THE STARTUP CHECKLIST

25 Steps to a Scalable, High-Growth Business

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Preface

Why Every Entrepreneur Needs This Book . . . Instead of the Other 93,210 Books on Entrepreneurship

"To open a business is easy, to keep it open is an art."

—Chinese proverb

Entrepreneurs have been starting companies without reading instruction books since the first Phoenician trader bought his first ship over 5,000 years ago. And for those who do want some guidance, Amazon would be pleased to sell you any of the 93,210 books listed in its "start a business" category, many of which are quite good. So why is there a need for yet another startup book?

Because this book is designed for a very specific type of business starter: the entrepreneur who is deliberately setting out to create a scalable, high-growth business designed for the 21st century; a business that will likely hire employees, issue stock options, raise money from outside investors, grow rapidly, and eventually either be acquired by a larger company or "go public" through an initial public offering. It turns out that starting that kind of business gets very complicated, very quickly. Making even small mistakes at the beginning can cause problems at every later step along the way.

I've been starting companies myself for over 45 years as a serial entrepreneur (over half a dozen of them), and as an active business angel investor I have personally funded and advised over 100 others. I've founded, taught in, and advised many of the country's leading entrepreneurship training programs, and, as the founder and CEO of Gust, I've learned from the aggregate experience of providing the tools used by more than half a million startups around the world. I've also answered over 4,000 questions from aspiring entrepreneurs on Quora, the online question and answer site, and heard of just about every variety of problem in the playbook.

Along the way, I have learned firsthand the problems that can quickly arise from starting off on the wrong foot. They range from the fundamental (charging off to start a business that just doesn't make sense) to the painful (hooking up with people whose interests are divergent from yours) to the tragic (getting equity allocations wrong at the beginning and never being able to recover), all the way to the really, really expensive (making simple mistakes at the incorporation level that result in five- and six-figure clean-up costs the first time a serious investor is thinking of supporting you).

This book is intended to be your one-stop checklist to starting up right. I assume no prior knowledge on your part about business—just a strong desire to create something seriously big, and to do so in the most effective, most efficient, and least expensive way possible. My goal is to walk along beside you throughout the process, providing the background you need to understand the *whys* in addition to the *whats* and the *hows*. I will take you step-by-step through the nitty gritty practical tasks of starting up a high-growth venture, introduce you to the latest online tools that will save you time and money, point you to the standard books that should be in every entrepreneur's library, and give you a peek behind the angel/venture curtain so you can understand what potential investors are thinking when they are considering funding your startup.

As my hero, Ben Franklin, wrote, "Experience keeps an expensive school, but fools will learn in no other." Having spent a lifetime painfully learning from experience, my goal now is to short-circuit the time that you will need to spend in Ben Franklin's "expensive school."

> Ben Franklin was an amazing entrepreneur. You should read his delightful *Autobiography* for some cool startup experience and tips. (Not to mention his will, which established the first seed fund for entrepreneurs…)

Introduction

25 Key Action Steps for Every Entrepreneur

Because you are undoubtedly raring to go out and change the world, I'm going to start this book off by providing you with a crash checklist in "starting smart," so that you can avoid the biggest, most bone-headed errors made by many bright-eyed and enthusiastic first-time founders. I'll give you a quick overview of each of the steps that will take you from an idea to an exit, and I'll explain how to use this book as your companion along the way.

Note that the 25 steps in this Introduction are slightly different from the 25 chapters in the book, because they focus more on your business idea and pre-launch activities. So even if this chapter is all you read, at least you'll know what you should be doing, and where to find an in-depth discussion in the book on each topic.

Now, off we go!

Prepare for Launch

1. Educate Yourself.

Just as you wouldn't start on a trek to the North Pole without reading at least *Arctic Exploration for Couch Potatoes*, so should you start your entrepreneurial journey by at least getting oriented to the basics…and that's exactly what this book is about. So read it! Once you've finished, if you're typical of most hyperactive entrepreneurs, you'll be off getting your parka and snow shoes. But if you can eke out just a bit more patience, among those other 93,210 startup books, a few have become known as classics for a reason. They deal with everything from "what is entrepreneurship?" to "how can I start cheaply?" and "how do I turn an idea into a company?"

Therefore, after you finish *The Startup Checklist*, the next thing I'd suggest you do is take the time to read at least a few of the other basic books on the whole "starting a company" thing. While this book deals with the hands-on, practical aspects of starting up, there are several others that will provide invaluable context, advice, and theory, as well as detailed help with specific challenges many entrepreneurs face. I realize that the thought of reading even one book, let alone more, may sound boring or painful, or like a big waste of time. But when you stack the task up against the vital future of your entire enterprise, it begins to look like the best deal in town. In this book, I have pulled out a few gems of wisdom from the industry's leading thinkers and teachers to at least get you started, but I've also included in Appendix A a Startup Reading List of classics that are full of mission critical information that I can't hope to cover here. Read them.

2. Define Your Business Concept.

> For working through your business concept, there is a great planning tool called the Business Model Canvas, which we'll walk through in Chapter 1.

A business is created in order to execute on an idea. Not having a clear picture of that idea is virtually guaranteed to result in an extraordinary amount of wheel spinning. While you will spend the rest of your business career refining your idea, there must be something at the core, or you'll have nothing to refine. In particular, it is crucial at the very beginning to distinguish the business concept from the product concept. It is all well and good to come up with an idea for a cool new widget or app or website, but much more important is to understand what value the product brings to which customer, and therefore understand who will be willing to ultimately pay you for your work in developing it. At this point, you don't need a full-fledged business plan (don't worry, we'll be talking about that shortly), but you do need the ability to be able to clearly explain what you're doing, and why—and that's your business concept.

3. Perform a Reality Check.

With your concept sketched out, I strongly suggest you invest the time to get some pre-feedback. Take your nascent idea around and talk to several domain experts in your field to see what they think about it. Don't worry, they're not going to steal your idea (really, they won't!). What they will do, however, is to give you the beginning of a reality check to see if your idea makes any kind of sense to people who know the industry you're preparing to enter. Whatever they tell you shouldn't necessarily be dispositive (because it is true that sometimes it takes a fresh creative look from outside an industry to make a conceptual leap), but it should absolutely be taken into consideration…and not just given lip service. It is far, far better to find out before you start that your idea has already been tried multiple times with no success than it is to find out after you've spent two years of your life trying fruitlessly to smash a round peg into a square hole.

> I am constantly surprised by the number of enthusiastic entrepreneurs who approach me with bold new ideas for online platforms for angel funding…when they've never made or received an angel investment, started a company, or have any idea whatsoever about the industry. All I can do is shake my head in wonder.

4. Analyze the Strategic Landscape.

With an idea in hand that seems promising, take a look around to see who else is working on the same thing. That's because—as much as I hate to spoil the surprise—someone else is. Consider this: On the Gust online platform for the early stage industry, as of this writing, there

> Once you've identified the competition, you want to keep an eye on them—not as an obsession, but so you can be up-to-date on what they are doing. We'll discuss this in Chapter 3.

are over 500,000 companies who have created their startup profiles. Do you believe that there are 500,000 different business types in the world? Hint: No, there are not. How about 50,000? Nope, not that either. 5,000? Maybe, but I don't think so. 500? Yup, that sounds about right. So what does this mean to you? It means that, right at this moment, as you are about to start pouring your soul into a new venture, there are somewhere between 100 and 1,000 other founders doing exactly the same (or similar) things!

That said, just because there are competitors is no reason that they will succeed and you will not. Counterintuitively, experience has shown that a business arena with no competitors is often considerably more difficult to conquer than one in which a few other people have already paved the way for you (a lesson I painfully learned in the mid-1990s when I had a brilliant, breakthrough product for which we could never actually find a market). But it is important that you are aware of what the field looks like, so that you won't be unhappily surprised down the road.

5. Develop Your First Plan.

> For writing a lean business plan, a great tool is LivePlan.com, the online tool from the experts behind Business Plan Pro.

Assuming the feedback you're getting indicates that you may be on the right track, now is the time to start organizing your business concept into a more detailed roadmap for your venture. In Chapter 1, we'll walk through creating a visual business model using the Business Model Canvas. In Chapter 2, we will discuss how to prepare and use a lean written business plan. Whichever one you choose (or both), doing this exercise up front will give you the framework for everything that you will be doing down the road. It provides the context that will let you assess each new opportunity, product, option, and even employee in light of where you are trying to go and how you plan to get there. Equally important, although most investors these days don't read business plans, they do always ask detailed questions of you…questions that you can answer only if you have already carefully thought through your business to the level of detail required to do a plan in the first place.

6. *Get Feedback on Your Plan.*

When you've got something you believe in, run it by a few mentors or advisors in the early stage field. In contrast to the previous set of feedback (which was in the context of the domain), this set will give you a reality check on the idea as a business. All too often, I meet entrepreneurs who are in love with a product, or a slogan, or even an industry, but who have never really considered their business from the perspective of a long-term, operating venture.

> "Mentor" is a very special term that has been corrupted by overuse. Most people will be extraordinarily lucky if they find one or two real mentors during their entire careers. Realistically, what you want to find are advisors who will help steer you onto the right track.

Part of the challenge of getting valuable feedback in the startup world is that those whose advice would provide the most value are often those with the least time to provide it. In contrast, there are many well-intentioned people happy to provide you with advice that can be useless at best, and harmful at worst. Rather than trying to cold-call famous people and ask for advice, your best bet is to take advantage of the many programs that have done the work for you and already lined up advisors who have offered to provide feedback to startups. These include entrepreneurship professors, accelerator mentors, successful serial entrepreneurs judging pitch events, angel investor group screening sessions, VCs who hold office hours, etc. As they have allocated the time for precisely this purpose, make the best use of it by presenting your plan concisely, and then listening closely to their comments.

7. *Dip Your Toe into the Water by Testing the Market.*

Assuming that all signals are still "go," at this point you know that you've at least got a plausible shot at a venture. Now it's time for your initial market testing. Following the lean methodology and the process of customer development (discussed in Chapter 6), the goal here is to see if any of your potential users might really be willing to pay for what you want to sell. If your landing page, crowdfunding campaign, or other market test comes back positive, you're good to go. (On the other hand, if, at any of the above stages, reality or sage advice suggests you're off target, reformulate the concept or pivot the business model, and try again.)

Start the Business

8. *Incorporate as a Delaware C Corporation.*

Everything you have done so far can (and probably should) take place before there is an actual business in existence. But as soon as you are ready to bring on partners, hire employees, develop intellectual property, raise capital, or generate revenues—in short, anything that creates or shares value of any kind—you need to establish an entity to be the owner of that value. In Chapter 9 we will discuss the various types of possible business structures, including sole proprietorships, partnership, LLCs, and corporations.

In the real world, however, there is only one serious option. If you plan to do anything involving employee or advisor options, venture capital, or serious angel funding, you need to be established as a C corporation so that ownership of the business is divided into shares of stock. And while the corporation can theoretically be formed in any state in the US, for a number of practical and economic reasons, it almost always makes sense to set up the "official" home of your company in the state of Delaware.

On one level, incorporating a new entity can be cheap and easy: Read the state's instructions, spend a couple of hours of do-it-yourself time and $89, and you're all set. Alternatively, there are a number of online services that cater to small businesses that will do much of the work for you for a few hundred dollars more. But that is where danger lies. It's one thing to incorporate a simple, one-person company for a hobby business. It's a different thing entirely to make sure that your company's by-laws, stock option plans, shareholders' agreements, and myriad other documents are done correctly to set the stage for the scalable, high-growth business that you are destined to become.

9. *Get Yourself a Good Lawyer.*

Because a few dollars saved by incorporating "on the cheap" are almost guaranteed to cost thousands—or even tens of thousands—of dollars the minute you begin dealing with investors or option holders, it is critically important that you begin working from the very beginning with a good startup attorney. We'll discuss how to find and work with one in Chapter 10.

10. Divide the Equity With Your Cofounders.

If your founding team consists of more than just you, there will come a time when equity—that is, ownership of the venture—needs to be clearly established. In the same way that "good fences make good neighbors," a clear, rational, and mutually agreed-upon equity structure sets a company up for success, whereas a poorly thought-out or implemented one can be a recipe for failure. We'll walk through the intricacies of equity allocation in Chapter 5, but for now, the important things to remember are that (a) "equity is forever," so once it's in someone's hands, there is no way for you to get it back; and (b) equity is all about the future enormous upside of the business, and thus should be held by the people most likely to be instrumental and indispensable in making that upside real, rather than people whose services can be purchased on the market for cash.

> One cool tool for figuring out what your equity structure will look like after a few rounds of funding and recruiting can be found online at www.ownyourventure.com.

11. Become Part of the Entrepreneurial Ecosystem.

Back in the Dark Ages, around 2000 AD, there was no such thing as an "entrepreneurial ecosystem." Today, however, entrepreneurs are as highly regarded as baseball players, and the world in which you are starting your business is replete with the equivalent of Little Leagues, coaches, sporting goods stores, and back-lot *Fields of Dreams*. While it is certainly possible to survive as a loner, you will give yourself many more allies (and get access to many more

> One quick way to find kindred souls near you is to seek out Meetups (in-person gatherings that are organized online) for startups in your area. Search www.meetup.com with terms like "startup," "entrepreneurs," and "tech."

benefits) if you proactively put yourself in the middle of the action. Whether it is going to Meetups, applying to an accelerator program, pitching in business competitions, or participating in online forums, embracing the ecosystem will likely pay off in the long term more than you realize.

Grow the Business

12. Recruit Top-Flight Talent.

> The smartest thinker on this subject that I've come across is Lex Sisney, author of *How to Think About Hiring* (Amazon Digital Services, 2014). It is a short, seminal book that should be mandatory reading before you decide who to hire, and for what roles.

As the demand for your products or services grows, so will your business, and that means you'll need help. Recruiting, hiring, and training A+ employees is a challenge that many entrepreneurs aren't fully equipped to handle in their first venture, and mistakes here can have lasting repercussions. In Chapter 17, we'll discuss the key things you should be looking for when bringing together your team, and how you should treat them once they're on board.

13. Recruit Your Board of Directors and Advisors.

A world-class coder? Plan on $150K+ a year. A world-class chairman of the board? Priceless. Although it's an established fact that all entrepreneurs know everything (present company not excepted), in the real world, I have found that other people have often been both smarter than I am, and more insightful at identifying issues that were too close to my nose for me to see. But unlike employees you will hire for their skills, and cofounders you will partner with for their entrepreneurial energy, advisors and board members are typically the kinds of people you would not be able to hire at any price. Whether they are angel investors in your company, CEOs of other companies of your size, or grizzled veterans in your industry, great advisors and mentors are truly worth their weight in gold. In Chapter 11, I'll talk about how to find them, attract them, and make the most of their contributions.

14. Consider Outsourcing.

As the business grows, you'll also want to think about the option of outsourcing particular functions rather than hiring employees to handle them—an alternative that offers both advantages and disadvantages. Some companies get started by outsourcing virtually everything. But to develop real value in your enterprise (the kind that other companies or the public markets will be prepared to pay for), you will have to increasingly bring key parts of your operation in-house.

> In the so-called "gig economy," there are many online platforms where you can find freelance designers, coders, engineers… even product managers. One of the oldest and largest is www.upwork.com, which I've used for everything from designing logos to doing telephone research.

15. Make the Most of Professional Help.

You'll need to augment your founding team with a supporting cadre of knowledgeable professionals who can advise and assist you in dealing with the myriad small things you might otherwise miss. In theory, a determined, smart entrepreneur could handle by herself most of the legal, accounting, and administrative details that are a necessary part of business operations. But in reality, these are too important to "just wing it." Like the Lorenz Butterfly Effect (in which the flap of a butterfly's wings in Brazil can set off a tornado in Texas), getting one or two seemingly insignificant details wrong at the beginning can lead to immense pain and suffering (or at least tens of thousands of dollars in costs) just a few years down the road, when the company is seeking investors or considering an exit. We'll discuss which professionals you'll need—and how to find them—in Chapters 10 through 14.

16. Choose Your Supporting Services.

One of the advantages of starting a company in the 21st century is that it will not be operating in a vacuum, but will instead be able to take advantage of an extensive world of Cloud-based platforms for banking, human resource management, payment processing, and more. Figuring out which ones are best for your particular needs—and then how to get set up with them—is something that we'll discuss in Chapter 15.

17. Manage Your Business With Analytics…on Everything.

As quality guru H. James Harrington wrote, "Measurement is the first step that leads to control and eventually to improvement. If you can't measure something, you can't understand it. If you can't understand it, you can't control it. If you can't control it, you can't improve it." While terms like "big data" and "customer analytics" have become so common as to be almost clichés, in my experience, they are things that are routinely ignored by first-time founders. But if you are truly planning to found a high-growth business, I can assure you that "analytics" (as I'll discuss briefly in Chapter 16) are critical: First, to figure out how to run your business; and second, to answer the questions that you will hear from the very first (and second, and third…) investor when you start looking for funding.

18. Establish and Manage Your Credit Profile.

As a brand new startup, your business has no history or financial track record, which means that you may find it challenging to do business with other (particularly bigger) companies who might not even be sure that you exist. Because of this, it's important that you start thinking of your company's credit profile right from the start. Indeed, one of the first things you'll do as soon as you incorporate is apply to the IRS for an employer identification number (EIN), which is a bit like a social security number for businesses. You'll be using this to identify your company to anyone who pays you money or receives money from you, to file your taxes, and open bank accounts. You'll also want to get a D-U-N-S number, which is managed by Dun & Bradstreet and identifies your company's credit profile. While it's generally a good idea to know what your business credit looks like to potential partners and customers, you'll find that D-U-N-S numbers are required to do business with companies like Apple, Walmart, and other major players. We'll talk about credit in Chapter 13.

19. Set Up Your Employee Stock Option Plan.

As an angel investor, I routinely deal with startups that are just coming out of the "garage" stage. They've hired a few people, and are getting ready to launch their first product. When I ask about salaries, I'll hear "so much in cash, and so much in equity." But then, when I ask how the company actually issued the equity to the employee, all I get is a blank stare. Suffice it to say, you can't simply "promise" your team that they'll get equity! Instead, you need to work with your lawyer, set up an employee stock option plan, reserve shares of stock in your certificate of incorporation to back up the options, have all option grants officially approved by the company's board of directors, and then actually issue grants to your employees, as we talk about in Chapter 18. There are no shortcuts here!

20. Identify and Attract Investors.

While bootstrapping is a great way to start your business, the more successful your company is (or, conversely, the longer it takes you to find the correct product/market fit with your minimum viable product), the more cash you will need to fund your growth. Since banks will not lend money to startups (did I mention that a majority of all startups fail?), you will need to attract the right investors, win their support, and work with them to ensure a long and mutually satisfying relationship.

> Banks don't fund startups because banks are not in the "risk" business; they're in the "renting money" business. They'll loan you cash as long as they are absolutely sure you will be able to pay it back…which isn't always the case for startups.

If your MVP works and develops initial traction, you may be ready to raise money to help fund your nascent venture. For most people, this initially means taking small amounts of cash from friends and family. But if you really appear to have a tiger by the tail, there is a chance that you could successfully approach professional angel investors…or even, in rare circumstances, venture capital funds. Unfortunately, this is often where I see the biggest disconnect between perception and reality.

> Historically, most "friends and family" investments have been very informal (and usually in violation of SEC regulations.) But the new crowdfunding options under the JOBS Act of 2012 will soon make this a viable vehicle for many startups' initial funding.

If you read the industry blogs and breathless stories in the popular press, you might assume that everyone with a good idea for a startup simply walks in to a VC's office and walks out with a check. In reality, however, it is nothing like that. Less than one quarter of one percent of real companies each year that incorporate, hire employees, and open for business actually receive financing from venture capitalists! So before going out for funding, you should make it a point to understand how the entrepreneurial financing world really works. Chapter 19 is an overview of the process, with a behind-the-scenes look at angel investors.

21. Learn How to Pitch.

The days when a starry-eyed entrepreneur could spin a tale of riches to a well-heeled patron over a napkin in a coffee shop are long gone. Today, the art of the pitch is a fundamental one for anyone hoping to engender outside support for a new venture. You'll need a bunch of different pitches in your arsenal, including stand-up, verbal, and elevator pitches, and the canonical 20-minute PowerPoint presentation aimed at angel investors and venture capitalists. In Chapters 19 and 20, I'll walk you through the basics, and lay out what you'll need to have in your "presentation wardrobe."

22. Preparing for Due Diligence Is a Perpetual Activity.

At every stage when you are dealing with third parties who are interested in the company's ownership—whether because they are planning to invest in you, lend to you, acquire you, or be acquired by you—they are going to ask detailed, probing questions about everything the company has ever done. Not only that, but they are going to ask to actually see your books and records, your certificate of incorporation, the written minutes of every board meeting you've ever had, the copies of your stock option grants, the board resolutions authorizing you to sign on behalf of the company, the signed employment agreements with everyone who has ever worked for you, and the intellectual property assignments from every contractor you've ever paid to do something for you. And that's just the first half page of a 10-page list of questions (which you can find the back of this book)! In my experience, fully 80% of the time and cost of doing any kind of corporate financing or acquisition is spent cleaning up all of the things that should have already been done, and finding the elusive paperwork that proves you actually did it.

But because you are a smart founder and are reading this book, I am going to walk you through doing all this stuff right the first time, keeping the correct kind of records (as we'll see in Chapter 22), and getting everything ready for your inevitable due diligence examination…even before your investor asks. While this may not result in an instant marriage proposal or bonus on the sales price, it will certainly put you at the top of the investor's "heroes list."

23. Raise Funds Through Online Platforms.

In the old days, funding for startup companies came solely from the founders and the founders' families. By the 20th century, "angel investors" began to appear—rich business people willing to take risks on startup entrepreneurs. But they were few and far between, and you had to know one personally in order to get funded. After the stock market crash in 1929, the US government established the Securities and Exchange Commission to regulate how companies could raise money. This made the process more organized, but also included a rule saying that you while you were allowed to sell shares of your company privately to rich people…you couldn't tell anyone about your company, or ask them to invest! In fact, it wasn't until 2012 that the laws were changed to reflect reality: Namely, that you can reach a lot of potential investors through the Internet! Today, raising startup funds online through "equity funding platforms" is still in its infancy, but already accounts for hundreds of millions of dollars annually. In Chapter 21, I'll explain the different types of platforms, and discuss which ones make the most sense for a high-growth entrepreneur.

24. Manage Your Investors.

One of the biggest mistakes that first-time entrepreneurs make is to think of funding and investors as a "one and done" task, when in reality nothing is farther from the truth. Once an investor puts money into your fledgling venture, that investor is your partner for life (or at least until the company has an exit). As such, the nature, content, and timing of your investor and other stakeholder communications are critical, and will often determine whether you are able to raise follow-on rounds when you most need them. I'll give you pointers on the care and feeding of your investors in Chapter 23.

Manage the End Game

25. Head for the Exit.

There are four possible endings for the business venture upon which you are currently embarking, all of which end up having to do with turning the value you have created into cash:

1. You can continue running the business in perpetuity and take out cash to fund your lifestyle.
2. You can sell the business to a larger company and walk away with cash.
3. You can register for an IPO and "take the company public," thus converting your ownership to publicly tradable shares that can be sold for cash.
4. You can shut the company down and lose the cash you (and your investors) have put into it so far.

While no one likes to imagine the fourth scenario, which one of the first three you are aiming for can have a significant impact on everything from the type of business you enter to whether and how you will be able to finance it, and even what options you might have for an exit. We'll walk through the alternatives in Chapter 25.

So that, in a nutshell, is the quick guide to how to conceive, start, and scale a high-growth business. If you have a short attention span, then feel free to dive into and out of specific chapters when you feel you need some direction. Otherwise, turn the page and let's get started… the right way!

PART I

Prepare to Launch

1

Translate Your Idea into a Compelling Business Model

Every great business starts with a great idea. You probably wouldn't be reading this book unless you already had at least the glimmerings of a business idea. In this chapter, you'll learn how to take your raw, perhaps unproven idea and measure its likelihood of success—then enhance, improve, and solidify it.

Elements of the Business Model

A business model is the idea that underlies a successful business. It describes how the business creates value for customers, delivers that value to them, and captures a portion of the value for its owners. Every successful business, no matter how large or small, complex or simple, operates according to a business model that makes sense. (Of course, some large, complex companies operate according to several business models at once, since they include divisions or departments that create, deliver, and capture value in varying ways. But don't let that confuse you.) Therefore, one of the most important steps you need to take as an entrepreneur is to transform your business idea into a business model that shows how you'll create, deliver, and capture value.

There are many ways to think about a business model. One of the most effective is described and illustrated by Alexander Osterwalder and Yves Pigneur in their best-selling book *Business Model Generation*. In their structure, a business model includes nine basic elements:

New York: John Wiley & Sons, 2012.

- **Customer segments**. The specific, different groups of customers the business serves—that is, the identified customers for whom it will create value.
- **Value propositions**. How the business solves problems and meets the needs of its customers, creating value for them in the process.
- **Channels**. How the business reaches its customers and delivers the value to them—for example, through direct online sales, retail distribution channels, Value Added Resellers , company-owned storefronts, or affiliate programs.
- **Customer relationships**. The ways in which the business connects with, relates to, and retains customers.
- **Revenue streams**. Where the money comes from: how the business generates income from the value propositions it offers to customers.
- **Key resources**. The assets required to create and deliver the value propositions to customers—for example, physical assets such as buildings and machinery, and human assets such as employees with particular skill sets.
- **Key activities**. What the business does to make the business model work, such as inventing, buying, building, distributing, operating, and so forth.
- **Key partnerships**. Outside organizations, such as suppliers and partners, who help the business model work.
- **Cost structure**. The costs that the business incurs in operating its business model.

These nine elements can be mapped in a diagram that Osterwalder and Pigneur called the Business Model Canvas, which provides a standardized, visual way of analyzing, developing, and refining your ideas. You can print out a large-format version of the Business Model Canvas and post it on a wall or spread it out on a table so that you and your co-founders can work on it together.

One benefit of the nine-elements model in the canvas is that it forces you to think through all the key pieces that need to be in place to make a business idea into a viable basis for a profitable, self-sustainable company.

An online, interactive version of the Business Model Canvas specifically designed for high-growth startups is available at LeanMonitor.com. Another comprehensive online version is available at Strategyzer.com.

> Copies of printed templates for the Business Model Canvas can be downloaded for free from businessmodelgeneration.com.

> Another good guide to the process of analyzing and sharpening a business model is *The Startup Owner's Manual* by Steve Blank and Bob Dorf (2012, K&S Ranch Inc.), which walks you through the process of developing and refining the Business Model Canvas within the context of a startup.

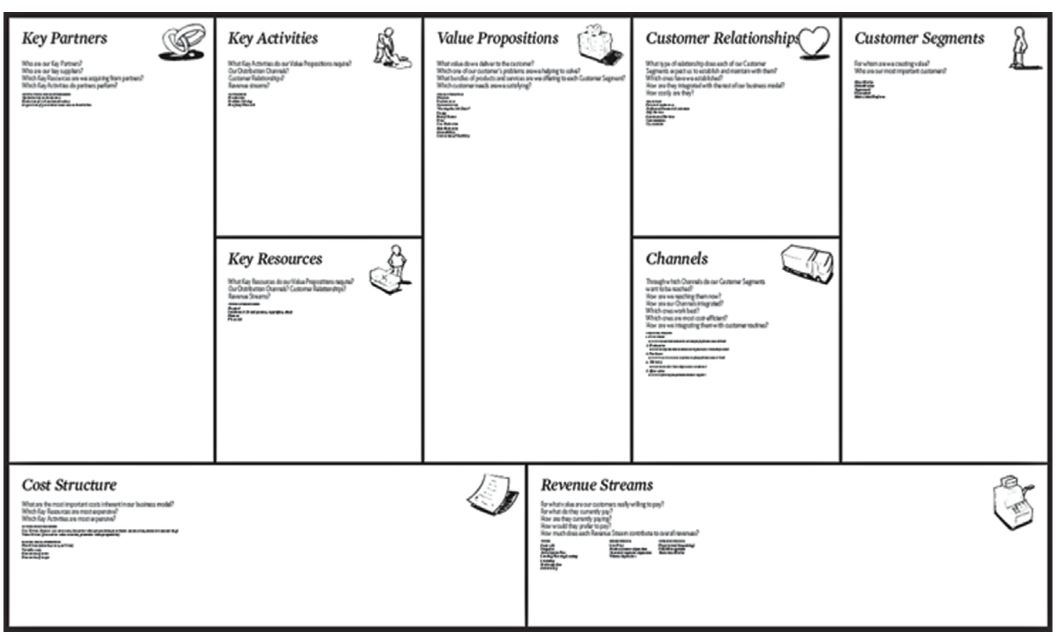


Figure 1.1

The Importance of Understanding Your Business Model

These days, it seems like everyone is a wannabe entrepreneur—just as everyone used to be an aspiring actor or have the Great American Novel in their back pockets. And while I have heard many clever ideas for products and services over the years, in my experience, the number one differentiator between an aspirant and a real founder is that the former is in love with his product, but the latter is in love with her business model. I have often had discussions with other investors about companies that have approached us for funding, and we have all had the same reaction: "I can't wait to buy the product when it comes out…but no way would I invest in the company!" That is because a product or service can be cool, or innovative, or beautiful, or even useful, but it only becomes a viable business if the aggregate economics of the value being created is significantly more than the aggregate economics of the costs of operating the business. And if you are aiming for a scalable business, then you're further looking for a viable business that gets better—not worse—as it gets bigger.

How can you determine whether your business idea has the potential to become a multi-billion-dollar unicorn? In general, there is a simple math equation that estimates basic viability by multiplying four factors:

Number of potential purchasers ×

Percentage of capturable market share ×

Absolute dollar amount of each sale ×

Percentage margin of profit =

Total potential profit

The perfect new business idea would be one that would check all four boxes—that is, it would be appropriate for a very large number of potential purchasers, be plausibly attractive to a high percentage of those possible customers, generate sales with high dollar value, and promise a high profit margin on each sale. And then, to make it truly scalable, you'd want to check a fifth box—the business would need to get even better as it got bigger.

For example, if you were trying to evaluate a concept for a house-cleaning business, it would be great if everyone in the world needed their house cleaned; if you had a way of locking up the entire global market and servicing every house in the world; if everyone would be willing to pay a large amount for this service; and if your cost to clean a house was low, and dropped with every additional customer. I assume you would take that business, right?

Unfortunately, these five propositions turn out not to be true in regard to house cleaning—which explains why no one has yet ascended to the top of the *Forbes* list of the world's richest billionaires by launching an international house-cleaning business.

As you might imagine, business concepts that check all the boxes are exceedingly rare. However, when you look at successful businesses, you'll discover that even three out of the five can make for a viable—and even potentially scalable—business.

For example, take the business of sending tourists up for a visit to the International Space Station. There's obviously not a giant market for that, since it can only accommodate one visitor every few years. But it so happens that one of my portfolio companies actually does that. Why? Because the ticket price is around $50 million per person, they have decent margins, and they have 100 percent market share. (It was also a business, believe it or not, that could be started relatively inexpensively, because their customers paid in full, in advance, before the company was required to pay the Russian government for the actual experience.) And while it's not scalable per se, the company has leveraged its experience into allied areas such as zero gravity airplane flights, astronaut training, and jet fighter missions.

Furthermore, when you do the analysis, it's important to be clear about what the business is actually doing. Let's go back to the idea of a house-cleaning business, for example. It would be very problematic to try to grow "house cleaning" into a truly large business. The logistics of service delivery around the world would make it extremely difficult to eke out a decent profit margin, and the minimal cost of entry by competitors (who need only a van, some tools and supplies, and a few employees to set up a rival cleaning company) means that you would probably never develop a large market share.

But if we're talking about something like Angie's List or HomeAdvisor, the first thing we need to realize is that the business these companies are in is not actually "house cleaning." Instead, it is "lead generation and/or booking and intermediating payment for house cleaners." Looked at in that way, it completely changes the equation. Your marketing and service delivery costs are at "Internet scale," and therefore both low and decreasing the larger you get. On the other hand, the value you are delivering to the person willing to pay for it (the actual house cleaner) is quite high relative to their opportunity costs (which means you can extract a decent margin), and because you can target everyone on the Internet, you have a sizable addressable market (even if only the top one percent would be willing to pay to have their houses cleaned).

This is also the case for other apparently small or low-margin businesses, such as urban taxis (Uber), errands (TaskRabbit), cups of coffee (Starbucks prepay cards), and free radio (Pandora, Spotify, IHeartRadio, etc.) Once you add in the dozens of potential future revenue streams for each of these enterprises based on their same existing infrastructure (Uber providing "just in time" delivery services, online music sites selling concert tickets and memorabilia, Starbucks selling music and coffee machines, etc.), these apparently quixotic businesses become potentially very large profit centers.

One way to get into the right mindset is to study the business models that have been developed and employed by other company founders—including both the successes and the failures. Some great companies have been launched by adapting a business model from one industry to another, or by tweaking a familiar and proven model in a way that unleashes a remarkable flood of new resources, customer demand, or technological creativity. In certain circumstances, it's possible to create a successful new company by simply altering one of the nine business model elements in the Business Model Canvas as applied by competing businesses in the same market sector—for example, by discovering and applying a new channel for delivering value to customers; by devising a new way of forging intimate, lasting relationships with customers; or by

> A great place to examine other companies' business models in an easily digestible form is businessmodelgallery.com, which has re-created over 100 well-known models in Business Model Canvas format. Browse through them by industry or type of company to be inspired.

identifying ways of improving the cost structure of the business and thereby making it more profitable.

Developing a Scalable Startup Business

The subtitle of this book is *25 Steps to a Scalable, High-Growth Business*, and the word **scalable** is included for a very good reason. There are many enterprises that are successful, profitable, and contributing much to society, but that would be unrealistic, unprofitable, or at least overly challenging for you to start building as a one-man or one-woman startup on your way to becoming a unicorn.

If you're reading this book, then you are unlikely to be building a Death Star, opening a barber shop, or offering xylophone master classes in your living room. That's because while all of those might be interesting opportunities, for different reasons, none of them are scalable.

> A "unicorn" is a term used to describe a company with a market capitalization of over $1 billion.

There are three characteristics that together make a startup business model truly scalable.

1. *You have to be able to start small.*

   Unless you happen to be the long-lost daughter of the Palpatine Emperor, the odds are that you do not have enough capital to build your first Death Star, nor will you be able to raise the funds to do so. The ideal startup is one that can be bootstrapped from its own early revenues—or at least funded from the founder's personal savings account.

   > In case you are curious, students at Lehigh University worked out that the cost to build the Death Star would be about $8,100,000,000,000,000 ($8.1 quadrillion), which is 13,000 times the world's GDP.

2. *Your marginal costs must drop over time, so that each additional dollar of revenue costs less than the previous dollar.*

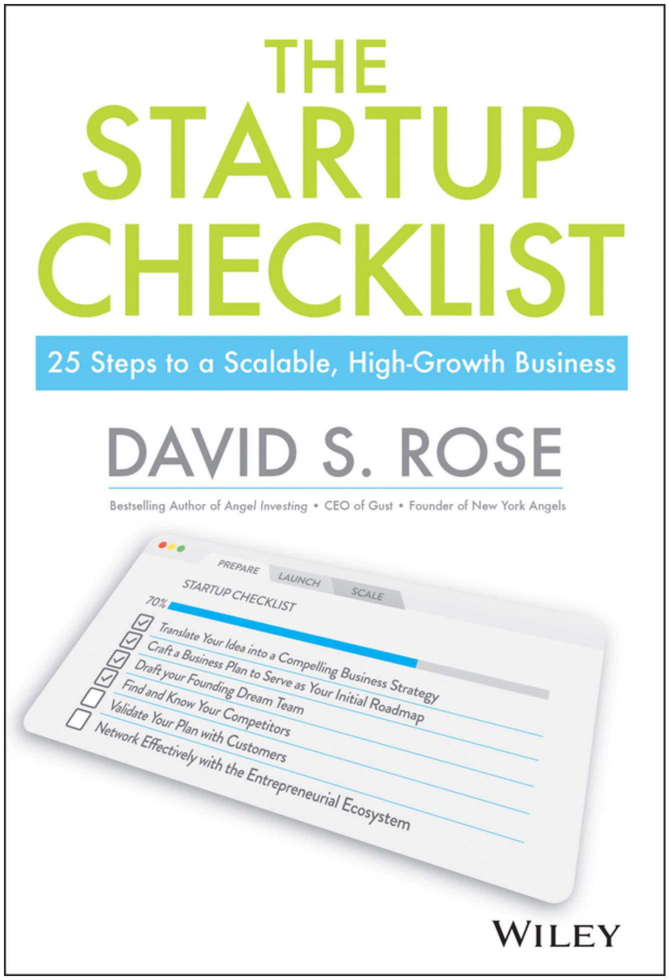
   This is the core of what most people mean when they discuss business scalability. For example, Amazon's Kindle publishing business is scalable because, after the cost to Amazon of selling the first digital copy is taken into account, each additional copy is almost pure profit. In contrast, if you wanted to expand your

For a longer discussion on scalability, see the article by my fellow New York angel investor Christian Mayaud at http://www.sacredcowdung.com/archives/2005/06/what_is_a_scala.html

barbershop, the second shop would cost you almost exactly as much as the first one (for rent, equipment, and barber salaries). Since no business is infinitely scalable (that is, there is no business where all costs drop to absolute zero), an associated consideration is relative scalability, which means that a business needs to be scalable over a longer range than its competitors.

3. *Your scalability needs to be built into your business model, rather than relying on any special exogenous factors.*

   Subway, for example, currently has 45,000 sandwich store locations around the world. And they are opening more than six new stores every single day, including weekends! They would not be able to do that if they had to find world-class cordon bleu chefs for each location. Similarly, if your business depends on recruiting a never-ending supply of xylophone virtuosos who are also good teachers, I'm afraid that it is simply not scalable.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70%
Translate Your Idea into a Compelling Business Strategy
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Draft your Founding Dream Team
Find and Know Your Competitors
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