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NEW RESEARCH SHOWS MOST BUSINESS PLANNING ADVICE IS WRONG

More Successful Local Service And Infrastructure Companies Are Adapting To The Changing Business Climate By Abandoning Classic Business Planning And Applying More Effectual Logic And Principles To Start Their Business

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Why Being Told You Need a Business Plan May Be Bad Advice

Entrepreneurship has changed in recent years. As a result you may no longer need to write the classic version of a business plan. Based on these changes, we will build the case that most business advice in the public domain is based on old paradigms. In light of this situation, we will show you how you can adjust your thinking to succeed in today's changing market place.

Before the advent of the internet and the flattening of the globe, the cost to start and grow even a very small business required a significant amount of upfront investment. Today, however, the business landscape is quite different.

- No longer do businesses need to open a physical storefront. They do not need to pay rent and staff to sell their goods. Instead, businesses can use technology to sell the same goods to the entire globe using automated e-commerce websites for free or at a very low cost.
- No longer do businesses need to invest in expensive advertising and marketing collateral. Businesses can engage with customers more effectively by using social media channels.
- No longer do businesses need to hire full-time, local employees. Instead, businesses can contract many part-time, highly specialized, and even offshore resources for much less money. For example, they can hire bookkeepers and web designers at a fraction of the cost using tools like upwork.com, freelancer.com, TopTal.com, and Guru.com.
- No longer do businesses need to focus primarily on mainstream products and services. They don't need to produce their products in large batches to counteract the considerable upfront costs. With bottlenecks between supply and demand disappearing, businesses can take advantage of what Chris Anderson calls "the long tail economy."

Yet, in spite of the changing economic landscape for local businesses, the standard business advice to write a thoroughly researched business plan for every type of business remains rooted in outdated models and paradigms designed around the justification of expending large upfront amounts of capital to start a business. While still appropriate for some businesses, such as innovation or manufacturing startups, it is far less appropriate for other businesses since their startup capital requirements and customer acquisition strategies are quite different.

Why The Business Planning Advice You Have Received Is Probably Stale

The startup landscape has changed in recent years and more businesses can be bootstrapped than in the past. As a result, there has emerged greater differentiation between businesses that need large upfront capital infusions and those that can be bootstrapped. This essentially has created two types of entrepreneurs, each with different reasoning styles driven by the type and maturity of their business.

Manufacturing and innovation companies dominate the mindset of most authors of business books as well as government sponsored small business offices such as those sponsored by the Small Business Administration (SBA). It's no surprise that the focus is on manufacturing and innovation companies because if they are successful, they can become very large very quickly, which makes for great success stories for authors and government officials to draw on.

However, by their nature, innovation and manufacturing sector companies have very high startup costs because it may take months (or even years!) and considerable expense to develop a viable product. Moreover, these companies have a higher likelihood of failure and losing all their invested capital. Therefore, they are quite risky

to start. In fact, according to the Cincinnati research agency AcuPoll, 95% of all new products will fail.

Because of the risk and high pre-start costs, there is so much at stake in getting it right the first time. Innovation startups need startup capital to fund intangible expenses, such as the research and development (R&D). For example, a software development company needs capital to fund the R&D required to write a new application or program. Manufacturing startups, on the other hand, need startup capital to fund tangible assets, such as specialized production equipment needed to produce a new product. Since startups in both of these industries need copious amounts of startup capital, they also require significant upfront planning to minimize the risks necessary to secure large equity investments or obtain debt financing from banks or other lending institutions. While startups in these industries make headlines when they are successful, they represent only a small fraction of all new businesses in a given local ecosystem.

Unfortunately, the startup advice recommended for these promising innovation and manufacturing businesses (with their inherent business risks and large upfront capital requirements) is the basis of most business advice from business book authors as well as government sponsored business offices. The recommendations, while appropriate for a manufacturing or innovations type startups, can be inappropriate for infrastructure (e.g., transportation, communication, and construction) and local service (e.g., barber, retail, and restaurant) type businesses that can be bootstrapped much more easily and started with far less risk.

The heavily postulated advice of writing the classic business plan is most appropriate for risky businesses that are developing a product or service for the mass market and require large upfront investments. However, the vast majority of new businesses these days operate in the long-tail market place. These businesses focus on a narrow product niche, provide infrastructure and local services to businesses or local consumers, and are for the most part not very scalable. Therefore, a case can be made that a "one size fits all" educational, counseling, and mentoring model that recommends writing the classic business plan for ALL businesses is stale given the changes to the business landscape.

Most new businesses, therefore, need a completely different type of advice than provided to the more capital intensive businesses. Furthermore, these long-tail product, infrastructure, and local service businesses are better able to evolve their business and economic models as they continue to grow and mature over time. Eric Ries of the Lean Startup Movement calls this validated learning.

Why The Business Advice You Are Getting Is One Sided

What has emerged, as the funding and risk gap has widened, is a greater awareness that there are different entrepreneurial reasoning skills required depending on the industry sector, growth stage, and scalability of the startup.

Based on research performed by Saras D. Sarasvathy of the University of Virginia's Darden School of Business, there are specific characteristics, habits, and behaviors of successful startup entrepreneurs. The thought and problem solving processes of successful entrepreneurs, as identified by this research, uncover a set of principles and logic that are quite contrary to the advice entrepreneurs are frequently urged to follow.

Most of the standard entrepreneurial advice from books, courses, and consultants is provided by corporate leaders from legacy businesses, professors at academic institutions, and business service consultants such as CPA's or lawyers. These advisers, based on their locus of personal experience, have more management dominated reasoning skills. However, most startup entrepreneurs (outside innovation and

manufacturing driven industries) look at the problem of starting a new business with a different set of reasoning skills that are often better suited to launch less costly and lower risk ventures.

These advisers often focus on business administration and high levels of pre-planning. According to Saravathy, this advice is out of sync with the advice needed for the vast majority of startup entrepreneurs.

According to Sarasvathy's research, what makes the startup entrepreneur's mind different is that they employ effectual reasoning. However, most business advisers come from, and therefore, focus on causal reasoning.

For additional information on what makes the entrepreneurial brain different, check out "The Entrepreneurial Brain."

How Your Reasoning Skills Can Affect Your Business Success

Let's explore how the reasoning style of the manager entrepreneur, with their predominantly causal reasoning, approaches a business startup very different from the founder entrepreneur, who approaches a startup business primarily with effectual reasoning.

Causal Reasoning

Causal reasoning is the domain of innovation and manufacturing type startups with their higher degree of risk and large upfront capital requirements. This is true as well for second stage businesses in more mature and competitive industries looking to scale up. I like to call entrepreneurs with causal reasoning skills "manager entrepreneurs."

Causal thinkers start with a destination or goal in mind and back up one step at a time to figure out all the steps that need to happen to effectively reach the stated goal.

A field general is an example of a person with superior causal reasoning skills. The general's target is clear (e.g., taking that hill, capturing new lands, or defeating the opponent's army). Causal reasoning is goal-driven and a person with causal reasoning skills comes up with the best, quickest, most inexpensive, and most efficient way to achieve the desired objective.

Below are a few examples of business decisions that use causal reasoning skills:

- Should I make it or buy it?
- Which customer segment will give me the highest possible return?
- Who is the best person to hire for a job?

All of these decisions have a terminal goal in mind and are the basis of causal reasoning.

When it comes to business advice, causal reasoning supports the more traditional paradigm of extensive upfront business planning and analysis prior to launch.

Effectual Reasoning

Effectual reasoning is quite different and is the domain of most infrastructure sector and local service startups. I like to call entrepreneurs with effectual reasoning skills "founder entrepreneurs."

With effectual reasoning, the person does not begin with a specific goal or target in mind. Instead, they focus on their assets, talents, and abilities and look for ways to use them to solve a problem. Essentially, they start with the means and not the goal. By following the means, the goal emerges over time.

An explorer is an example of a person with effectual reasoning skills. The explorer often has a vague idea of the end goal, but is very open to swapping the goal with a new and better one based on new information.

For example, Christopher Columbus left Spain to

sail westward to establish a spice trade with Asia. On his way to Asia, he landed in the Americas and met the indigenous people, many of which were adorned with gold jewelry. Rather than continuing to focus on reaching Asia, he pivoted and attempted to locate the source of the gold.

When it comes to business advice, effectual reasoning supports a different paradigm predicated on extensive testing with minimal investments, knowing that the business and economic model will continue to evolve.

The classic business plan is often much less effective for this cohort. In fact, drafting a business plan can actually cause the business to put too much emphasis on the end goal rather than being open to a pivot or change as new information becomes available.

Affordable Loss Principle - Reaching Markets with Minimum Resources

Manager entrepreneurs use their causal reasoning skills to focus on the "expected return" while founder entrepreneurs use their effectual reasoning to focus more on "affordable losses." To be more specific, manager entrepreneurs have been taught to analyze markets and choose a market segment with the best possible returns. Founder entrepreneurs look for ways to reach markets with a minimum expenditure of resources (e.g., time, effort, and money) and with minimal risk even if they may not produce the best returns.

Since founder entrepreneurs rely less on upfront planning, they are not sure their approach will work. Thus, they make their decisions based on how much they can afford to lose if their idea does not gain the desired traction.

Founder entrepreneurs have a "just do it and measure what happens" attitude while manager entrepreneurs insist on a thorough, upfront analysis before launching.

Market research for a founder entrepreneur starts with small scale experiments or minimally viable products (MVP) to test the waters with real customers. Often, they do not even assume the expense of developing an MVP. Instead, they may use mock-ups or try to sell products or services before actually developing them to make sure there is a market willing to pay for their solution.

Therefore, founder entrepreneurs approach their business development from the prospective that it may take several tries to reach a successful offering. As a result, capital preservation takes a prominent role in their planning process.

All too often conventional business advice discourages founder entrepreneurs from practicing the affordable loss principle of pursuing a series of soft micro launches or experiments as a way to settle on the best business and economic model for the business with minimal risk and expenditure of resources. Instead, conventional business advice recommends extensive pre-planning and aiming for the highest returns even if the risk of failure is greater.

Strategic Partnership Principle - The Truth about Competitive Analysis

Manager entrepreneurs use their causal reasoning skills to conduct a competitive analysis to help them define a unique niche for their business. This is demonstrated by the blue ocean strategy postulated by W. Chan Kim and Renée Mauborgne. In contrast, founder entrepreneurs use their effectual reasoning skills to build strategic partnerships with customers.

Founder entrepreneurs do not start with a pre-determined target market or niche in mind nor do they conduct a competitive analysis to see who else is offering similar solutions since they are not sure of their ultimate solution yet. Instead,

they target a single customer and conduct a dive deep analysis on their very specific needs. This analysis helps them understand and then design a custom solution to meet that customer's specific needs with a “one size fits one” solution. They pick the brain of their single target customer and do not focus on their competitors. They strive to develop a product or service that is so well aligned with the customer’s desires that it dislodges any incumbents that are operated by manager entrepreneurs with a “one size fits many” solution. Once the solution is established, the founder entrepreneur looks for ways to re-purpose the solution for other potential customers.

By engaging the customer in designing the solution, founder entrepreneurs invite their clients to be strategic partners as opposed to simply someone to sell to.

When I started Horizon Interactive, an infrastructure business, my first customer was Digital Equipment Corporation. As a former employee, I worked with their divisions to design our deliverables and processes based on their specific needs. Rather than performing any upfront competitive analysis, we engaged the client directly to help us design our service offering. We even educated the client to possibilities they were not aware of based on our technical domain experience using the three T's of challenging sales.

Having the client participate in the design was more effective than speculating on what a potential customer might want, building it, and then trying to sell it to them. Furthermore, our customer has ownership in the solution since they helped design it and were much less likely to switch to competitors in the future.

Moreover, founder entrepreneurs often secure development funds before even committing resources to a solution by having a strategic partnership with their client. In this way, the founder entrepreneur has a low level of capital outlay when developing their offering.

One of my business mentors, Ron Muns, used the strategic partnership principle very effectively when he started his company Bendata. With the personal desktop computer just making inroads into businesses, companies needed a way to track the location of all their computer related assets since they were no longer all located in a central computer lab. Ron developed a strategic partnership with three clients to develop a software application to track all their computer related assets across their businesses. Each strategic partner contributed technical specifications for the application and provided a portion of the capital needed to develop the the first product.

In the end, Muns owned the rights to the underlining software while the strategic partners got their application for a fraction of the cost of doing it alone. The software Bendata initially developed morphed several times as he added new features to the application for new customers and to achieve a better Product Market Fit (PMF). Ultimately, the product went on to become the wildly successful GoldMine Customer Relationship Management (CRM) application and spun off several other successful businesses, including the Help Desk Institute, along the way.

As a variant of the strategic partnership principle, some founder entrepreneurs leave their employer and develop a business based on their extensive industry knowledge and relationship with their former employer's vendors and customers. This was the case with Sam Walton who parted ways with his former employer, Ben Franklin Five and Dime, and created Walmart. Another example is Arthur Blank and Bernie Marcus who left their former employer, Handy Dan Home Improvement Center, and started Home Depot.

All too often conventional business advice discourages founder entrepreneurs from practicing the strategic partnership principle of making the customer part of the design process, fearing that exposing them to a less than perfect product will diminish their brand. Instead, they advise new businesses to identify the most

profitable customer segment, perform a detailed market and competitive analysis, and define and build a unique product where there is limited competition before ever getting any real customer feedback.

Leverage Contingency Principle - Planning for the Unexpected

Manager entrepreneurs use their causal reasoning skills to try and predict the future in an effort to avoid surprises. Founder entrepreneurs use their effectual reasoning to turn an unexpected result or condition into a profitable end. They plan for the expected, but try not to extend too much in the way or resources just in case they are forced to pivot. Surprises are welcomed as inputs to pivot their new venture.

In a former career, I was a Fire Control Technician (FT) in the United States Coast Guard. As an FT, we used a radar to track a target and a sophisticated computer to account for a score of variables to adjust the aim of our gun mounted on the bow of our ship. These variables included air temperature, wind speed and direction, projectile and powder temperature as well as a dozen other factors that would ultimately affect the flight of a projectile weighing more the 50 lbs as it travels from the muzzle of our gun to the target potentially ten miles down range. The goal was to point the gun at an imaginary point in space where the bullet and target would both occupy the same space at a given point sometime in the future, hitting and destroying the target on the first shot. A lot of effort was required to deliver an accurate first shot. After all, during a ship-to-ship or ship-to-airplane battle, hitting your target first is essential to survival.

This fire control example is equivalent to the needs of mass market product type startups which rely on lots of upfront planning where speed and accuracy of execution is paramount. Moreover, this approach is the paradigm of conventional business advice that promotes lots of upfront planning prior to launch and assumes that pre-start money is no object and all that matters is a success first launch.

Compare the fire control example to the way a Gunner's Mate (GM) in the Coast Guard approaches the same problem. They use a bunch of relatively cheap 50 caliber bullets and a simple optical sight. The GM simply aims at the target, knowing that his first few rounds will most likely miss the target since he does not account for any of the variables which affect the trajectory of the projectile up front. After a burst of a few rounds, he simply observes the fall of shot and then adjusts his aim using what we in the shooting sport call “Kentucky Windage” until he hits the target.

The contingency principle is the embodiment of the GM's example. It uses little upfront planning, lots of cheap Minimally Viable Products (MVP's), and observers the results to adjust their next move until a better solution is reached. Rather than following the “ready, aim, fire” model of the manager entrepreneur, the founder entrepreneur practices the “ready, fire, adjust aim” model until they get a hit.

In the early stages of a company, manager entrepreneurs often experience a “ready, aim, aim, aim, and never get to fire” scenario. In contrast, founder entrepreneurs plan for contingencies and use their effectual reasoning to recognize and leverage surprises to adjust their aim.

Here again, all too often conventional business advice discourages founder entrepreneurs from practicing the leverage contingency principle. Instead of encouraging the founder entrepreneur to make small incremental steps to observe what happens and adjust their models, they recommend extensive upfront planning as a way to hit their ultimate target or goal on the first try without any type of feedback loop to test assumptions during the development process.

Exploit the Future by Shaping It –

Don't Try to Predict It

During the past few weeks, we have looked at how the business landscape has changed, why the advice we receive from so called experts has not kept pace, and how the reasoning skills of successful entrepreneurs have adapted to the new reality of business. Let's conclude this series by comparing the logic practiced by the manager and founder entrepreneurs and why one is favored over the other based on industry and maturity.

According to research performed by Sarasvathy of the University of Virginia's Darden School of Business, the logic practiced by the manager entrepreneur is predicated on the belief that:

“To the extent that we can predict the future, we can control it.”

Manager entrepreneurs endeavor to conduct copious amounts of research and analysis in an attempt to predict the future and then write a business plan that defines the steps necessary to exploit a future opportunity.

In contrast, the logic practiced by the founder entrepreneur is predicated on the belief that:

“To the extent that we can control the future, we do not need to predict it.”

Founder entrepreneurs look for ways they can shape the future right from the get go.

For most startups, being in a predictable market is generally not a good market to be in. It is difficult to find success, especially for small businesses in predictable markets, because there are always smarter people with more money who can build better prediction models. However, being in an unpredictable market means that the market itself can be shaped through the founder entrepreneur's own decisions. Their decisions and actions work in conjunction with stakeholders, customers, and partners to shape the market. Thus, founder entrepreneurs are in the business of creating the future and not trying to predict it.

Moreover, a founder entrepreneur's logic is people-dependent while a manager entrepreneur's logic is target-dependent. With causal reasoning, the target (e.g., the customer segment) is chosen first. Then all decisions (e.g., who to hire or partner with) is dependent on the target chosen. Effectual reasoning does not assume a target. Instead, it builds on the idea and the assets available to the founder entrepreneur. The market they create is based on the people they bring together and their ability to influence the future.

Most successful entrepreneurs possess some degree of both causal and effectual reason skills. However, founder entrepreneurs have more well developed effectual reasoning skills while manager entrepreneurs have more well developed causal reasoning skills.

Founder entrepreneurs are leaders who focus on generating ideas, creating value, attracting followers based on their vision, and motivating their audience.

Manager entrepreneurs, by contrast, are about planning and execution, counting and measuring value, and coordinating and controlling the efforts of others.

Based on this list of attributes, it becomes pretty clear why manager entrepreneurs are more appropriate for startup ventures that are more risky and require large upfront capital investments, such as innovations and manufacturing companies. That being said, the vast majority of startups do not involve investments other than from the founder and perhaps his friends and family. Founder entrepreneurs are therefore more appropriate for ventures with less risk and less upfront investments that represent the vast majority of new businesses in the infrastructure and local service markets.