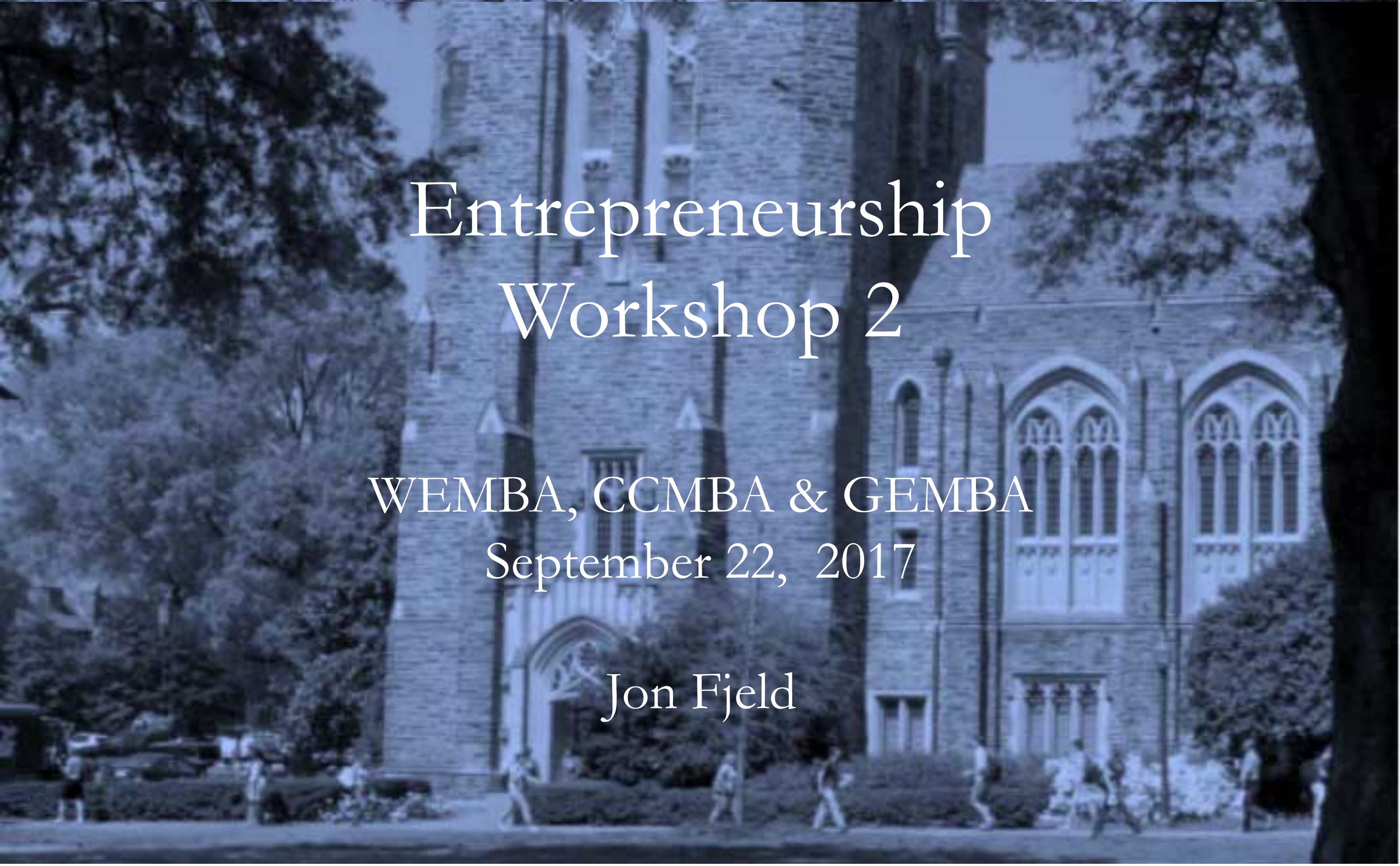

Entrepreneurship Workshop 2

WEMBA, CCMBA & GEMBA
September 22, 2017

Jon Fjeld

DUKE
THE FUQUA SCHOOL OF BUSINESS

Agenda

- Quick review / framework
- Brief introduction to strategy
- Discussion: strategy in a new venture
  - Target customers
  - Business Model
  - Sustainable competitive advantage
  - Milestone planning
- Project presentations
- Wrap-up

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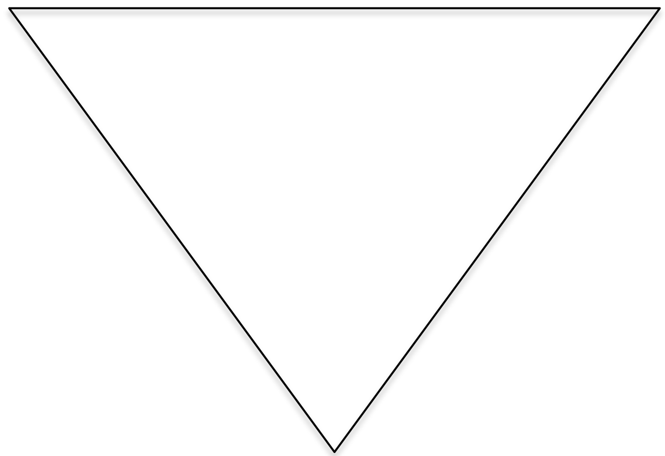
Evaluating an opportunity

Is there a need?

Is there a solution?



Is the venture sustainable?

- Competition
- People
- Financially

Evaluation of an opportunity

1. Is there a sufficiently attractive market opportunity (need or problem)?
2. Is the proposed solution feasible, both from a market perspective and a technology perspective?
3. Do we have an team that can effectively capitalize of this opportunity?
4. Can we compete (over a sufficiently interesting time horizon)?
5. What is the profile risk and return of this opportunity?

Strategy: the key choices

Target customer?

Business model?

Sustainability?

- Competitive advantage
- Resources

+ Roadmap / Milestones

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Evaluation and strategy

Opportunity evaluation

Fact gathering, analysis, basis for decision making

Need / problem

Feasible solution

Team

Possibility of comp. advantage

Risk reward

Strategy

Decisions, choices: investment and priorities

Target customer

Business model

Choices for sustainable comp. advantage

Milestones

These activities are ongoing

Business plan document

Opportunity evaluation:

- Need/problem
- Solution
- Possibility of competitive advantage
- Team
- Risk / return

Company's plan:

- Strategy:
  - Target customers
  - Business model
  - Choices for sustainable competitive advantage
  - Roadmap / milestones
- Operating plan:
  - Plan for each functional area
  - Budget

Two sides of execution

Exploration	Production
• Observe	• Build
• Question	• Sell
• Experiment	

Framework for analysis

Investment prospectus:

- Need
- Solution
- Sustainability
  - Competitive advantage
  - Risk / return
  - Team

Company's plan:

- Strategy:
  - Target customers
  - Business model
  - Sustainability
  - Milestones
- Operating plan:
  - Plan for each functional area
  - Budget

Execution:

- Market Research
- Strategy development
- Marketing
- Business development
- Sales planning
- R&D Management
- Operations management
- Process and infrastructure management
- Budgeting
- Financing
- People management

STRATEGY

What is strategy?

There are two basic questions in strategy.

- What should we do?
- How should we do it?

Strategy does not set the goals. Strategy doesn't tell you what to want. Strategy is about formulating, evaluating and choosing paths to get there.

Strategy in a new venture

- Similar but different
- More and less freedom

Compared to corporate strategy

Strategy in a new venture

- In a start-up, there are no constraints and no history (at least in principle) so these elements have a simple application.
- In an established firm, current position and capabilities must be taken into account.

Alternatives and choice

- Strategy is choosing among alternatives. Successful strategy involves choosing well (based on correct analysis) and formulating good alternatives (creativity). No amount of analysis can substitute for lack of creativity. Analysis does not tell you the answer. Strategy is creative and synthetic, not analytical and reductive.
- Strategy is based on beliefs about the future. You can't analyze the future.

Strategic decision making

A strategic choice has a basic structure.

i. Identify the objective or goal.
ii. Identify the question.
iii. Formulate the alternatives.
iv. Decide what considerations are relevant.
    - Strategic and other organizational constraints
    - Industry factors
    - Internal capabilities
    - External environment
v. Make a decision.
vi. Formulate a plan to manage/mitigate risk.

Business plan document

Opportunity evaluation:

- Need/problem
- Solution
- Team
- Possibility of competitive advantage
- Risk / return

Company's plan:

- Strategy:
  - Target customers
  - Business model
  - Choices for sustainable competitive advantage
  - Roadmap / milestones
- Operating plan:
  - Plan for each functional area
  - Budget

How are these related?

Opportunity evaluation

Fact gathering, analysis

Strategy

Decisions, choices: investment and priorities

Need / problem

Feasible solution

Team

Comp. advantage

Risk reward

Target customer

Business model

Sustainable comp. ad

Milestones

New venture strategy

1. Target customers
   - Segments?
   - Value / market size?
2. Business model
   - “Whole product”
   - Value chain, eco-system
3. Sustainable competitive advantage
   - How can you compete over the long term?
   - What investments should you make?
4. Roadmap / milestones
   - What is the order of execution?
   - How do you structure financing?

> These questions are all linked.
>
> The process is iterative and piecemeal, not sequential

A conceptualization

Segments”: Groupings of customers whose purchase decisions relative to the firm’s product are similar — identified by **independent** attributes, e.g. demographic information

Value/
Differentiation

Difficulty / cost to the company

Size of market also a consideration

New venture strategy

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Business model

Product:

- What is the "whole product"?
  - How will it get to the customer?
  - What will your role be? (place in the value chain)

Price:

- What is the perceived value?
- What will customers pay for?
- How do they want to pay? (revenue model)

Place / promotion:

- Description, messaging, articulation of value, outlets
- Distribution

Business practices:

- How will customers interact with the company?
- Service / support

Functions inside vs. outside the firm

- Partnerships
- Staffing

A complicated example: the iPod

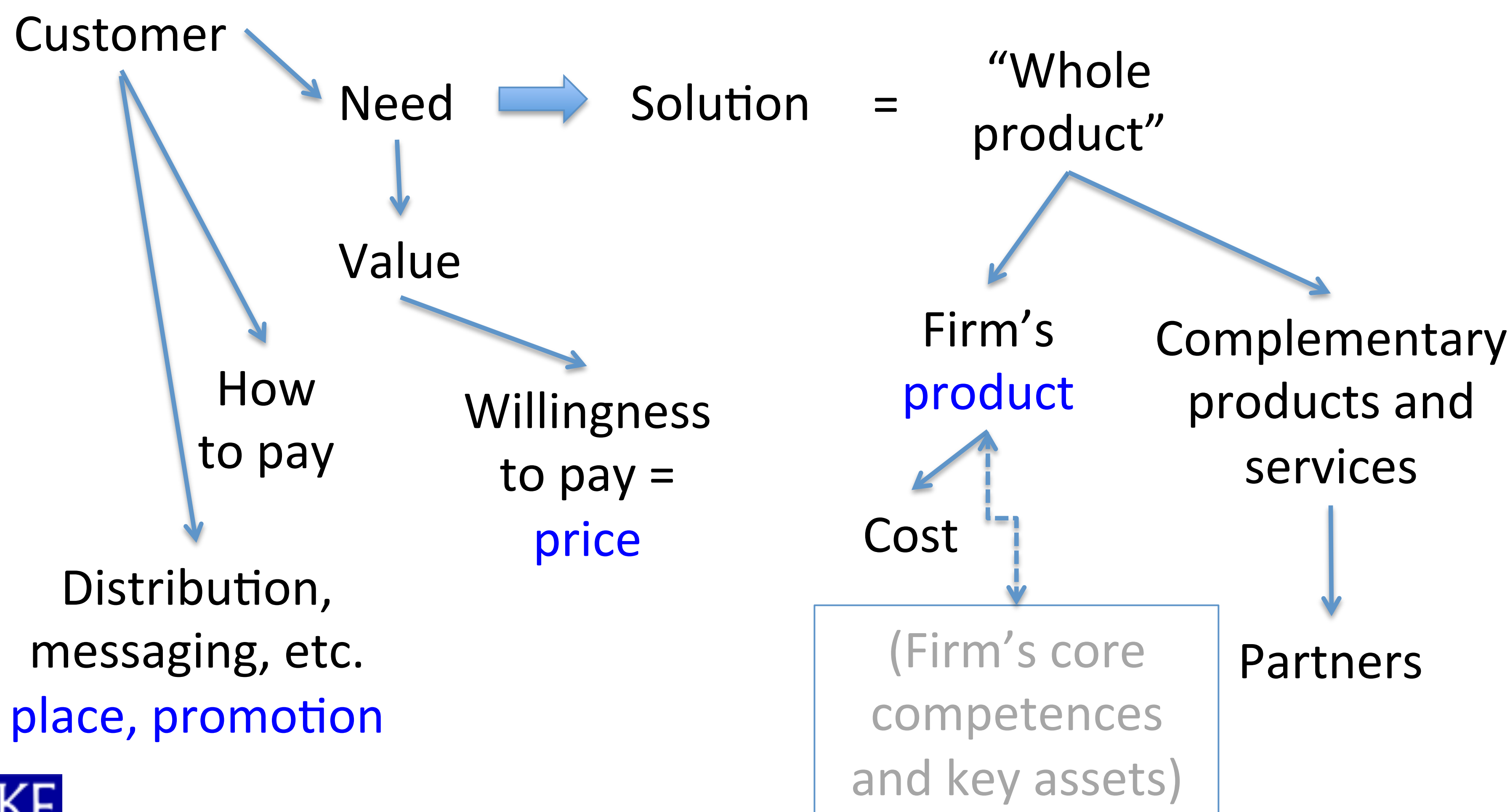
Need	Solution	Product	Technology
Portable music for average consumers		iPod	

- What is the innovation?
- What connects the product to the need?

The iPod solution

Need	Solution	Product	Technology
Portable music for average consumers	System: • Acquiring • Storing • Organizing • Selecting • Playing	iPod	iPod click wheel
		iTunes software for PC & Mac	
		iTunes Store	

Business model



Position

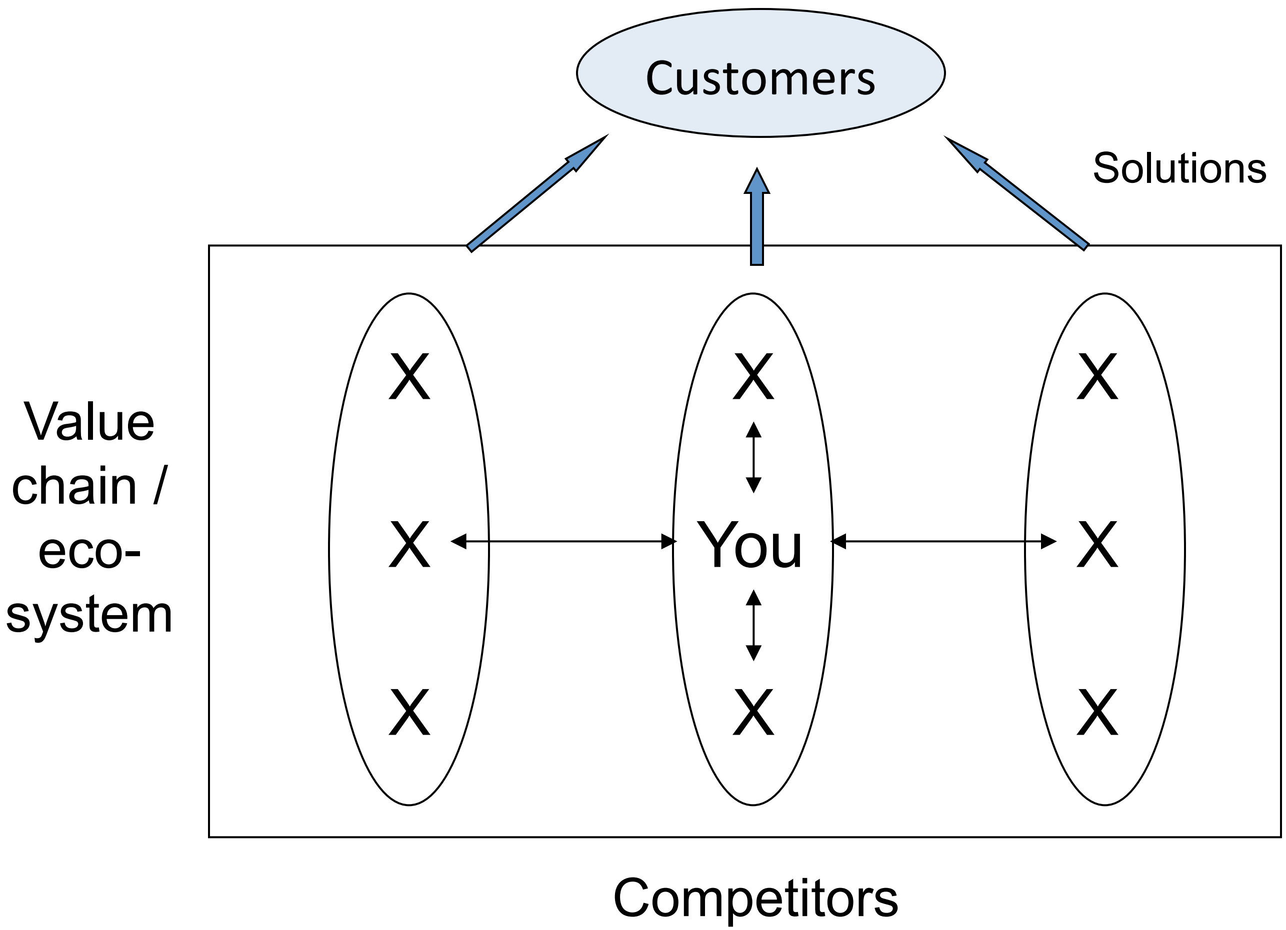
Position in the value chain:

- How much and what part of the solution will you provide?
  - Core competencies
  - Business relationships

Position versus competitors:

- How are you uniquely identified?
- What is defensible?
  - Core competencies
  - Messaging
  - Plans

Position


Customers
Solutions
Value chain / eco-system
X
X
X
X
You
X
X
X
X
Competitors

New venture strategy

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Core competences: a fundamental concept

Business model ↔ Core competences ↔ Sustainable competitive advantage

How much and what part of the solution will you provide?

Position in the value chain

Business relationships

How are you uniquely identified?

Position versus competitors

What is defensible?

Brand / messaging

Competencies

Firms do many things

- Design / develop
- Manufacture
- Market
- Sell
- Service
- Hire
- Innovate
- Strategize
- Plan
- Respond to changes

Where is the company on the spectrum?

Mediocre ⟵ Competent ⟶ Advantage

Where do you need to be?

Competitive position

Objective: Sustainable competitive advantage: VRIN

What is competitive advantage?
• Something that allows the firm to deliver value to the customer profitably • (implies that the firm does it better than competitors)
What is *sustainable* competitive advantage?
• A competitive advantage that is rare & hard to imitate or innovate around

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Sources of sustainable competitive advantage

- Skills & expertise: people
  - Hiring / HR policies
- Intellectual property
  - Patents
  - Other forms of protection: TM, secrecy
- Complementary assets
  - E.g., distribution for a content company
- Relationships
  - Customers: “first mover advantage”
  - Suppliers
  - Key partnerships

Digression on innovation

Sustaining:

- Make a product or service perform better in ways that customers in mainstream market value
- Always introduced by incumbents

Disruptive:

- Create an entirely new market
- Perform worse on some dimension important to mainstream
- Lower margin

How to analyze industry players

RPV analysis

Resources:
- People
- Equipment
- Technologies
- Cash
- Product designs
- Information
- Relationships
- Customers

Processes:
- Patterns of
  - Interaction
  - Coordination
  - Decision making

Values:
- Standards by which employees set priorities, e.g.:
  - Margin
  - Revenue potential
  - Position / brand

The VRIN test

1. Is the resource/capability <u>valuable</u>?
2. Is the resource/capability <u>rare</u>?

   Do rivals have or are they developing the resource or capability?

3. Can the resource/capability be imitated? (<u>inimitability</u>)

   Are there isolating mechanisms?

4. Can the resource/capability be substituted for? (<u>non-substitutability</u>)

New venture strategy

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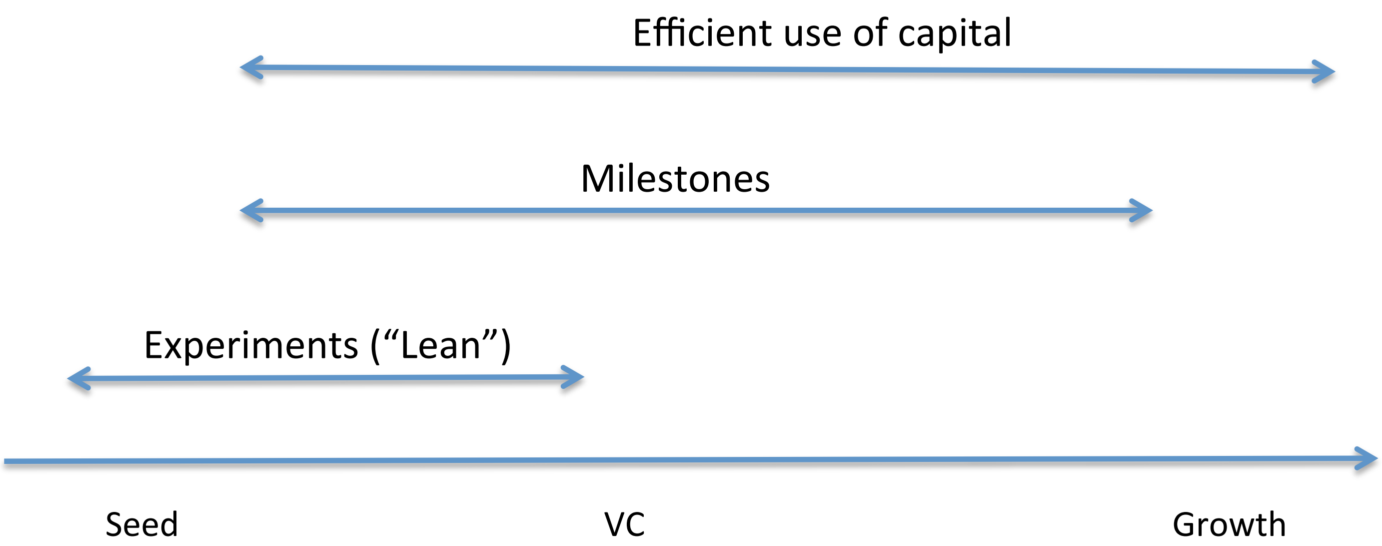
Managing uncertainty



Different terminologies, same underlying concept

How to proceed

- Your idea is probably wrong
- Can you find a good idea before you run out of resources — time and money?
  - Time is money.
  - Early money is more expensive than later money
- When you find a "good idea," how efficiently you use capital determines your share, overall return, and possibly even success or failure.

Net cash

Cost of money

- Time actually is money

- An imaginary homerun; 100,000 shares, 2 founders, 1 year before money

Stage	Shares	Company value	Amount invested
Founding	100,000	$100,000	$200,000
Seed	100,000	$1M	$500,000
Series A	150,000	$15M	$7.5M
Series B	225,000	$225M	$112.5M

Cost of money

- Time actually is money
- An imaginary homerun; 100,000 shares, 2 founders, 1 year before money

Stage	Shares	Company value	Amount invested	Share value	Value of $1 in equity
Founding	100,000	$100,000	$200,000	$0.50	2
Seed	100,000	$1M	$500,000	$10	0.1
Series A	150,000	$15M	$7.5M	$100	0.01
Series B	225,000	$225M	$112.5M	$1,000	0.001

Why?

- "Risk" of failure is high.
  - Many assumptions that may not be true.
- And goes down as you reduce uncertainty.
  - Probability of success goes up as assumptions are determined to be true.

Many unknowns

Market + **Product**

Market
- Value / willingness to pay
- Constraints / parameters of solution
- Necessary complements
- Alternatives
- Inhibitors
- Influencers
- Customer acquisition
- Etc.

Product
- Features
- Business model / price
- Competitive position
- Distribution
- Etc.

What can go wrong?
(What are you assuming?)

1. Nobody wants what you are selling.
2. Somebody wants it, but they don't represent a real market.
3. People want it, but for some reason they can't buy it or can't use it.
4. People want it, but you can't get it to them (economically).
5. The technology doesn't work.
6. The technology works but you can't protect it.
7. The technology works but you can't get it into a reasonable product.
8. You build a bad product.
9. You can't build your product for a low enough cost.
10. Somebody introduces a better product.
11. Somebody has the power to stop you and exercises it.
12. You need somebody else in the value chain to do something and they don't.
13. You can't find the right people.
14. You just don't execute on something important.
15. Etc.

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Not all risk is the same

A measure of risk:

severity of impact X probability

Risks also differ on

cost of resolution

Milestones

Basic question: Will your venture succeed?

Imagine a series of big steps that increase your confidence

- E.g.: a customer, validation of technology, selling model

These steps can constitute a series of objectives for the venture:

- And become the milestones in your financing plan

Lowest cost resolution of uncertainty

1. Identify the assumptions and discrete steps (elements of uncertainty) required for your venture.
2. Rank order the points of uncertainty (assumptions) in decreasing order of risk to the venture

$$\frac{\text{severity X probability}}{\text{cost}}$$

   - This is the sequence of execution
   - Requires finding a way to resolve each point of uncertainty for the lowest cost (time and money).
3. Factor in any issues of overall timeliness and interdependencies.
4. Use these milestones as a framework for your plan.
5. Commit sufficient resource to achieve the next milestone.
6. Make corrections as you learn ("pivot").

Resolution of uncertainty

- Involves evidence — hypothesis testing
- Requires judgment & imagination

The issue is generally to establish market / product fit before the market exists

- Validation of the need
- Technical feasibility
- Possibility of partnerships
- Protectability
- Etc.

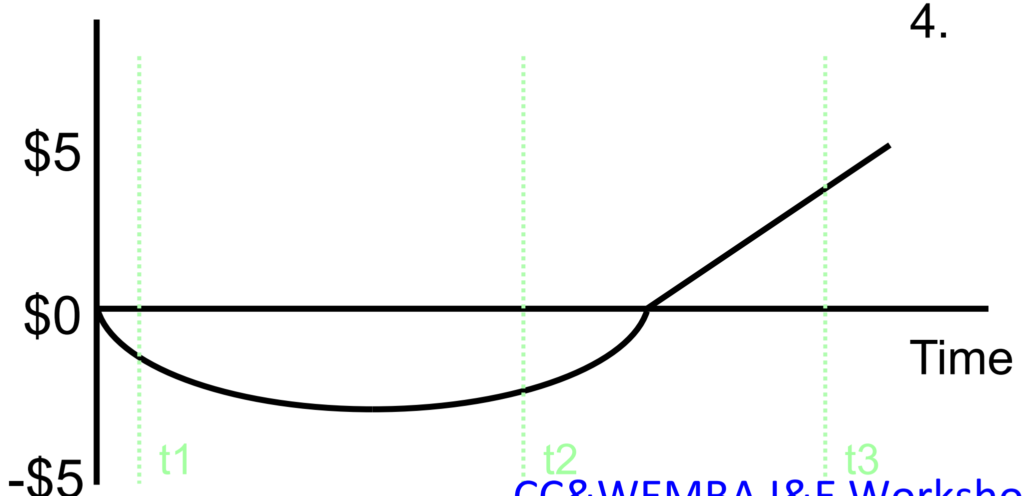
How much money should you raise or invest?

- Should you raise the total amount of cash needed (according to projections) in a single investment?

  Usually not

- How much is the business worth?
- What increases the value of the company?

  Reduction of uncertainty



1. Establish a plan (which you will end up revising):
2. Determine a milestone that produces a step up in valuation - what will remove the (a?) main source of uncertainty?
   - (Keep in mind that investment may be tranched)
3. Determine cash needs
   - Including asset based financing to reduce requirement for equity based financing
4. Raise enough to get you to the next milestone that would cause step up in valuation (+ small cushion, if possible)

New venture strategy

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The process is iterative and piecemeal, not sequential

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The first two laws of entrepreneurship

First Law

Always start with the need.

Second law

Make no investment before its time.

- Analysis — comprehensive and discrete elements
- Sequencing — based on severity, probability, and cost of resolution

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Resources

Guidelines for the entrepreneur:

http://www.dukeven.com/

Program for Entrepreneurs:

http://www.dukep4e.org

CONCENTRATION

http://www.dukep4e.org/fuqua-program-for-entrepreneurs/emba-concentration

Teams

- An important principle of start-ups: you cannot tolerate anyone who is not performing.
- Seek diversity in your team

Concentration process

Summer, 2017

- Identify opportunity
- Form team
- Memo to Fjeld summarizing

Fall, 2017

- Validate opportunity
- Formulate strategy
- Submit as final project in *Entrepreneurial Strategy* or *Entrepreneurship & New Venture Management*

Spring, 2018

- Create business plan document
- Submit in fulfillment of concentration