# Stanford eCorner

Tools for Business Model Generation [Entire Talk]

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Entrepreneur and business model innovator Alexander Osterwalder discusses dynamic, yet simple-to-use tools for visualizing, challenging and re-inventing business models. Osterwalder articulates how to use the visual language of his business model canvas framework, and shares stories of how this approach helps organizations of all sizes to better create, deliver and capture value.
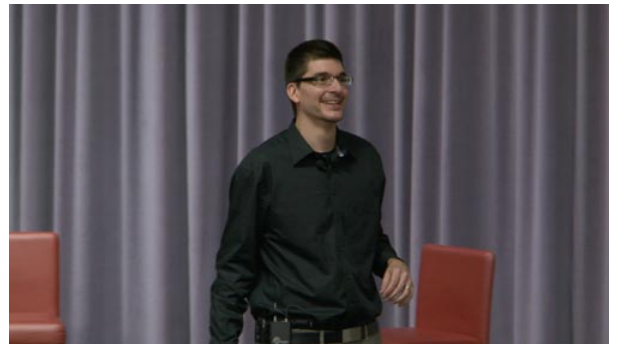
Transcript

Without further ado, Alexander. Thank you, Tina. Okay. So, hello, everybody. You know it's funny actually to stand here because when I started out with this topic, I got a phone call from somebody who wanted to work with me who is in Geneva and I live just around the corner. We were talking and he said, oh, I would like to fly you over. I asked, fly me over from where? Oh, from California. So why from California I live just beside you. That guy thought that ideas like business models can't come from Switzerland. Ideas and entrepreneurship, they can't come from Switzerland, but you know what? Actually, there are some ideas that come from Switzerland that now with the business model topic that we're going to talk about it went across the world.

So, I'm going to talk a little bit about this idea of cracking the code of entrepreneurship, some tools that we can use to talk about business models, design business models and ultimately to test business models, okay? So, I think that until now the tools that we were using were pretty basic. So, you have lots of smart entrepreneurs, I'm pretty sure. Who is an entrepreneur in the room or wants to become one, okay? Who've done a lot of great stuff. But with tools that might not be 100% appropriate, okay? So, one tool that you've definitely heard of is the business plan, right? You may have heard of this sentence here, the famous quote from Steve Blank, "no business plans survives the first contact with customers". So, the first thing you want to do is want to burn your business plan, okay? Because it's a waste of time. Now, planning as such is not wrong, but you got to plan the right thing. So, plans are worthless, but the planning part is important. Now, the question is why do we plan in entrepreneurship? Do we plan how the business is going to look? No. What we actually plan is the search for the business model and once we found one, that's when we start executing on it, okay? That's a pretty big shift from what we've been doing until now. We usually think the idea is the most important at the beginning but it's what you give the shape you give to the idea, how you evolve the idea until you figure out, hey, this could really work and then you execute, okay? That's when you start spending the money.

Now, I am pretty excited about tools, conceptual tools but I think we can push it even further, have software-supported tools that can help us in our thinking when it comes to business models. So, I don't think we'll ever replace the creativity, the art in entrepreneurship, but I do think we can enhance this thinking, okay? So, I'll go into that a little bit. Now, I want to talk about three things. First, the concept of business models, so some of you might know the Business Model Canvas. Who has ever heard of the Business Model Canvas? Okay, quite a few. Who has never heard of this? Okay, half-half. So, I'll show a little video of what this is about and then I'll show you what I mean with tools. Tools of entrepreneurship and at the end, I'll go a little bit into the process, okay? Three things, does that sound good? Okay good. Seeing a reaction I should actually leave the room, okay? So, first, we are going to talk about the concept and I'm going to talk about business models, but the question is, hey, what is a business model? What is a business model? I ask this question everywhere in the world, Brazil, Singapore, wherever I go and guess what the answer is? Well, probably as many answers as people in the room, it's like having a set of very many different languages, it's a word we all use quite a lot. Who's never ever used the word business model in this room?

Okay, you'd probably be the fourth person in an audience that I talked to.

So nobody, right? You all use the word business model, so you should know what it means. But actually it turns out that everybody has a quite a different mental model that we use the same word, but some talk about strategy, some talk about channels, some talk about profit, product, technology, process, and what would be more interesting is if we would have a better discussion about what the business model is, okay? So, if you watch a team talk about business models, say we need to find a business model for our product or you know, an existing company might say we need to reinvent our business model. This is how the discussion is going to look. So, it is going to talk, blah, blah, blah. What? Blah, blah, blah. What? So, smart people in the same room using a lot of words but not understanding each other and this phenomena is called blah blah blah, okay? It's a great book that came out by Dan Roam, you might have heard of Dan Roam who wrote, The Back of the Napkin, his last book in September, it came out, it's called Blah, Blah, Blah: What to Do When Words Don't Work. So, I think when it comes to business models, words are not enough. We need to be able to a, have a shared language, but a visual language that allows us to sketch out business models because when we sketch them out, when we map them out, that's when our discussion becomes clear, okay? That's really important. So, when I started out with this topic that was what I wanted to figure out. How would a language look like a shared visual language to talk about business models? And I started a PhD on the topic and I got a PhD for this title here "The Business Model Ontology" - a proposition into design science approach.

I know here some people laughing, right? Because you know that to get a PhD, you need to use words like ontology, right? Then you get a PhD, it's as simple as that, okay? Now, the funny thing is I put this online and people started reading it. They downloaded it. They used it in companies, which means okay, there is something there that people really think is interesting. Now, nobody told me when I started my research and enroll in my PhD that the dissertation would be read, okay. I would have maybe done a better job, okay. So, PhDs are usually made to write and then you have three people who read it but here, this went around the world. Now, I thought, hey, these ideas are interesting for people. So you know what? I want to write in a bit naive way I thought. I want to write a management bestseller. Now, if you know the publishing industry, you know that there is 1 million English books coming out every year.

Of those 1 million, 11,000 are business books. So nobody is waiting for 11,001, nobody. So, what we did is we tried to publish the book with an innovative business model and we actually did turn it into a bestseller. So, it's about a quarter million books now circulating around the world, 23 languages and even more important, people are using this stuff, okay? So, this is how the book looked. Who has a book, who has the Business Model Generation book? Okay. For those who don't have one, there are couple in the back after the lecture and you can take them with you, okay? First come first serve. So, the heart the book - for those of you who know it, for those of you don't know it - is this visual language that I was talking about. The Business Model Canvas that allows you to sketch out existing business models or business models that you want to create, okay? Now, what is this language about? It's about nine building blocks. Nine building blocks that allow you to describe or design every business model you can imagine, ultimate possibilities, thousands of alternatives. So, let's watch a little movie, two minutes that will explain what the Business Model Canvas is.

If I explain it, it will probably take 15 minutes. So that's why we made a movie so you can get a quick overview of the Business Model Canvas. So nine building blocks, pretty straight forward, the individual building blocks are not new. Probably most of you know every piece of it, right? If you looked that business a little bit you have an idea of what this is. But the important thing here is that we have all nine on one slide or on one poster if we print it out and that we understand how they all fit together. So we get the big picture understanding, not just the product, it's for the engineers in the room products, great products are becoming a commodity. It's the combination between great products and a great business model is going to keep you ahead in competition in the coming decade. So what you really want to understand is how all these pieces fit together and what the best business model could be for your idea. That means you need to search for the right business model, okay. So let's look at an example, we're going to sketch out the business model and when I say sketch out, I literally mean sketching it out with post-it note.

So now you know why you have post-it notes. So we're going to work on a little case together, okay. So if we can start distributing the canvas that will be great. So the idea is that we map out all the different pieces and I'll give you some basics here. You never write on a canvas that's a crime, okay. Because God invented post-it note, okay. I don't have any stocks in 3M, but what you really want to do is you want to - for every building block you want to use a post-it notes, so these are a little big so I made them a little bit smaller and why - one for each idea that you have for each customer segment for each channel because then it's mobile, you can put it up, you can discuss, you can take it down or if you have, if you mapped out a business model, let's say you have a product idea you mapped out all the pieces, you want to ask yourself, oh I have two segments here, but what if I took this one away. What's the impact on the rest of the business model? Can I take a channel away; can I take resources away, follow me on this? So it's like a balloon, somebody told me hey the Business Model Canvas is like a balloon, you push in on one side, it will have an impact on the other side. So you can see the relationships between the pieces, okay. So, let's work on a little case and it's end of the day so I thought the best thing we could do is talk about coffee, okay.

And we'll talk about coffee because it's a commodities business and there is some interesting stuff going on in this business, okay. And you can learn from any type of business model that has nothing to do with the domain you're in because that's the interesting thing. Not like with products where one product may be not - will not relate to another from one industry to another, but you can learn from the amazing business models that are out there. So we'll look at one and I'll start with a little question from Switzerland where I come from because I have the data there. Question to you is, how much less or more do you think Swiss households pay for coffee consumed at home? So if you look at the last couple of years, do you think we paid 20% less, 20% more for coffee consumed at home what would your guess be, what do you think, some guesses? Plus 50%. Plus 50%, okay courageous guess. Others? Minus 20%. Minus 20%, it's a commodities business, right, pretty straight forward. Other guesses? Plus 200%. Plus 200%, right.

I mean, it's Stanford, Silicon Valley we need to be a bit courageous here, right. Yeah, go ahead. I need post-its. You need post-its, okay. How could you be in here without post-its? That's correct, yeah. Turns out that in this commodities business there is one company that could get us in Switzerland and now all around the world it get us to pay 600% to 800% more in a commodities business. That's amazing, particularly if you know that we Swiss we don't throw money out of the window, okay, that's why we have these big secured banks. So the reason is not George Clooney either so George Clooney stands for one brand except in the U.S. George Clooney stands for Nespresso. The anecdote is that the U.S.

is the only country where George Clooney does not advertise for Nespresso because if as a TV actor, as an actor in general, you advertise it means you're on the way down, okay. So he doesn't want to do this in the U.S. Now what did Nespresso do? So who's ever had a Nespresso coffee? Okay. Wow! Okay so they're already acquiring entire U.S. that's pretty cool. At the heart of it is a technology. They were the first to invent single portion coffee, where you have the machine, you have aluminum pods, you take the pod, you put it in the machine, you press the button and out comes a very good espresso with crema on top, it's like Milano. It's not like in Finland or other places in the world where the espresso is a bit doubtful. So the results that they had are pretty amazing. So after two decades, it's still one of the fastest growing businesses in the Nestle Empire.

Nestle is the biggest food company in the world. It has about 30% growth rates still after two decades for the last 11 years, okay. I know if you're creating a start-up and you want to be Google or Facebook whatever you'll say 30%, ooh, okay. But if you are a company that exist for a while, 30% is pretty good, if you continue that all the time. And it represents now a business of about US$3.2 billion. Question to you is, now this is one product line, okay. The machines, pods is the main business. Question to you is, I want you to work a little bit on the business model. What do you think are the core components of their business model that made them so successful? So you know the technology, machine, pods, but what is it in the business model that turned them in such - into such a successful company? I'll give you about six minutes to work on this idea, in groups of two. So work with your seat neighbor, use the post-it notes, sketch out what you think was relevant, crucial in their business model, let's go, okay.

Okay, let's do this together, let's do this together, okay. You didn't expect you'll to have to work at this time of the day, right? But you're dealing with a Swiss here, okay. Now what did you come up with, some ideas, what's crucial in their business model that made them so successful, what do you think, anybody? Yeah, go ahead. So my guess is that they would likely sell the coffee maker itself at cost without making a loss. And I'd guess they would make that back by selling the coffee itself to the customer. Okay, so get the machine into the market and then earn from the pods right? Repetitive sales, right? Great, what else. For a value proposition, you can get a premium coffee without having to leave your house. Right, and you have different flavors, with a different colors of the pods, okay what else? Everything you order online, so you get the machine at your home very easily, it's very low cost. Okay, so interesting. Let's just stick with this for a moment.

Where can you buy the machines, the Nespresso machines, what do you think? Where can you buy them? Amazon. Amazon, okay. Everywhere, right, everywhere. Where can you buy the pods? Only through them. Only through them. Why do they make a difference between the machine and the pods? Because once when you own a machine then you'll have to have the pods. Right, you're screwed. Once you have the machine you don't have a choice. So they will use - oh, sorry it's filmed, okay. Now just go beep.

In Switzerland they would leave it. So you get the machine into the market and they want as much reach as possible so they're really going to try to push you to buy that. But once you have it you don't have a choice. It's the only pod you can put in there, so they don't need the reach anymore because you will go get the pods, okay? If you want to switch, you need to buy a totally new machine. So, that's the idea behind that. So, let's look at this visually, all the components of their business model. So, let's sketch it out. So, I didn't write any fancy value proposition here. I sketched it out with the strategy of machines and pods. So if you look at what they do within Nespresso machines, they sell them through retail, mainly to households about 85% of their market, little bit to businesses, they would have another sales force here.

They sell the machine once and they don't even make it, they work with machine manufacturers because what they're interested in as you correctly pointed out are the pods. So, for the pods, they've a different strategy, they sell them directly

through their own channels, started out with mail order and with call centers, then nespresso.com and now you find Nespresso stores all over the world, Champs-Elysees, Fifth Avenue, why do you think they set up stores, it's pretty expensive, you can sell everything through the Internet, why would they do that? Branding. Branding will develop a little bit. Prestige. Prestige, it's a very high-end brand, they ask you for a lot of money, six to eight times more for espresso and you can't establish that only through the Internet, so the similar strategy to Apple, right, building their own stores to create a high-end brand. George Clooney is good, but not enough, okay, you need the stores. So, then you start buying the pods and then have recurring revenues with insanely high margins and all the money goes into their pockets. That's what makes them such a successful company. Now let's look at this side, what did you put up in key resources, what are some of the most important things in their key resources, what did you come up with? Patents. Patents, right? Patents is a key component of their business model.

So, the entire business model is built on patents because otherwise anybody else could make pods and push the margins down. The interesting thing is, this year some of the patents are running out. So, it'll be interesting to see how Nespresso is going to evolve the business model because they need to change it, a business model is never finished, okay? What else do we have in the key resources, what else would be important here? Coffee! Yes. Straight forward, but they just want high-end coffee. What else? Give me another one. What else would you put in key resources? Basically if you know, what you do here on the right hand side, you should be able to figure out what you need on the left hand side. Give me another key resource, anybody? What is missing? We have, patents, coffee... Access to an international company. Access to an international company, Nestle is pretty international, yeah, correct. What else? Transportation.

Transportation, logistics - that would be more than key activities, absolutely. Capital. Capital, access to capital, maybe it's not so important here. Style. Okay, style, you might want to call it brand. If you're in a consumer business you have no brand, you're dead, okay? And that's expensive to create. So if you want to go in that type of business, you better have this brand, okay? Then key activities, business to consumer distribution marketing production, interesting thing here this was the first time that Nestle sold to households. They were used to sending pallets to retailers. It's the first time they needed to build logistics that sends small boxes to households, okay? And if you know this here on the left hand side, very quickly you can figure out the cost structure. So, on the right hand side, we have a little bit the front stage related to the customer, on the left hand side, we have the back stage that enables the front stage.

Okay? See that duality? It's little bit like a mirror. So, why did I choose Nespresso talking at Stanford in the engineering school because there's something you can learn that's really, really important for you. When Nespresso started out, they were so close to going bankrupt. Why? It's exactly the same product, same technology because their business model didn't work, same product, same technology, their business model didn't work. This is how it looked - I'll keep it simple, joint venture with machine manufacturers, so this is the similar piece to before, but they would sell it to offices, to companies through the sales force of the joint venture, through the sales force of the machine manufacturers. Two things didn't work, offices were not interested, and the sales force, they didn't want to sell these small machines. Okay? So, that business model didn't work. Actually they invested a lot of money in this before they moved or pivoted it for use the Silicon Valley term to a new business model. Okay? The only reason why they did it is the board said we produced all these machines; our warehouses are full. We might as well try something else.

So, they shifted to a new business model. They actually moved the inventor of this, who was the CEO, back to research where he came from and brought in a new CEO who came up with the business model that we saw. Okay? So, they experimented with that. But they could have done it in a less costly way; they would have experimented before building this business. Now, second part, I want to talk couple of minutes about tools. So, what you want to do when you think about your business model, so you want to sketch it up, you want to have all those nine building blocks and you want to have a good story, okay? But if we look what we've done until now or you've done before, what we're doing here, what's missing? What's missing? What didn't we do yet? Numbers. Numbers, right. Like this, it's still intellectual masturbation. Okay? What we really want now, so we want to go a little bit further and do something that paper tools can do easily, which is throwing some ballpark figures, some numbers. So, I thought about a year ago, two years ago now, hey, if we could create an iPad app that would allow us to sketch out a business model and throw in some numbers, we could make a business model prototype in 5 minutes or 10 minutes or 15 minutes without ever opening Excel because if you want to put numbers in Excel, fine, but you're going to waste a lot of time, and you can't play in Excel.

So, let me show you this, want a little demo? Sure, yeah! Okay. Right, I'm shamelessly selling the iPad app here, but this is not our business, so - let's look at this, here our business model toolbox, and we're going to create a canvas for this app, okay? So, we're going to make a business model for this app. So, let's say, business model tool, business model app, who could we target, let's say, entrepreneurs and consultants, what are the channels that we used if we're selling app? iTunes. The App Store and the iTunes, right? Okay. And let's say, we are selling the app. So, I can do the same thing as I can do on paper, I could sketch the whole thing up. what then becomes interesting is it by turn on the little estimator up there in the left hand corner, now start throwing in some figures. So, how many entrepreneurs could be interested, let's say, total possible market, 30,000, how many consultants, let's use the same number to play with it a little bit. And now let's draw in a revenue stream. So,

we said we're going to sell, so we have a list of revenues streams here, we're going to sell the app, okay, to entrepreneurs, but if I sell through the App Store, there is a little detail there, what do I have to do? Pay Apple.

I have to pay Apple 30%, right? So, the revenue stream is basically a revenue stream minus the transaction cut, sales minus a cut of 30%, so a new formula comes up. How many could I reach - how many customers could I reach in the first year, let's say, 15%. How many times are they going to buy the app? Once, except that they lose their iPad like me all the time. How much are they going to pay? $29. How much do I pay to Apple? 30%. So, immediately I can see just playing around, this is not worthwhile, it doesn't even cover the development cost. If I had mapped out the whole thing here, I'd see that this is more expensive than what I could earn. So here is where it gets interesting. Now I'm going to play, let me take another idea, let's say, I'm going to create a web app and I'll only sell this to consultants and the channel is the web, okay. Now they have a different job to be done.

Entrepreneurs want to find one business model that works. Consultants, it's a bit different, right? They're helping others again and again and again, every week, every month. So, what kind of revenue stream would I make? Recurring one. Recurring one, right? Otherwise, I'd be silly to throw money out of the window. So, I will say, I'm going to make here a subscription. I'll use different revenue stream subscription, web app to consultants, let's say, the same numbers, 15%, you're going to pay $9 really cheap per month and I can see boom. It's much more interesting. So, of course, we know that recurring revenues subscriptions are more interesting than app sales. But imagine if you could do this for the entire business model, you can play, you can do two, three, four - four different alternatives in half an hour or an hour. Because let me remind you again.

It's the product, value proposition plus the business model, the right business model, that's important. So, you want to play with this to find the right business model, okay? So, you can find this on the App Store, it's called Business Model Toolbox. And it really plays into this idea of design thinking that prototyping is actually the conversation that you have with your ideas. So, when you start trying it out, that you get new ideas. You will try something else. You will develop different alternatives, okay? Now, let's look at the last part here, process. So, using an app like that you can come up with great alternatives, amazing alternatives. So, this is going to work. But you know what? Even the best business model on paper is only a set of hypotheses, a set of guesses, right? So, this is what Steve Blank called well, get out of the building because ... What do you know about Steve Blank for? I don't know anything.

Why are you interrupting me, I'm talking - who are you to interrupt this? Steve Blank could interrupt me, but ... Well, I'm Steve Blank. Wow, let's welcome Steve Blank. That's a surprise. Thanks, Alexander. Oh, yeah. So, we have a chat about ... Let's have a chat about this, Alexander? Shall we sit down? Let's sit down. I just happened to be wandering through and heard my name used in vain, what do you know about getting out of the building? How do you take the Business Model Canvas and actually make it actionable? You know I think when I came across your work, it was a pretty much an eye opener because in the book, we talk about design thinking, right, about trying out prototypes and seeing what could work and what couldn't work. But what I didn't realize was that, hey, you can really test the business model and here the real idea is you can actually test them before you build them.

So, that was something that we didn't write about and I think it fit pretty well and I think you have the same idea, is that right? Sure. It was so because when I came across your work, I was - in fact, Ann Miura-Ko, who teaches here at Stanford with me. Ann and I were already trying to design our own Business Model Canvas and one day, I found this great PhD thesis online and tried to show it to Ann. In the meantime, she had been trying to show me a book that she had found online and we discovered it was the same person. It was you. And for us, the whole idea about entrepreneurship is actually to be able to break it down to a series of untested hypothesis. And the best way we found to do that was your Business Model Canvas. And the part I thought I had added was the ability to go in a time axis, which is a customer development process which was a rigorous test of hypothesis. And that brought us to kind of expand an idea of the canvas. And you know, what I found interesting in this time axis is how you go through these different business models and I mean I - probably many of you know that Steve put up a course, right? What was it your E245? Right.

The Lean LaunchPad and I found it interesting that to see how the canvas evolves, right? You take pieces, you test the hypothesis to see that, that doesn't work, you changed the canvas. So that tied in pretty well with what we were doing, but in the building. Right. And so here is the thing that I would add to that is that you can understand the canvas in several ways. And two weeks ago, I was in London in a conference called the Leancamp, it's called and somebody told me who was actually interested in this whole customer development and being start-up he said when I came across the canvas, I thought it's pretty interesting because it's like a checklist. If you spent four years, five years working this out and somebody tells you, you came up with a checklist, you're pretty disappointed, right. So, I thought that can't be it. So, what I realized is, well, it's actually true. But that's the first level, let me draw something here. That's the first level of understanding when you use, oops, something like the Business Model Canvas, wonders of technology.

I think the - I'm not moving away because I don't like you. I'm going to follow you. Okay. So what I realized is that there is different levels of using the Business Model Canvas. And what would the first level be, Alexander? It's the checklist, okay?

So... And that's a hypothesis checklist. Let's say you are an engineer, right? You have an idea or a vision of a product here. And you said, well, you know there are a couple of more things to create a business. Oh, I need a customer, right? Right. Oh, I need to reach the customer.

Oh, I need actually activities and resources to do this and at the end of the equation revenues are bigger than costs. So, you just fill out the boxes. But I think you can go a step further is the second level is when, yes, you fill out the boxes, but you understand that there are connections between the different pieces. And that was the Nespresso example you use. It's exactly what I just shown there that they have a real story. They have a strategy between the machine and the pods to create recurring revenues at a very high margin, all the money goes into their pockets, right? And I think when you came for our class, you saw our students already starting with level one, which is, gee, the biggest step for most entrepreneurs is just trying to figure out what were the hypothesis is a level one example. And when you kind of get that and get out of the building, then you realize this is another game to be played. And the thing to remember for those of you doing start-ups or want to compete even in an existing company, if your competitor is playing a level one strategy, that is just simply customer product market fit, but you figured out a Nespresso strategy where you're using other pieces of the Business Model Canvas, you could kill them every time even though technically they might have a better product. My favorite example is Microsoft. Anybody ever believe DOS was the world's best engineering solution to an operating system? Microsoft played a channel game on a way that was chess when everybody else was playing checkers as a strategy.

And Bill Gates' biggest contribution to business was not technology. It was the ability to use the channel and distribution and pricing in a way that was actually if you drew it out, the other pieces of the Business Model Canvas that no one else saw because they were playing on a technology level of, gee, I got this value proposition. Look at my features. Right. And the best play that I found to get people to develop this idea of a story... Yeah. ...and connections between the pieces was, in a workshop I was always puzzled that people were just throwing these post-it notes on the board at the beginning. Yeah. So, I force them to do something in a different way. They said, hey, the worst thing you can do when you explain your business model is put everything on the slide and show that, why? Because that's cognitive murder, okay? It's information overload.

Nobody can follow your story and you'll have a hard time explaining it. So, I get them to start from a blank canvas and you can even do this by yourself just to figure out what's the story here. And I get them to put up one post-it note or one building block at a time to walk the audience through the business model. So, that would be something like this, hey, I'm addressing this customer segment and this is the job that they want to get done. Today in the market, nobody actually gets that job done. So, this is what I'm offering them, so they can get the job done, and you know what? They are willing to pay this much to get it done. But if I want to do that I need these key resources at these costs and so on. So, if you're at that level, you're at level two, you really can walk me through a strategy. That's a big difference to level one. And is there more levels or is this kind of like a Zen-like thing where I...

It's not enough, you want another level, okay. So... Every consultant needs multiple levels, so it could keep coming back. Don't insult me, I'm not a consultant, I'm an entrepreneur. No, not you, I mean, people who make a living off of your work. Right, which is fun that people likes to use it. So, there is a level three and a level three is when you don't just understand your own story but you start understanding those business model dynamics that exist in different business models. So, you can understand, hey, Google, that's actually something that with complicated terms, you'd call it a double-sided market. We have several pieces that fit together and you'll find the same dynamics in several business models. And what I realize is the best way to start understanding what we call, patterns, business models with similar dynamics to study different business models.

So, you can almost capture the wisdom of what others have been doing by just mapping out the business model of Skype, mapping out the business model of Google, mapping out the business model of Nespresso and starting to understand, hey, what did they do that was so powerful and once you understand those patterns, you can use them, patterns comes from architecture, it was used in software engineering, you can take them right from the library and ask yourself, could I create a double-sided market, could I create a freemium model and if you know the patterns, you know the dynamics. Have do you go out and test those? Test them. Yes. Yeah. So, here's the problem, right. Right. You can get very excited about doing this on paper again and again and again or you can hire consultants to do it for you, but what you really want to do is -- and that's where there is a great fit between your book, which new version is coming out, right? Or well is that a secret? Since you asked, no one here will tell anybody, don't worry, it's called the Startup Owner's Manual, which is the 10 years in the making, replacement for The Four Steps to the Epiphany, now available for pre-order, but -- since you asked, but truly this notion of the canvas used to be thought as a static 2D document, right? Yeah. And now there is some more insight, I think from you as well about what the canvas means over time. I would actually almost call that level four... Okay.

Where you could say, you know what, this is not a static document as you said, it's something that evolves. So, if we draw it out, you actually test several business models, not just the design, but you create hypotheses, you create a test for that hypothesis and then you try to figure out what actually works and what doesn't, right? So, let me just observe as Alexander is drawing that. Those snapshots of the canvas over time, which when I teach, I call, scorecards has an amazing characteristic.

Over a period of - let's say, you take a snapshot of week, here is what I thought before, here is what changed since I've gone out of the building, you actually for the first time are documenting the process of entrepreneurship over time. And when you play back, that is, here is week one, week two, weekend, you actually have a filmstrip of how much you've learned as an entrepreneur over time and the hair will stand up in the back of your neck because there is never a way to capture that learning of, gee, what did I learn and how did I learn it because every entrepreneur has a great characteristic among many. They always claim that what they're doing now is what they always thought from day one, right? Of course, I knew that these weren't the customers. I was just practicing over here. This way you can't reinvent the past. Here is what I thought, here is why I moved, from here to here to here and it captures that learning in a way that's really impressive because it's just using our process over time. Let me - maybe show how you could conceptually understand, let's zoom in one at one moment, right? We could say it's like laying the canvas here flat, saying this is the business model that we came up with.

Yeah. Okay. So, that's your design, that's your best guess. Okay. Your best hypotheses. But then what you want to do is you want to ask yourself, hey, another layer, second layer, what are the underlying hypotheses of every one of these box and then maybe select which one are the most important ones to make this work. Okay. And so how would you figure out over time, what would you have to do next on top of the hypotheses? So, on the next level, next layer is you would start designing tests because the hypothesis is bringing it out into the open, making it explicit. So, hypotheses are used here at Stanford because these students are paying enormous sums to attend class, but this is podcast to other parts of the world and the word hypothesis there means what? It's a guess. Guess, all right.

So, we allow you to use hypotheses inside of Stanford because you're paying a lot of money and this is actually a joke, so some of you are allowed to laugh, but we call them elsewhere, guesses because really what you're doing unless you're a domain expert in a startup, you have constructed your business model out of the series of untested guesses and so this is a process to actually articulate them and now start designing experiments in this test layer to actually test them. And you know, some go further than guess and there is some strategy professors, they call this, WAG. Yeah. Wild Ass Gamble, okay? If you know testing hypotheses and why am I saying this because let's just look at the difference between a startup. Yeah. And a large company, right. Okay. Because there is a thing like corporate entrepreneurship. And that's one of the areas I face a lot and we actually want to make a difference between the hypotheses and testing and the execution of existing business models. So, in large companies you probably have more of a continuum where you have the existing business model and you could use the canvas to simply improve this, right? That's more of an incremental innovation.

But then large companies are facing huge challenges, entire industries like the movie industry, for example. Right. They need to come up with new business models. So, they actually need to do something over here, which is create new business models, play around with them and see if they could work. And so on the left is my existing business with an existing profit and loss division and a staff and a functional organization et cetera. Who's doing this stuff on the right? So, here's the difference, right. You have - as you said, here you have a work chart, you know how to do this. Right. So here we're in the space of execution. Yeah.

All right, existing business model. Here you have plans, oops, plans well you got it, plans and budgets. Okay. Over here, good question. Who's doing that? Yeah. The problem is that often, we take the best people from here and we bring them over here. So what's wrong with that? Well, what they're going to try to do is plans and budgets, okay. And sometimes well, they're really evaluated on that. Now, if you want to work in a big company, you're hired to do this and you're going to have to face specific plans and budgets, run as fast as you can, okay, because that's a career suicide. Because the logic here is different, it's actually what you describe in the four steps.

You don't want to plan and budget, yet you want to experiment, right. You want to go through the four steps. You want to iterate through, so this doesn't work. So basically what you want to do is, you want to experiment. You want to fail or succeed, learn and then use those insights and experiment again and you want to go through this loop. And this loop is actually something like this, right? Okay. And so this is an interesting insight. If we think about it, on the left hand side in execution, large company executives or company executives who are executing an existing business model are hired to do repeatable things that are known. And if they fail, it's a failure of competence. That is there is a job spec, they were hired for that spec, the business model was already known; failure in an existing corporation is because you personally did not do your job.

But, when you're searching for the business model, the rules have changed. You're no longer hired for known execution. And, in fact failure isn't punished; failure is in fact just hypothesis testing. And, if - what we've never done is actually articulate the fact that when you're searching from a business model, it's more likely that you're going from experiment to experiment, as they fail, not as they succeed. And, different people with different make-ups do better in one section than others. Absolutely. And, we should save some time for questions, by the way. Right. Should we do one - there's some new thinking here.... Do you want to - you were telling me something about problem/solution or product/market fit or you had a better phrase for it.

What was that called? I thought that was incredibly insightful. Yeah, I was troubled by the fact that, in Silicon Valley, but in engineering technology, innovation in general, we focus a lot on problem/solution or market/product fit, right? Yeah. And, I

thought that's a pretty basic concept, two words. Could we create a canvas to sketch that out, to work on it the same way we do for the business model? I thought we already have a canvas with value prop and customer. Should we draw - just zoom in on those two boxes or...? That's a good point so it's like - if you tick here.... Yeah. ...the value proposition, you take the customer segment.... Yeah. ...and you look at the fit here, right? That's it. And, you take this....

Yeah. ...you blow it up like a magnifying glass. Okay. And, you start explaining why do you think this product or value proposition has a reason to be. Why does that fit with the customer service, okay? Okay, why? So, let's draw this up here. Let's do a little test. Can you see - can you guess what this is? Can you guess what this is? A gift. It's a Tiffany Box. That's the best you can do? It's a value proposition. Can't you see that? Hey, look, come on, here, right? It's a value proposition.

Let's try again. Okay, what is this? Customer segment. Customer! Exactly! Great! Okay, you won some chocolate; I have chocolate with me. So, what you basically want is a fit between the two, right? So, we already had that. Okay. But, where it gets interesting is, if I have a visual map to start sketching this out and understanding it better. So, let's look at the customer segment first. First thing we want to do is we want to ask ourselves what jobs is this customer trying to get done. What do you mean by jobs? It means if there's a - if you're a web retailer and you want to sell salads to mothers, what is it you're trying to get done? Well, probably if it's a working mother, she wants to buy groceries in the most efficient way with losing the least time.... Absolutely.

...and all those kind of things. So, she's not buying salads; she's actually trying to solve her problem. She's trying to sell her problem and you're going to sketch out all those jobs that she's trying to get done. Got it. Then you want to dig deeper and you want to ask yourself, well, what are the pains and the gains that she has here. So, you want to start sketching out here the pains. What are her pains when it comes to buying salads, right? Oh, there's a long line in the store, when she's finished from work, and so on. What are all the pains? And, then you want to sketch out what are the gains. She wants to have healthy food; that would be a gain; all those things that you learn in the market by talking to her, customer development, right? So, on this side, we observe everything around the customer segment, okay? So, we can start maybe with a hypothesis but we can even start with talking to customers. So, then we've figured out everything around the customer.

Okay. Now, we want to look at what are we offering as a response? So, we're going to look at the left hand side, and let me use a different color here. So, again, we're talking about the value proposition here, okay? And, a value prop, is that my product? We try to avoid any type of buzzword in the canvas, right? Right. Probably the last one that survived is the value proposition. Right. So, the value proposition could say, it's the offer, and the offer is composed of products, services, and if you're doing a software or web product, well, you could say even its features. Okay. We use the word features, alright. Wow! Now, you haven't yet described how your products and services.... Yeah.

...fit or relate to the jobs and the pains and the gains. Couldn't we just call those benefits or something or...? We could call these benefits over here. Yeah. Now, you want to describe how exactly you're creating value, how exactly you're creating benefits for the customer. So, the first thing you want to do is you want to describe how your products and services are. Can you figure out what this is? Let's try it again. What is this? It's not coffee, come on. It's a painkiller. You can see that, right? It's right beside here, pains, painkiller. So, you want to sketch out what are the painkillers, buying online in efficient ways so you don't have to stand in line.

So, the last one is over here you start sketching out the gain creators. Now, this is just another canvas to zoom in, into one part of the business model; most importantly is you need to get both right. It's not just this; it's both together. Wow, absolutely awesome! And, this isn't even in your current book, is it? This is, could be a new book. Yeah, it could be a new book. So, Alexander, this was absolutely amazing. And, thank you very much and I think...