed venture makes sense – from market, industry and team perspectives, viewed independently and collectively.

Thus, by ensuring that all aspects of the opportunity are examined, the new business road test reduces the entrepreneur's risk of entering a venture that simply has no chance. What entrepreneur wants to be the next contributor

## “the feasibility study jump-starts the business planning process”

to the sorry statistics of business failures? Surely not you. And it enhances the chances of starting a successful business that attracts both customers and capital.

Further, from a societal perspective, doing the seven-domains homework – before writing and pitching business plans – can reduce the waste of precious entrepreneurial resources now devoted to crafting business plans for fundamentally flawed opportunities. Entrepreneurs are the drivers of the global economy. Their firms create the new jobs and offer role models for others to follow. Let's be certain that today's entrepreneurs are working on ventures that have at least a fighting chance of success!

## Who should read this book?

Principally, this book is for serious, opportunity-focused entrepreneurs.

- People who are dying to get out of the big, stifling, inflexible businesses where they work today to strike out on their own. People who have identified one or more opportunities that might just be the ticket out, but who need a way to test them. People who want to run their own business and benefit from the significant upside potential that could bring them economic freedom.
- Entrepreneurs already running a start-up who are finding the challenges more daunting than they had imagined. Perhaps they are wondering whether their chosen path is a good one.
- Engineers and inventors with ideas or technologies that can spawn something more than just a new product.

There are two other groups, too, that can benefit from the new business road test and its seven domains.

- General managers, new product managers and business development professionals in businesses now mired in stagnant performance – or worse – in an unforgiving economy. They know their companies must find attractive new markets and develop successful new products in order to grow. Business as usual won't cut it. But how, they wonder, can their company be made more entrepreneurial?
- Investors – whether family or friends or business angels or even newcomers to venture capital – who want to sharpen their skills and bring more than their money to the entrepreneurial table.

Independent, clear-sighted advice from investors is more valuable to entrepreneurs than the money they bring.

What are these people – perhaps you are one of them – doing today? Some are spending every waking moment looking for an opportunity to join the

ranks of today's growing entrepreneurial culture.

Others are already engaged in conceiving or starting a new venture. Still others have recently done so, but the path to success remains unclear.

Whichever of these types of entrepreneur or would-be entrepreneur you are, if you are serious about succeeding in your new venture – not simply starting one – this book is for you. It will

help you avoid the disaster that's waiting to happen to the majority of new ventures. Yes, even to yours.

**“if you are serious about succeeding in your new venture – not simply starting one – this book is for you”**

## What will be the result of reading this book?

Entrepreneurs or managers having an opportunity in mind – whether it's still in the planning stages or already navigating the turbulent waters that early-stage ventures must sail – will reach one of three conclusions after finishing this book and putting their opportunity through the new business road test.

- Perhaps the most common outcome will be that the fatal flaw(s) will be uncovered. 'Whew! I'm glad I didn't write a business plan for *that* idea' is the likely sigh of relief. The disaster that would have ensued is now avoided, and all the time and energy that would have been invested in crafting the business plan can be invested more productively in a better idea. Those already in a new venture who reach this conclusion can plot a way to change the direction of the business – or sell it – before disaster strikes.
- Another common outcome will be that flaws that are identified can be fixed. Opportunities are malleable, and the entrepreneur is often able to reshape an opportunity to improve its attractiveness by:
  - targeting a different market;
  - offering a different product or service than the one originally planned;
  - playing at a different level in the value chain – as a distributor rather than a manufacturer, for example;

- adding skills to the entrepreneurial team that were missing in the original conception.

Opportunities can evolve, and the thought process outlined in this book hastens and strengthens that evolution.

- A third possible outcome – the happiest, but most rare – will be that the seven-domains test finds no fatal flaw. No matter how hard you look. Better yet:
  - your homework identifies a real problem that someone – your prospective customer – has, and you offer a solution that's better, faster or cheaper than current solutions;
  - your proposition stands a chance to establish sustainable competitive advantage;
  - the market is large enough to make the effort worthwhile;
  - the industry is sufficiently attractive;
  - your entrepreneurial team has what it takes to succeed.

**“the seven-domains homework provides the evidence-based research foundation for a persuasive and compelling business plan”**

The best news about this kind of outcome is that, in jump-starting the business planning process, the seven-domains homework provides the evidence-based research foundation for a persuasive and compelling business plan. A better business plan in half the time is the tangible result.

## Why John Mullins? What does a business school professor know about starting an entrepreneurial business?

This book brings together, from a single author, the hands-on, done-it-before experience of a three-time entrepreneur with the research expertise found among faculties at only a handful of the world's leading business schools. Put simply, I've practised what I preach and I have the entrepreneurial badges and scars to prove it. I've learned the way most entrepreneurs learn, from both failure and success.

I served as vice president in the early high-growth days at a then young company with great clothing stores called Gap; I founded Pasta Via International and took it public before market and technological changes took our company down; and I pioneered chimney-type charcoal starters for American barbecue enthusiasts. From all these experiences and from the



extensive research effort that underlies this book, I have drawn insights that deliver powerful lessons from which every entrepreneur – and many investors, for that matter – can learn.

As chair of the entrepreneurship faculty at London Business School, where my entrepreneurship colleagues and I – most of us successful entrepreneurs in our

**“ignoring even one of the seven domains can be a road map to entrepreneurial disaster”**

own right – develop world-class entrepreneurs and train and provide talent for the venture capital industry, I am well positioned to have written what I hope you will find is an accessible and eye-opening book. Once you have read it, I believe you’ll agree with me that ignoring even *one* of the seven domains can be a road map to entrepre-

neurial disaster. Entrepreneurs who start writing a business plan without putting their idea to the new business road test do so at their peril!

## Why a second edition?

The first edition of *The New Business Road Test* was a rousing success, not only in the English-speaking markets where it was first introduced, but also in translations into three other languages – Spanish, Russian, and Chinese. ‘But are the case histories still current,’ we wondered, as the book neared three years in print.

This new and fully updated edition brings each and every case history up to date, adding an important and timely ‘What happened’ to each of the stories. More important, though, is the addition of an extra chapter, 11: How to learn what you don’t know you don’t know, that forms the first chapter in Part 2 of this edition. Here you’ll find a powerful interviewing and road-testing technique that’s grown out of the experiences of dozens of users of the first edition of this book. You’ll learn how to get customers to tell you what you *don’t know* you need to ask them about their needs and their behaviour – their customer pain – that could provide the breakthrough insights on which to base your competitive advantage.

To clarify the structure of the book, it’s made sense to present this edition in two parts. Part 1 is all you’ll need to know to road test your new business idea while Part 2 provides you with the practical toolkit to carry out your road test.

## In 20 seconds or less

This book helps serious entrepreneurs and business professionals avoid impending disaster. It shows them what to do *before* they write a great business plan, to enhance their chance of winning both customers and capital and actually achieving their entrepreneurial dreams. And it reveals the seven key issues that astute investors examine *before* they invest. Intrigued? Read on.

JWM

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# 1

## My 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 II<sup>1</sup>

**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 business, they can deal with it in many ways. They can modify their idea – shaping the opportunity to better fit the hotly compet-

itive 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 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. Business plan, here we come!

## 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 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 can use to resolve these questions and eliminate these uncertainties *before* writing a business plan. It addresses the seven domains that characterize attractive, compelling opportunities. 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 quite 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, although it does offer suggestions about how to choose a business-planning book to guide that effort. It's about what to do *before* you write your business plan to ensure

that your plan 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.

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 characterizes attractive opportunities across a wide variety of market and industry settings (see Appendix 1). This research brings together new insights gleaned from leading venture capital investors and successful serial entrepreneurs. Their insights apply equally to high-potential ventures and to lifestyle businesses that can enable you to be your 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.<sup>2</sup> 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 quick”**

Finally, this book is not about how to get rich quick. It's about how serious entrepreneurs – whether embarking on a new start-up or building something new within the confines of an existing organization – 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.

## The seven domains of attractive opportunities

At its heart, successful entrepreneurship is comprised of 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



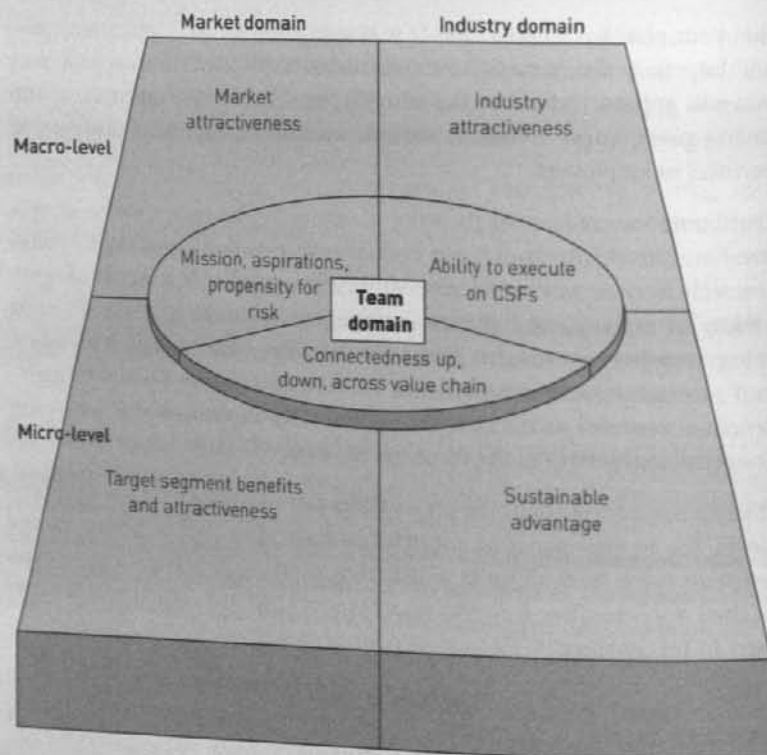


figure 1.1 The seven domains of attractive opportunities

answer the crucial question that every aspiring entrepreneur must ask themselves every single morning: 'Why will or won't this work?' The model offers a better toolkit for assessing and shaping market opportunities<sup>3</sup> and a better way for entrepreneurs or entrepreneurial teams 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 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.

At first glance, the seven domains model appears simply to summarize 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 other hand, sufficient

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

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

As the model shows, it is comprised 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 as well as a sustainable 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 organizations and their needs – 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.

### “markets consist of buyers, not products”

An industry consists of sellers – typically organizations – 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 candy 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

**“an industry consists of sellers”**

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 organizations 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, 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 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, and sustainable competitive advantages, all delivered by capable management teams – that characterize 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 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 the macro- (broad, market-wide) and micro- (particular to a specific segment) 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 venture capitalists 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.<sup>4</sup>*

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.<sup>5</sup> 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 the entrepreneur, for he or she risks investing years committed to an idea that, in the end, may not be large enough to be worth all the time and effort. It's important for the entrepreneur 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 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 domain 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

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

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 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 provide us entry to other segments 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 the entrepreneur needs.

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

As we shall see later in this chapter, many aspiring entrepreneurs 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,<sup>6</sup> and in ignoring how entry into this segment might create one or more options for growth into other market segments,<sup>7</sup> 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 sneakers and saw no need for another. From a micro-perspective, however, distance runners loved Knight's and Bowerman's new shoes, and their 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 – 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 closet 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 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. Serious entrepreneurs also prefer to compete on the basis of some sustainable advantage that their competitors do not enjoy. How might these crucial judgements be made?

### Macro-level

Michael Porter, in the late 1970s, identified the forces that determine industry attractiveness.<sup>8</sup> 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 then asks a series of questions (discussed in detail in Chapter 4) 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.

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 profes-

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

sional 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, 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 sustainability of the proposed new firm's competitive advantage 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's competitive advantage 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. These 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 organizational processes, capabilities or resources that others would have difficulty duplicating or imitating.<sup>9</sup>
- 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.<sup>10</sup>

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](http://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 by entrepreneurs 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 Internet. If the entrepreneur doesn't have such experience, then they must obtain it from others. Picking up the phone and calling those who they know can help, and it helps build your network, too, a topic we address further later on.

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

**“favourable industry conditions at the macro-level are not a panacea”**

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 venture capitalists 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?
- 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.' In other words, the ability to combine tenacity with a willingness to change course – typically due

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

to changes in the marketplace, fortuitous or otherwise – can make all the difference. Thus, 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 in 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. Doing this early enables the business planning effort 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 likely not only 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 that 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 [e.g. the Internet] 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 the entrepreneur obtain and interpret the necessary data?

In Chapter 10, we address this question in considerable detail. For now, however, let us note that much 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, some primary data – from interviews, observation, surveys of prospective customers and/or industry participants, or market experiments – are necessary for the two micro-level assessments comprising 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 and get some feedback! Make the connections up, down and across the value chain that your team will need to assess fully 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 the entrepreneur 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 that may be 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 shaping the opportunity in a different way.

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 though you have gone to great lengths to craft a business plan 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.

**“most business plans should have been abandoned before they were written”**

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.

- *Worst case:* The second, though less likely, outcome of pursuing a fundamentally flawed opportunity through the business planning stage 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.



## 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 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 additional individuals who can help the team deliver on the

**“potentially fatal flaws are there to be fixed”**

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

## Mapping a route to your entrepreneurial 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 to make the necessary mid-course corrections to reshape the opportunity so that it becomes worth pursuing – *before* writing a business plan. Most likely, your initial conception of your opportunity isn't quite optimal. It can probably be improved. This book provides the tools for doing so.

In this chapter, I've provided an overview of the seven domains framework and shown how it can protect entrepreneurs 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 summarize 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.

Finally, 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 an effective business plan. This chapter then outlines the steps that aspiring entrepreneurs should take in researching and writing a customer-driven feasibility study for their own opportunity. Such a study – a short memo to oneself, really – documents and clarifies the conclusions of the seven domains road test. It provides a clear, customer-focused vision about why the proposed venture makes sense – from market, industry and team perspectives. Best of all, it takes the entrepreneur halfway home in preparing a compelling business plan, thereby jump-starting the business planning process and ensuring it rests upon a firm foundation. So, read on and enjoy the ride!