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哈佛商学案例精选集
（英文影印版）

商务基础系列
Business Fundamentals Series

创业企业融资

Financing Entrepreneurial Ventures

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from
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FINANCING ENTREPRENEURIAL VENTURES

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INTRODUCTION

Welcome to the Business Fundamentals series from Harvard Business School Publishing!

The readings in this collection were developed for the MBA and executive programs of Harvard Business School. These programs rely heavily on the case method of instruction, in which students analyze and discuss firsthand accounts of actual management situations. Students also learn the fundamentals of what managers do: how they measure performance, make choices, and organize their activities. At Harvard Business School, the fundamentals are often taught through background notes, which describe business processes, management techniques, and industries.

The collections in this series are not meant to be comprehensive, but to present the fundamentals of business. Each collection contains several notes, and perhaps an article or two, that provide a framework for understanding a particular business topic or function.

Business is not an exact science. Your own business knowledge comes from your own experiences and observations, accumulated over many years of practice. These collections aim to give you a framework for past and future experiences, using many of the same materials taught at Harvard Business School.

The Business Fundamentals collections are designed for both individual study and faciliated training. If you want to use this collection for self-study, we've provided an abstract, outline, learning objectives, and questions for each reading to help you get started. If these readings are part of a training program in your company, you will find them to be a rich resource for discussion and group work.

You can search for related materials on our Web site: www.hbsp.harvard.edu. We hope that your learning experience will be a rich one.

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SOME THOUGHTS ON BUSINESS PLANS

(W.A. Sahlman / #9-897-101 / 32 p)

Abstract

Sahlman shows entrepreneurs how to understand their business in terms of the people, the opportunity, the context, and the deal. Each dimension should be reflected in a business plan so that both entrepreneurs and investors gain a realistic view of the possibilities and limitations of the new venture.

Outline

People

Opportunity

Competition

Context

Deals

Risk/Reward Management

Financial Projections

Due Diligence

Learning Objectives

After reading the note and completing the following exercises, entrepreneurs should be able to:

- Understand their venture in terms of people, opportunity, context, and deal.
- Assess what growth opportunities exist for their business.
- Determine whether they have "economically viable access to customers."
- Identify the key drivers of success for their business.
- Assess how their deals are structured in light of Sahlman's criteria for sensible deals.

Questions to Consider

- Why should others invest in your company? Why should they invest in you?
- How have you analyzed the industry you are entering? Is it structurally attractive?
- Have you systematically studied your competitors? From what sources did your information come?
- How much do your investors know about your industry? How much experience do your investors have?
- Do your financial projections reflect a sensible business model? How would you explain and defend that model to a prospective investor?

Some Thoughts on Business Plans

Internet Wicked Ale

Bill Sahlman, Dimitri V. D'Arbeloff Professor of Business Administration, smiled as he was handed the business plan for Internet Wicked Ale, Inc. (IWA), an interactive, on-line marketing company being formed to sell premium beers made by microbreweries over the Internet. According to the president of the company -- a soon-to-graduate MBA candidate at a well known eastern business school -- a prototype web site had already been developed using the now ubiquitous Java programming language. Literally thousands were visiting the site each day: an early review had described the web site as "way cool." Participating in the meeting were two other MBA candidates. Prior to jointly founding IWA, the three had worked in management consulting and investment banking: each, however, did have substantial experience with beer.

Sahlman glanced over the shoulder of the IWA team -- he took note of his ever growing stack of Internet based business plans, each proposing to "revolutionize" an industry, each "conservatively" projecting at least $50 million in revenues within five years based on a modest market share of under 10%, and each containing a projection of likely investor returns of over 100% per annum. He quickly averted his stare from the business plans in the corner of his less than tidy office so as not to offend his eager audience. They looked so young - they were so enthusiastic - their business plan was so meticulously printed on the new color laser printers in the technology lab ..... Sahlman wondered what to say next.

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Introduction

This note is about entrepreneurial ventures and the role of business plans. Few areas of new venture creation receive as much attention. There are MBA and undergraduate courses on business plan writing. There are countless books describing how to write a business plan. There is even software that will help create a business plan, complete with integrated financial projections. All across the U.S., and increasingly in other countries, there are contests designed to pick the "best business plan."

Judging by the amount of attention paid to business plans in graduate business schools and the popular press, you would think that the only thing standing between a would-be entrepreneur and spectacular success is a well-crafted and highly regarded business plan. Yet, in my experience,

Professor William A. Sahlman prepared this note as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

nothing could be further from the truth: on a scale from 1 to 10, business plans rank no higher than 2 as a predictor of likely success. There are many other factors that dominate the business plan, per se.

The disparity between my view and that implicit in the business plan feeding frenzy is rooted in over fifteen years of field research and personal experience in the world of entrepreneurship. The rest of this note develops a conceptual framework for understanding entrepreneurial venture creation and management, which is based on studying hundreds of successful and unsuccessful companies. The goal is to give the reader insights into sensible entrepreneurial management, and, by implication, into the business plan used to describe a venture.

In my framework, there are four dynamic components of any entrepreneurial process or venture:

- the **people**;
- the **opportunity**;
- the **external context**; and,
- the **deal**.

By people, I mean those individuals or groups who perform services or provide resources for the venture, whether or not they are directly employed by the venture. This category encompasses managers, employees, lawyers, accountants, capital providers, and parts suppliers, among others. By opportunity, I mean any activity requiring the investment of scarce resources in hopes of future return. By context, I mean all those factors that affect the outcome of the opportunity but that are generally outside the direct control of management. Examples of contextual factors include the level of interest rates, regulations (rules of the game), macroeconomic activity, and some industry variables like threat of substitutes. Finally, by deal, I mean the complete set of implicit and explicit contractual relationships between the entity and all resource providers. Examples of deals range from contracts with capital suppliers to the terms of employment for managers.

The fundamental insight gained from studying hundreds of successful and unsuccessful ventures is the concept of integration, referred to as "**fit**," which is defined as the degree to which the people, the opportunity, the deal, and the context together influence the potential for success. Phrased differently, the degree of fit is the answer to the following questions:

- To what degree do the people have the right experience, skills and attitudes, given the nature of the opportunity, the context and the deals struck?
- To what degree does the opportunity make sense, given the people involved, the context and the deals struck?
- To what degree is the context favorable for the venture, given the people involved, the nature of the opportunity and the deals struck?
- To what degree do the deals involved in the venture make sense, given the people involved, the nature of the opportunity, and the context?

These questions focus attention on the fact that excellence in any single dimension is not sufficient: the proper perspective from which to make an evaluation takes into account all of the elements simultaneously. An appropriate analogy might be that of a sports team. It is not sufficient to have the best individual players at each position; rather, success will be a function of how they play together, how the team is managed, what deals have been struck inside and outside the team, and what else goes on in the league. A diagram of the basic framework is provided in Appendix 1.

Nor is it sufficient to focus on these elements and their relationship from a static perspective. The people, opportunity, context and deal (and the relationship among them) are all likely to change over time as a company goes from identification of opportunity to harvest. To focus attention on the dynamic aspects of the entrepreneurial process, three related questions can be asked to guide the analysis of any business venture:

- What can go wrong?
- What can go right?
- What decisions can management make today and in the future to ensure that "what can go right" does go right, and "what can go wrong" is avoided, or failing that, is prevented from critically damaging the enterprise? Phrased another way, what decisions can be made to tilt the reward to risk ratio in favor of the venture?

This framework and set of questions are extremely powerful in understanding how ventures evolve over time and how managers can affect outcomes. The balanced emphasis on anticipating (as opposed to predicting) good and bad news is a distinctive feature of the framework. Most students (and practitioners) are adept at identifying risks, far fewer are practiced at foretelling the good news, and even fewer have thought systematically about how they can manage the reward to risk ratio. Yet, there are some recurrent themes in the world of venturing. That projects often take more time and money than originally estimated should not surprise people. Indeed, part of the goal in a course like the one I teach on Entrepreneurial Finance is to provide people with a rich sense of the patterns that underlie real-world entrepreneurship.

These questions described above concerning potential good and bad news also shed light on the fact that current decisions affect future decisions: some decisions open up or preserve options for future action while others destroy options. Managers must be cognizant of this relationship between current and future decisions.

According to this framework, great businesses have some easily identifiable (but hard to assemble) attributes. They have a world class managerial team in all dimensions, from the top to the bottom, and across all relevant functions. The teams have directly relevant skills and experiences for the opportunity they are pursuing. Ideally, the team has worked successfully together in the past. The opportunity has an attractive, sustainable business model: it is possible to create a competitive edge and to defend it. There are multiple options for expanding the scale and scope of the business and these options are unique to the enterprise and its team. There are a number of ways to extract value from the business either in a positive harvest event or in a scale down or liquidation mode. The context is favorable both with respect to the regulatory environment and the macroeconomic situation. The deals binding the people to the opportunity are sensible and robust: they provide the right incentives under a wide range of scenarios. The venture is financed by individuals or firms who add value in addition to their capital, thereby increasing the likelihood of success. The financing terms provide the right incentives for the provider and the recipient. There is access to additional capital on an as-warranted basis. In short, the venture is characterized by a high degree of dynamic **fit** (see Appendix 2 for a diagram of the expanded fit management framework).

A great business may or may not have currently, or have ever had for that matter, a great business plan. In the beginning, moreover, a great business may not even have demonstrated a high degree of **fit**: the important issue is whether the deficiencies are recognized and fixable. Phrased differently, the role of management is to continuously adapt a business to improve the degree of **fit**: doing so does not guarantee success, but it does increase the odds.

This assessment raises the obvious issue of what role a business plan plays in entrepreneurship. I believe that a useful business plan is one that addresses the elements of the venture - people, opportunity, context, and deal - in the proper dynamic context. In the end, the business plan must provide reasonable answers to the following questions:

- Who are the people involved? What have they done in the past that would lead one to believe that they will be successful in the future? Who is missing from the team and how will they be attracted?
- What is the nature of the opportunity? How will the company make money? How is the opportunity likely to evolve? Can entry barriers be built and maintained?
- What contextual factors will affect the venture? What contextual changes are likely to occur, and how can management respond to those changes?
- What deals have been or are likely to be struck inside and outside the venture? Do the deals struck increase the likelihood of success? How will those deals and the implicit incentives evolve over time?
- What decisions have been made (or can be made) to increase the ratio of reward to risk?

Each of these areas will be addressed in the sections that follow.

People

When reading any business plan, or assessing any business, for that matter, I start with the resume section, not with the description of the business. I ask a series of structured questions, some of which are listed below:

- Who are the founders?
- What have they accomplished in the past?
- What directly relevant experience do they have for the opportunity they are pursuing?
- What skills do they have?
- Whom do they know and who knows them?
- What is their reputation?
- How realistic are they?
- Can they adapt as circumstances warrant?
- Who else needs to be on the team? Are the founders prepared to recruit high quality people?
- How will the team respond to adversity?
- Can they make the inevitable hard choices that have to be made?
- What are their motivations?
- How committed are they to this venture?

- How can I gain objective information about each member of the team including how they will work together?

- What are the possible consequences if one or more of the team members leaves?

We can now come full circle and begin to evaluate the Internet Wicked Ale proposal and the team of MBA founders. Starting first with the people lens, I am not sanguine about IWA's prospects. The founding team has experience drinking, not starting an online business or a beer distribution business. Typically, the business plan for such a team talks about the need to recruit experienced people, but it's rather like trying to draw 4 cards to complete a 5-card straight in poker: a low probability event. Moreover, having a founding team without tremendous experience but large equity ownership often makes it extremely difficult to attract high quality people on "acceptable" terms.

I should note that the framework described above and the pessimistic assessment of the prospects for IWA are not foolproof. Lots of inexperienced teams succeed, occasionally because they are not weighted down by conventional wisdom. This is particularly true in new markets, the Internet representing a very important current illustration. In such markets, commercial innovation is often driven by relatively inexperienced entrants, teams that are repeatedly told they are unlikely to succeed. At the same time, starting a new enterprise with little or no management experience is a little like crossing the Mass Turnpike blindfolded: yes, you can make it to the other side, but having done so, you shouldn't assume the trip was riskless.

Reading a business plan from the resume section first also illustrates a truism of professional venture capital investing. A typical venture capital firm receives approximately 2,000 business plans per year. A non-scientific survey of several prominent firms reveals that they only invest in plans that come in with a specific letter of referral from someone well known by the partners of the firm. That is, they do not invest in, nor do they even investigate fully, plans that are unsolicited.

My colleague Myra Hart has a useful way of describing the process of attracting financial and other resources to a venture. Her research suggests that successful venture founders have two characteristics: they are "known" and they "know." Tackling the latter first, the founders know the industry for which they propose to raise capital and launch a venture - they know the key suppliers, the customers, and the competitors. They also know who the talented individuals are who can contribute to the team. At the same time, they are known in the industry: people can comment on their capabilities and can provide objective referrals to resource suppliers like professional venture capitalists. Suppliers, customers, and employees are willing to work with them in spite of the obvious risks of dealing with a new company.

Thus, the model in venture capital is to back teams with great (directly relevant) track records who are pursuing attractive opportunities. The old adage in venture capital circles is: "I'd rather back an 'A' team with a 'B' idea than a 'B' team with an 'A' idea." Of course, the goal is to only back high quality teams with high quality opportunities, but that is not always feasible.

In sum, the IWA business plan doesn't pass the threshold for consideration by professional investors even if the idea is a pretty good one. Again, a truism from the world of venture capital is that ideas are a dime-a-dozen: only execution skills count. Arthur Rock, a venture capital legend associated with the formation of such companies as Intel, Apple, and Teledyne, stated bluntly, "I invest in people, not ideas."[1]

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[1] Michael W. Miller, "How One Man Helps High-Tech Prospects Get to the Big Leagues," Wall Street Journal, December 31 1985, page 1.

Opportunity

Rather than rejecting the IWA plan out of hand, however, let's assume that the team is acceptable or that there are indications that an appropriate team can be built. What is the next step? What other questions do investors or entrepreneurs ask to evaluate prospective ventures?

In my experience, the next major issue is the nature of the opportunity, starting first with an assessment of the overall market potential and its characteristics. Two key initial questions are:

- Is the total market for the venture's product or service large and/or rapidly growing?
- Is the industry one that is now or can become structurally attractive?

Entrepreneurs and investors look for large or rapidly growing markets for a variety of reasons. First, it is often easier to obtain a share of a growing market than to fight with entrenched competitors for a share of a mature or stagnant market. Professional investors like venture capitalists try to identify high growth potential markets early in their evolution: examples range from integrated circuits to biotechnology. Indeed, they will not invest in a company that cannot reach a significant scale (e.g., $50 million in annual revenues) within five years.

Obviously, all markets are not created equal: some are more attractive than others. Consider, to illustrate, the independent computer disk drive business as it has evolved over the past twenty years. Disk drives were first developed by IBM in the late 1960s and early 1970s. Some of the original engineering team members ultimately left IBM to form independent companies to develop products based on the same technology. Indeed, over the next two decades, scores of new companies were formed to exploit the rapidly growing market for data storage. Examples include Memorex, Seagate, Priam, Quantum, Conner Peripherals, and EMC.

The problem with disk storage, however, is that the industry is not structurally attractive, nor is it ever likely to be. Disk drive manufacturers must design their products to meet the perceived needs of OEMs (original equipment manufacturers) and end-users. Selling a product to OEMs is complicated and often has low margins. The customers are large relative to the supplier. There are lots of competitors, each with high quality offerings in the same market segment. Because there are so many competitors, product life cycles are short and ongoing technology investments high. The industry is subject to major shifts in technology and customer base (e.g., the shift in form factors or storage medium and the shift from minicomputers to microcomputers). Rivalry also leads to lower prices and hence, lower margins. In the end, it is extremely difficult to build and sustain a profitable business.

In this regard, the disk drive business looks suspiciously like the tire industry. When the tire industry developed, there were many competitors, each trying to sell their tires to the automobile manufacturers and to end-users. Rivalry was intense. The customers got larger and larger, squeezing the profitability of the tire suppliers. Ultimately, the industry evolved to the point where there were a handful of competitors, each with modest margins and highly cyclical results.

Compare the situation described for disk drives to that confronting biotechnology companies. If a biotech company creates a new product, intellectual property laws grant a certain amount of protection from competitive forces. Competitors must invent new approaches to the same underlying problem or they must license the product from the inventor. The extended duration of patent protection makes it possible as well to build a brand image that provides a certain amount of economic protection even after patent coverage expires. In the end, a model for a successful biotechnology company is a pharmaceutical company. On average, the latter companies are far more profitable than most precisely because of the structural attractiveness of their industry.

This extended discussion of growth and industry illustrates another important factor in venture formation and investing. What are the appropriate analogies? If a venture is successful, what will it look like? Identifying opportunities is a complex game of pattern recognition which is aided by experience and by honest assessment of business history. Knowing that the disk drive business is like the tire industry and that biotech is like the pharmaceutical industry is helpful in determining where to invest capital or human resources. Tom Stemberg once described what he was trying to accomplish in founding Staples, "I said I wanted to build the Toys R Us of office supplies." He picked a successful model, one that spoke volumes about what he intended to do and the consequences if he were successful.[2]

To reiterate, the goal is to pick industries that have lots of potential to create and protect value. Growth in sales is not equivalent to growth in value. Also, marrying great management to such markets is the primary tool for increasing the likelihood of success. Consider, to illustrate, the story of the formation of Compaq Computer. The founders were senior executives at Texas Instruments. Their original business plan described a plan to enter the disk drive business. They sent the plan to L. J. Sevin and Ben Rosen, venture capitalists with extensive experience in the electronics industry. Sevin and Rosen rejected the plan but liked the team. Ultimately, on a place mat in a local diner in Texas, a plan was sketched out to design, manufacture and market a portable personal computer. The rest, as they say, is history.[3]

I am also reminded of what the immensely successful venture capitalist, Don Valentine, says about venture investing. Most in the venture industry focus on the three determinants of venture success - people, people, and people. Valentine insists that the real trick is to find markets with explosive potential, to back great technology, and to put management in place as needed. He wants to invest in industries where growth can overcome the shortcomings of management. Valentine cites as Exhibit A his $2.0 million investment in Cisco, a networking company, that seven years later was worth over $6 billion.[4] In like vein, Peter Lynch, the famous manager of Fidelity's Magellan Fund, tried to invest in companies whose fundamental industry factors were so favorable that even incompetent management couldn't cause the stock to go down.

What is most important in new venture formation - the market being served, the specific product or service, or the quality of the people involved? I suspect that the correct answer is "yes." In the final analysis, the issues are not unrelated. Great people are those who can identify attractive markets and build compelling strategies. As General Doriot, one of the early pioneers in the venture capital industry once stated, "The problem is to judge ideas and men and the value of the possible combination - a very difficult task."[5]

The next major issue in evaluating a venture is the specific plan for building and launching a product or service. I will not dwell on this topic in spite of its obvious importance but will instead focus on some very simple questions that can help sort out good ideas from potential disasters. I can also quote Arthur Rock to remind the reader of the proper perspective for evaluating business proposals, "If you can find good people, if they're wrong about the product they'll make a switch, so what good is it to understand the product that they're talking about in the first place?"[6] Rock's admonition notwithstanding, there are a few issues that a business plan must address, including the following:

- Who is the customer?

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[2] For information on the launch of Staples, see Thomas G. Stemberg, Staples for Success, KEX Press, 1996.
[3] Benjamin Rosen, "Rosen's Ten Rules," in Raising Money, Amacom Press, 1990, pp. ix-xxv.
[4] Valentine's perspective is described in "Rise of the Silicon Patriots," Worth Magazine, December/January, 1996, pp. 86-92,137-146.
[5] Georges F. Doriot: Manufacturing Class Notes, Harvard Business School, 1927-1966, The French Library, 1993, page 85.
[6] op. cit., page 1.

- How does the customer make decisions?
- To what degree is the product or service a compelling purchase for the customer?
- How will the product or service be priced?
- How will the venture reach the identified customer segments?
- How much does it cost (time and resources) to acquire a customer?
- How much does it cost to produce and deliver the product or service?
- How much does it cost to support a customer?
- How easy is it to retain a customer?

Often, asking and answering these kinds of questions will reveal a fatal flaw in a plan. For example, it may be too costly to find the customers and convince them to buy the product. Economically viable access to customers is the key to business, yet many entrepreneurs take the Hollywood approach to this area - "Build it and they will come." That strategy is great in the movies but not very sensible in the real world.

I should note that it is not always easy to answer questions about possible customer response to new products or services. One entrepreneur I know proposed to introduce an electronic news clipping service. He made his pitch to a prospective venture capital investor who rejected the plan, stating, "I just don't think the dogs will eat the dogfood." Later, when the entrepreneur's company went public, he sent the venture capitalist an anonymous package comprised of an empty can of dogfood and a copy of his prospectus. If it were easy, there wouldn't be any opportunities.

The issue of pricing is particularly important in analyzing a business proposal. Sometimes the "dogs will eat the dogfood," but only at a price less than cost. Investors always look for opportunities that entail value pricing in which the price the customer is willing to pay is high. A good example is Sandra Kurtzig's description of how she set prices in the early days of ASK Computer Systems. ASK developed programs to help users monitor and evaluate their manufacturing process (scheduling, cost analysis, etc.). The software was extremely valuable to a user and there were few competitors or alternatives: Kurtzig called her pricing model the "flinch method." When asked how much the software was, she would respond, "$50,000." If the buyer didn't flinch, she would add, "per module." Again, if there were no visible choking, she would add, "per year." And so on, and so on. Kurtzig was ultimately able to build a very profitable multi-hundred million dollar business using this kind of "street smart" pricing.

The list of questions above focuses on the top and bottom line of a business - the direct revenues and the costs of producing and marketing a product. That's fine, as far as it goes. Sensible analysis of a proposal, however, involves also assessing the business model from a different perspective that takes into account the investment required (i.e., the balance sheet side of the equation). Consider the following questions that I use to assess the cash flow implications of pursuing an opportunity:

- When do you have to buy resources (supplies, people, etc.)?
- When do you have to pay for them?
- How long does it take to acquire a customer?
- How long before the customer sends you a check?

- How much capital equipment is required to support a dollar of sales?

Underlying these questions on the balance sheet is a simple yet powerful maxim in business:

Buy low, sell high, collect early, and pay late.[7]

The best businesses are those in which you have large profit margins, you get paid by your customers before you have to deliver the product, and the fixed asset requirements are modest. It goes without saying, in addition, that such a business should also be characterized by insuperable entry barriers.

Consider, to illustrate, the magazine publishing business. Once up and running, a successful magazine has remarkably attractive cash flow characteristics. Subscribers pay in advance of receiving the magazine. Often, magazines can even get subscribers to pay for several years in advance. I once discovered that I had nine years worth of service coming on a magazine because I diligently paid the bill each time they sent it to me, taking advantage of multi-year discounts. If the magazine can maintain compelling content, then current subscribers tend to re-subscribe on a regular basis with low incremental marketing cost. It is always easier to retain a customer than to acquire a new one. If the demographic profile of the readers is attractive, then advertisers use the magazine to reach a target audience, a successful example of "if you build it, they will come." It takes very little plant and equipment to run a magazine: printing and fulfillment are often farmed out to vendors who specialize and deliver high quality service at low cost. The editorial costs of a magazine are typically low. In essence, magazine publishing has all the attractive characteristics listed above.

Of course, the fact that a magazine property is valuable once it is up and running has not escaped people's attention. Each year, hundreds of new magazines are launched: most, to quote test pilot Chuck Yeager, "auger in." The Achilles heal in publishing is the cost of acquiring a customer in a world where most niches have already been recognized and served.

There are some other attractive business models that warrant mention. When I assess a business, I look for ways in which a company can expand the range of products or services being offered to the same customer base. Often, companies are able to create virtual "pipelines" which support the economically viable creation of new revenue streams. In the magazine business, for example, it is possible to create other lines of products or services that are attractive to subscribers. Inc. Magazine, to illustrate, has expanded beyond the basic magazine business to offer seminars, books, and videos for the Inc. subscriber (and others). In this example, a virtuous cycle is established in which success in the basic magazine leads to new related business opportunities that might not exist in the absence of the magazine.

A similarly attractive business model is illustrated by Intuit, which is best known for its personal financial program Quicken. The latter program helps users organize their checkbook. After the initial success of Quicken, Intuit was able to offer a wide range of additional services, including electronic banking, personal printing supplies, tax preparation software, and on-line information services. Because some of these ancillary services are so profitable, Intuit is able to give away the software program in hopes of creating a lifelong customer who buys additional services and products from the company. Intuit also discovered that many users of its personal finance program Quicken were small businesses: they soon introduced a variant of the program, called QuickBooks, that is designed to meet the specific accounting needs of small businesses. The QuickBooks division is now

[7] This is the title of a useful book -- Richard Levin, Buy Low, Sell High, Collect Early and Pay Late: The Manager's Guide to Financial Survival, Prentice-Hall, 1983.

more profitable than the original consumer focused one, demonstrating how success in one business can lead to success in another that is closely related.[8]

Not all businesses are created equal in terms of the kind of growth opportunities described above. In some businesses, success in one product or service does not necessarily create additional opportunities with the same customer base. Again, the disk drive business is informative because competitors have historically been unable to replicate success in one part of the industry in another. For example those firms that were successful in producing 5.25" drives) were not, for the most part, successful in producing 3.5" drives. Catching one technology wave does not always imply an ability to catch the next one. As colleagues Clayton Christensen and Joseph Bower have observed, the old axiom about staying close to the customer works if and only if you choose the right customer.[9]

An obvious extension of the pipeline model relates to geographic expansion possibilities. Some businesses are attractive because a successful model in one region can be rolled out to other regions. Such is the case in the theme restaurant business. If Hard Rock Cafe works in Paris and London, then it will probably work in New York and Chicago. This kind of business is rich in growth options that result from success.

There are many other successful business models that entrepreneurs and investors look for when making resource commitments to opportunities. I try, for example, to find companies that "sell ammunition to all sides of the war without end" rather than engage in direct combat. An illustration is A. C. Nielson, which measures marketing response for companies selling products or services but does not have to try to compete in the actual markets (e.g., Coke versus Pepsi, or ABC versus NBC). A similar company called Internet Profiles exists in the Internet world: it measures activity at web sites rather than trying to compete with other web site purveyors.

Another illustration of the "ammunition" strategy is a company called Abacus Direct. This company was founded to help catalog merchants improve the effectiveness of their customer acquisition strategies. Briefly, the co-founders convinced a large number of catalog companies (e.g., Lands' End and Orvis) to give them a data file comprised of the purchasing histories of each catalog's customers. The data on customers of many different catalogs was then pooled and analyzed. Using proprietary software, Abacus Direct was able to help the catalog companies identify high potential customers to whom new catalogs could be mailed and eliminate low potential customers from their lists.

Six years after starting, Abacus Direct was able to achieve an 75% share of the domestic catalog business. The company was extremely profitable early in its development, with net margins in the 30% range. Three contextual factors helped Abacus Direct enormously. First, competition among catalog companies was fierce and Abacus Direct benefited by helping competitors be more effective. Second, postage cost increases changed the business model for catalog merchants, making it imperative that direct mail effectiveness be improved. Finally, the cost of managing and analyzing a massive database, one containing purchase histories on almost 90 million people, fell dramatically. What used to take a mainframe computer many hours to analyze now takes minutes on a powerful workstation. The founders of Abacus Direct had previously founded a company that handled warranty card registrations for major appliance manufacturers. Again, that company had sold mailing lists based on purchase histories: the company was successful and was sold to a larger company some five years after it was founded. To use the terminology introduced in the section on "people," the founders "knew" the industry and they were "known," dramatically increasing the likelihood of their success.

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[8] Interestingly, the original Intuit business plan was sent to quite a few venture capitalists, including two members of Scott Cook's HBS class. The plan was rejected by one and all. Only later did the two classmates get an opportunity to invest in Intuit while it was still private. The potential small business accounting opportunity was specifically mentioned in the original Intuit plan.

[9] Clayton Christensen and Joseph Bower, "Disruptive Technologies: Catching the Wave," Harvard Business Review (January/February, 1995), pp. 43-53.