JOHN MULLINS, PhD

COAUTHOR OF
GETTING TO PLAN B

START, FINANCE, OR GROW YOUR COMPANY WITH YOUR CUSTOMERS' CASH

THE CUSTOMER-FUNDED BUSINESS

WILEY

Praise for *The Customer-Funded Business*

"This is THE cornerstone idea for entrepreneurs—to shun all other avenues first and pursue customers to fund their venture. This provides a critical forcing function business leaders need, in order to guarantee they are creating something truly valuable. After learning this lesson the hard way (raising angel funds and failing), my two latest ventures have followed Mullins' sage advice and flourished."

—Verne Harnish,
CEO Gazelles;
Author of *Scaling Up* and *Mastering the Rockefeller Habits*

"The customer is not just king, he can be your VC too! John Mullins' brilliance has inspired my own success for many years and his ideas can drive yours as well."

—Bernard Auyang
Entrepreneur and investor;
International Chairman 2014–15, Young Presidents' Organization

"Mullins has connected the dots. His clarity of insight blazes through in the five crisp models of the customer-funded business. He sharpens our understanding of how to use the power of market innovations and customer traction to fund emerging businesses. A great set of tools for the new and experienced entrepreneur."

—Jerry Engel
General Partner, Monitor Venture Partners;
Adjunct Professor Emeritus,
Haas School of Business, University of California Berkeley

"John Mullins' sage advice for entrepreneurs and the investors who back them is just as important for established companies that are trying to unlock innovation and growth. Customer funding is a powerful approach that too many businesses have simply forgotten, or never understood. If you don't read this book, you'll lose out to competitors who do."

—Mike Harris
Founding CEO of First Direct and Egg Banking;
Author of *Find Your Lightbulb*

"Hits the nail on the head. Customer funding isn't just another source of capital for starting or growing your business. It is—by far—the most intriguing source available. Mullins shows why, and he shows five ways to obtain it, too."

—Tom Byers
Professor and Director, Stanford Technology Ventures Program,
Stanford University;
Coauthor, *Technology Ventures*

"A timely reminder not to see your customers only as a source of credibility when you are starting out but as a valuable source of funding—particularly in the early days. Packed with good anecdotes and inspirational tales of entrepreneurial success (and failure), John Mullins nails it again!"

—Richard Gourlay
Managing Director, Sussex Place Ventures

"Happiness is a positive cash flow. I remind my students that venture capitalists (and most angels) don't typically fund new businesses, they fund businesses that are poised to grow rapidly. The five models that John highlights can help entrepreneurs launch and validate their businesses when other sources of capital are scarce and expensive."

—Andrew Zacharakis
The John H. Muller, Jr. Chair in Entrepreneurship, Babson College

"There are many books aimed at helping you develop the perfect pitch to ensure you get investment. But entrepreneurs start businesses, not investment vehicles. This book is a grand journey through many ways that we can build these businesses using other people's money or shifting our business model. And importantly—keeping the valuable equity to ourselves. Do not raise equity investment until you have read this book and considered every other option."

—Dale Murray
Cofounder Omega Logic, British Angel Investor of the Year 2011

"Worth the price of the book for Chapter 8 alone. Most startups will never have a chance to secure an institutional investment. Some may never need one. John Mullins shows entrepreneurs another path employing proven *Customer-Funded Business* alternatives. Even if you plan on eventually scaling with venture capital, customer funding can be a smart path to experiment and prove your business in advance."

—Randy Komisar
Partner, Kleiner Perkins Caufield & Byers;
Lecturer, Stanford University;
Author of *The Monk and the Riddle*

"Very accessible, thorough, and will no doubt be useful to aspiring (or struggling) entrepreneurs. The models are a great analytical tool which the case studies bring to life."

—Amar Bhidé
Schmidheiny Professor, The Fletcher School, Tufts University;
Author of *The Venturesome Economy* and *A Call for Judgment*

"With *The Customer-Funded Business*, John once again provides us with a fantastic book. If someone is looking for inspiration on how to keep their cash requirements to a minimum and de-risk their investment—this is the first book they should pick up and read."

—James King
Founder and Chairman, Find Invest Grow (FIG)

"Truly engaging. 'Ring the cash register and sit on the float—and avoid running out of money and going out of business.' John Mullins convincingly guides entrepreneurs to dump their PowerPoint slides and look to their paying customers as their 'first ports of call.' Early stage investors might want to think in similar fashion!"

—M.S. Rao
Professor, S P Jain Institute of Management and Research

"Essential reading for any budding entrepreneur—a revolutionary approach to funding a new venture. A fresh perspective on funding and scaling ambitions."
—Jim Hall
Executive Director, Entrepreneurship Centre,
Saïd Business School, University of Oxford

"Professor Mullins breaks down the myth that the key to a successful business is to raise venture capital first. His prescriptions for finding the right customers and getting them to fund your business are a great step-by-step guide to raising venture capital—build the business first and the investments will follow!"

—Bill Earner
Partner, Connect Ventures

"Practical and pithy, and a must read for an entrepreneur, full of pragmatic insights relevant to any entrepreneur or business executive."

—Sunita Singh
Cofounder and Senior Director, National Entrepreneurship Network, India

"A truly fascinating book, long overdue. John Mullins has brought out a completely new paradigm in financing businesses. A lot of business failure will be avoided if entrepreneurs really understand the message and practice it."

—Kavil Ramachandran
Thomas Schmidheiny Professor of Family Business
and Wealth Management, Indian School of Business

"John Mullins has done it for the third time. After *The New Business Road Test* and *Getting to Plan B*, he has produced yet another book for entrepreneurs, investors and educators that is based on rigorous research and at the same time engaging and practical. He shows how entrepreneurs can postpone raising costly venture funding by obtaining funding from customers in the early stages of their businesses."

—Rama Velamuri
Professor of Entrepreneurship,
China Europe International Business School, Shanghai

"A timely and healthy antidote to the almost universal focus on financing issues in starting new ventures. Mullins argues very convincingly that for most non-tech start-ups, seeking external financing not only is extremely time consuming and only rarely works, but often is counterproductive to developing sustainable businesses serving real customers' needs. Mullins builds on his evidence-based approach to entrepreneurship successfully demonstrated in his previous best-sellers *The New Business Road Test* and *Getting to Plan B* and provides would-be entrepreneurs with well-thought-through tool kits and real-life case stories."

—Søren P. Hovgaard
Head of Entrepreneurial Development Unit;
External Associate Professor, Department of Economics,
University of Copenhagen

"A paradigm-shift in the way we think about startup funding. While 'lean startup,' 'bootstrapping,' and other methodologies have had their day in the startup spotlight, reading this book makes me realize that the next decade belongs to customer-funded businesses. And this book shows the way. Starting up, as well as angel investing, has more madness than method. But the five customer-funded models, as well as the 'John's Business Angel Checklists' at the end of each chapter, distill the process down to its essentials."

—Ajeet Khurana
Top-15 Angel Investor, India, 2013

"*The Customer-Funded Business* gets it. Great practical advice for those seeking to crowdfund their ventures. I recommend John's book to those wanting a grounding in customer-funded business that is also deeply entrepreneurial in spirit. I can't wait to put this book into action!"

—Norris Krueger
Entrepreneurship Northwest;
Fellow, Max Planck Institute

"Spot on for the entrepreneur as well as the angel investor . . . and even the business professor. Mullins' wisdom, experience and knowledge of entrepreneurs come through on every page. Particularly insightful to me were the 'John's Business Angel Checklists' at the end of Chapters 2–7. This book should be one that every entrepreneur takes time to read so that they build their business on solid and sustainable ground."

—Keith Williams
Senior Vice President Member Experience;
Entrepreneurs' Organization (EO)

"John and I came to very similar insights from over a decade of very different kinds of research into what successful entrepreneurs have learned to do well. This book captures beautifully what an expert entrepreneur I studied told me, 'Treat your first customers as your partners—they are your earliest investors and your best salespeople.' The compelling stories in this book invite you and inspire you to learn how to do that."

—Saras Sarasvathy
Isidore Horween Research Associate Professor,
The Darden School, University of Virginia

"Two of the most critical tasks that you as a startup CEO/Founder have to do are hire the right people and keep your company appropriately financed. While venture finance can accelerate the growth of businesses where appropriate, many times a company can benefit from other, more independent forms of funding their growth, particularly in the very early stages. Applying the concepts and tools in this book will likely make your company that much more attractive to an investor, for the investment capital they give you will be used to accelerate growth, rather than just provide financial subsistence."

—Carlos Eduardo Espinal
Partner, Seedcamp

"A very timely book. Investors are thin on the ground and entrepreneurs have to turn to alternative and even better sources of investment. Entrepreneurs are asked to prove the merits of their ventures and what better way than through customers. John's gift for writing makes this an easy read and reminds us that 'cash is king.'"

—Dr Shai Vyakarnam
Director Centre for Entrepreneurial Learning,
University of Cambridge, Judge Business School

"Whether you are starting up a business in a garage or doing as I did, building one overseas on behalf of a large North American firm, this book is a relevant and compelling read. You are left in no doubt that Cash is clearly still King! John gives you the tools as well as his practical 'business angel checklists' coupled with captivating anecdotes to challenge and ultimately help you choose the right funding model for your business."

—Peter Moores
CEO and Country Manager UK, Raymond James

"Another great book that gets to the heart of building companies. I wish more entrepreneurs understood the significance and freedom that cash generation can bring to young, fledging businesses. It puts an entrepreneur in the driver's seat. As a venture capitalist, I dream of entrepreneurs that are able to independently validate their product or service with the market, lay down early traction and are constrained only by capital to take their companies to the next level. John's book provides a comprehensive framework for thinking about how to generate cash and become self-sufficient as an entrepreneur."

—Hussein Kanji
Founding Partner, Hoxton Ventures

"Throughout my 30 years in business, finding quality books which get to the heart of key issues for both entrepreneurs and investors has been a rarity. *The Customer-Funded Business* does exactly this, providing excellent, straightforward advice along with real life examples. John has been there and done it in the business world. His knowledge and experience are clear to see."

—James Caan
Author of *Start Your Business in Seven Days* and *The Real Deal*

"John provides a vital sanity check for inexperienced founders. Time chasing investors is often better spent creating (and realising) customer value."

—Dave Chapman
Vice-Dean for Enterprise, University College London

"John Mullins' expertise is giving us forehead-slappingly new insights into taken-for-granted ideas. In this age of Kickstarter, we all *think* we know all about customer funding, but in this book John shows us Kickstarter is only one of five ways to get customers to fund our businesses. With great stories and great style, John takes what we all know and makes it fit together in new and powerful ways."

—Jerome Katz
Coleman Professor of Entrepreneurship, Saint Louis University

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Why This Book?

Becoming—and being!—an entrepreneur is difficult. Raising capital to fund one's entrepreneurial journey is *even more* difficult. Each year—in the good years—only about 1,500 U.S. startups get funded by venture capitalists, alongside another 50,000 or so by angel investors, a paltry number against the 5 million ventures that seek startup funding.[1] According to research from Statista, the numbers these days are worse: only 843 seed-stage deals were done by U.S. venture capital firms in 2013, though that figure is the best in years, more than double the number in 2010.[2] Difficult, indeed!

The numbers elsewhere, including in the UK, where I spend most of my time, are even more daunting. In Europe and Asia, they're tougher still. I know firsthand how difficult it is, because I've been in startup and capital-raising mode multiple times during the first half of my career. In the second half, as a professor at one of the world's leading business schools, and as a board member and investor, I've helped hundreds of individuals surmount—or circumvent!—the fundraising and other challenges to become thriving entrepreneurs. Some, you may be surprised to hear, did it inside large companies. Others, the more typical, got their start in their kitchens or garages, or over a couple of beers at the local pub.

The vast majority of them, however, *didn't* follow the prototypical path that the conventional wisdom holds as gospel today:

- *Step 1:* Come up with an idea for a new venture.
- *Step 2:* Write a business plan.
- *Step 3:* Raise some venture capital.
- *Step 4:* Get rich!

In fact, most of the companies whose names populate the lists of the world's fastest-growing companies—the *Inc.* 5000 in the USA, the *Fast Track 100* in the UK, and similar lists everywhere—didn't follow the conventional script, either.

Do You Really Need Venture Capital?

What did they do? The vast majority of them *never* took a pound or dollar or rupee of venture capital, and they didn't mortgage or pledge their houses, either. Instead, they managed to find ways to get their businesses up and running, and then growing, *without* pandering to VCs or groveling to their company's CFO. By solving pressing customer problems, or by developing delightful customer experiences that transformed the previously mundane—think Peet's or the UK's Coffee Republic in coffee bars or Banana Republic in casual apparel—most of these entrepreneurs built vibrant, growing businesses *without* raising troves of venture capital. "So where did their funding come from?" you ask. The lion's share of them got most of their money—initially, at least, and sometimes for the entire journey—from a much more hospitable and agreeable source: their customers.

"they didn't mortgage or pledge their houses, either."

The Problem: Limelight Stolen

"Why, then," you might ask, "have the business plan and the raising of venture capital become seen as the centerpiece of entrepreneurial endeavor?" Two reasons, in my view.

First, the venture capital community—VCs, business angels, incubators, and much of the rest of today's entrepreneurial ecosystem—has stolen the entrepreneurial finance limelight over the past two generations or so, first in California and Boston, and more recently practically everywhere else. They've done so for good reasons: the sometimes astonishing returns they've delivered to themselves and their investors, and the astonishingly large and valuable companies that this ecosystem has created. The valuations of companies like Apple, Amazon, and Twitter do make good headlines! If all the companies backed by the venture capital industry were thought of as a country, it would stand as one of the world's largest economies today.

"The valuations of companies like Apple, Amazon, and Twitter do make good headlines!"

There's nothing inherently wrong with venture capital. I've both raised it and provided it myself. But as we'll see in Chapter 1, VC has some drawbacks worth understanding, especially when it's raised too early in the life of one's venture.

Second, we in the academic community have learned that we can teach people to write business plans—which can be submitted as a pile of paper with a staple in the corner—and students will flock to us in droves! Never mind that one cannot really plan very well for a highly uncertain entrepreneurial venture, and that new-venture success most often arrives in the shape of Plan B or Plan Z, not the Plan A that has been so lovingly articulated in the business plan. We can teach them to plan (and we can teach them to pitch, too), so plan (and pitch) they will!

But the vast majority of fast-growing companies don't get their money this way. As we'll see in Chapter 1, there are compelling reasons why getting the funding you need from your customers is often a much better way to go.

"the vast majority of fast-growing companies don't get their money this way"

The Solution: The Customer-Funded Business—An Idea Whose Time Has Come

In early 2012, I embarked on a research journey to develop a deeper understanding of the plucky entrepreneurs who build great companies—sometimes small ones to fit their lifestyles, other times large ones that have become household names—and the methods (five of them, each different from the other) they've used to start and grow their businesses with their customers' cash. The book you are now holding in your hand or viewing on your screen delivers the fruits of my journey.

But the book delivers much more than just my own insights and the evidence I've gleaned. It's filled with the captivating stories of companies—Airbnb, Dell, Banana Republic, and many more—that have been built and financed this way (at least at the outset, though often not forever) and is brimming over with early-stage investors' perspectives. As a result, the book makes what I believe is a compelling case for customer funding as the *first* approach that entrepreneurs—whether in garages or around kitchen tables or in well-established companies—should consider when funding their nascent businesses. And I'm not alone in this view. Some of today's savviest investors share it, too!

Indeed, venture capital investor Fred Wilson of Union Square Ventures puts the folly of raising too much venture capital too early in stark terms. "The fact is that the amount of money startups raise in their seed and Series A rounds is inversely correlated with success. Yes, I mean that. Less money raised leads to more success. That is the data I stare at all the time."[3] Two-time entrepreneur turned venture capitalist Mark Suster of Upfront Ventures is of a like mind. "I say ring the freaking cash register," he says. "I have said so for years."[4]

"The fact is that the amount of money startups raise in their seed and Series A rounds is inversely correlated with success."

That's what customer funding is all about at the end of the day, through any of the five ingenious ways I've uncovered to do it. Ring the cash register early enough and often enough and you'll have the magic of customer traction—hence the funding—you need to get your fledgling business off the ground. Are Wilson, Suster, and I merely foolish or naïve? Or might we be onto something, even a customer-funded revolution, perhaps?

Who Should Read This Book?

Given the global diversity of the entrepreneurs and their companies—from Europe, Asia, and North America—whose often inspiring stories bring this book to life, there are six key practitioner audiences worldwide for whom I have written this book:

- Aspiring entrepreneurs who lack startup capital but yearn for the freedom and joy that running one's own business provides.
- Early stage entrepreneurs trying to figure out how to get their nascent but cash-starved ventures into takeoff mode.
- Angel investors, who are often an entrepreneur's first port of call when seeking capital. *You* are this book's most important audience, perhaps, for you are the ones with the power to set the entrepreneurial vessel on a more sensible course. In fact, you're so important an audience that you'll find at the end of each chapter a checklist—John's Business Angel Checklist—of due diligence questions that *you* should ask entrepreneurs seeking your capital. If you can set straight some of each year's 5 million and more who seek your capital—and that's the number in the United States alone—you'll have a made a really important contribution to tomorrow's entrepreneurial ecosystem. Better yet, I believe that in so doing, you'll win your entrepreneurs' thanks as well as preferential access to deals that have been de-risked through proven customer demand. I don't have to tell you what this can do for your investment returns!

  "you'll win your entrepreneurs' thanks as well as preferential access to deals that have been de-risked through proven customer demand."

- Those running the growing number of business incubators and accelerators, another set of early ports of call for aspiring entrepreneurs. Stop talking about how many of your startups successfully raise a Series A round, *please*, and start talking about how many of them achieve early customer traction and are growing while still owning and controlling the majority of their businesses! Who kept a greater portion of the value his company created: Michael Dell or Steve Jobs? It was Dell, hands down, whose customer-funded story is told in Chapter 2.

- The fabled three Fs: the family, friends, and fools who back so many entrepreneurial ventures. I suggest you do your loved ones a favor and ask them to come back to see you when they've secured their first paying customers (yes, even before they've produced their first product!).
- Finally, let's not forget the potential innovators at the top of—or hidden in the nooks and crannies of—today's growth-starved companies. Though it is through stories of entrepreneurs and their companies that I deliver most of this book's lessons (sadly, according to venture capital investor Bill Joy, "Big companies almost never innovate. It's not that innovation itself is rare—it's occurring everywhere. Which means, mostly, elsewhere."[5]), the principles articulated in this book are for you and your company, too!

There's one other important audience I have in mind as well. I've also written this book for my fellow faculty who are teaching entrepreneurship or venture capital in the world's growing number of business schools and other academic institutions offering vibrant entrepreneurship programs. Together we are creating and empowering a new generation of entrepreneurs who are charged with creating virtually all of what will be our communities' net new jobs in the future. It's a crucially important role that we and our graduates must play in today's volatile and uncertain economic environment.

"I've also written this book for my fellow faculty who are teaching entrepreneurship and venture capital"

I suggest that we faculty all add a session to our business plan and entrepreneurial finance courses that offers customer funding as an alternative approach—in my mind, the *preferred* approach—to getting a young company underway. In doing so for your students yearning to start their own businesses, whether now or later, you will join me in getting them focused on customers, instead of investors. Once they have enough customers, the investors—if needed at all—will surely follow.

“Once they have enough customers, the investors will surely follow”

Why John Mullins? Why Now?

My two earlier books, the first (*The New Business Road Test*) on how to rigorously and systematically assess an entrepreneurial opportunity *before* you get started,[6] and the second (*Getting to Plan B*) on how to get to a business model that will actually work—and might just revolutionize your industry[7]—have prepared me well and set the stage for the unanswered question that this book addresses: "How can I best start, finance or grow my company with my customers' cash, instead of that of investors?" But that's not all.

Having started two entrepreneurial companies and worked at a third, and having served on the boards of numerous others, including successes and failures, I've accumulated the scars and bruises that are always the surest sign of learning. More than that, though, for more than two decades in this, my second career, as a business school professor, I've been fortunate enough to have had the time and resources to dig deeply into the "whys" and "hows" that underlie entrepreneurial success and failure. Simply put, I'm in the right place at the right time to have researched and written this book.

In 60 Seconds or Less: The Elevator Pitch

My purpose in putting *The Customer-Funded Business* into your hands is to get entrepreneurs of nearly every kind to see that their top priority in the early going—and often later, too!—is to find a customer who will pay you on good terms (often in advance), *not* to raise venture capital. To address this purpose, the book brings to life five customer-funded models and the key questions that should be asked in considering (Chapters 2 through 7) and pursuing (Chapter 8) each of them. It also addresses the key implementation questions that will surely arise:

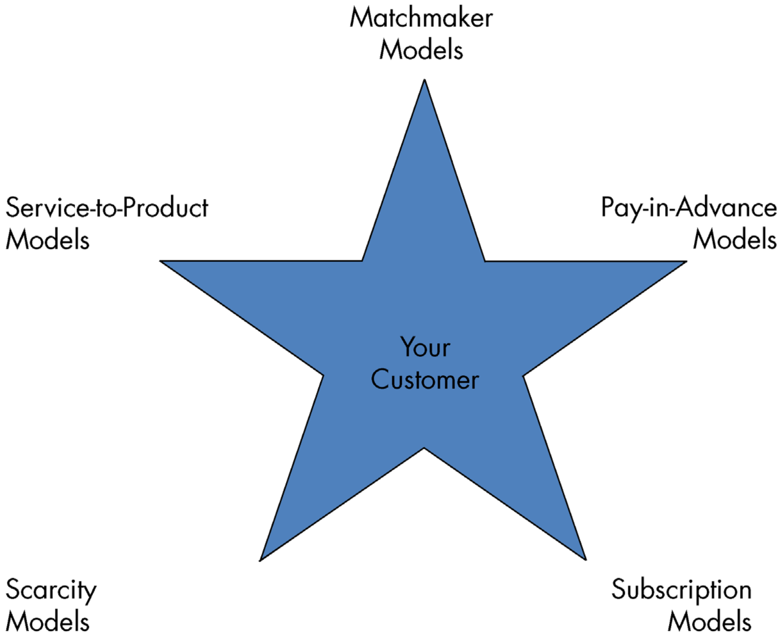
- when to use which model
- how best to apply them
- what to watch out for—the pitfalls that lie along the way

Whether you're an aspiring entrepreneur lacking the startup capital you need, an early-stage entrepreneur trying to get your cash-starved venture into takeoff mode, a corporate leader seeking funding to grow an established company, or an angel investor or mentor who supports high-potential entrepreneurial ventures, this book offers the most sure-footed path to starting, financing, or growing *your* business or one you support. Are you intrigued? Ready to be inspired? If so, turn the page!

"this book offers the most sure-footed path to starting, financing, or growing *your* business."

1

Craving Crowdfunding? Pandering to VCs? Groveling to Your CFO?: The Magic of Traction and the Customer-Funded Revolution



Imagine this. It was 1995, and the Coca-Cola Company had just reentered India after an aborted earlier effort, this time by acquiring the maker of Thums Up, India's leading cola. Along with the deal came a thick book describing each of the Thums Up bottlers' territories in plenty of legal jargon, but without a single map. Coke needed a way to find and understand its newly acquired territories.

Alas, no one had maps that could show Coke where its bottlers were located. Until the mid-1960s, maps had been largely unavailable in India, at least for anyone not in the military. Even 30 years later, a mapping culture and map-reading ethos simply did not exist, perhaps in part because there were very few accurate Indian maps.

Into the breach stepped Rakesh and Rashmi Verma, who had started a small IT training business in India, CE Info Systems, serving blue-chip clients like IBM. Their company also licensed American digital mapping software to aid India's nascent map-making industry.[1] Saying to Coke, "We can give you the maps you need" (even though they had not actually ever produced a single map!), the Vermas began to build a digital mapping business. First, they bought an ordinary office scanner and took out the kitchen scissors. Next, using their native Indian ingenuity, they began cutting what rudimentary paper maps they could find into A4 size and scanning them to make them "digital." Using Rashmi's software and programming skills together with the American software they had been licensing to others, they then overlaid demographic and other data to enable Coke—and soon other commercial customers—to do in India what they took for granted in other parts of the world.

"We can give you the maps you need."

CellularOne, entering India in a joint venture with Essar as the Indian telecommunications industry was liberalized, was their next client. "Where should we put our mobile phone towers?" CellularOne asked, from both a technical perspective (Where is the high ground? How do we achieve uncluttered line-of-sight coverage in Bombay, a city of high rises?) and from a marketing perspective (Where are there sufficiently dense concentrations of customers with the right demographics whom we can economically serve?). Once again, the Vermas delivered.

A Customer-Funded Model

So, did the Vermas need venture capital to start, finance, and grow their business? No. Instead, they identified customer after customer—even the Indian Navy—who could benefit from digital maps, charging the customers fees to cover most of the development costs of creating additional maps or applying additional demographic or other information to maps they had already created. Over the next 10 years, their mapping business grew slowly but steadily, funded by one customer assignment after another, and they became the dominant digital mapmaker in India. And they did so without raising a single rupee of venture capital.

The Vermas weren't doing anything radically new in shunning venture capital. To be realistic, such capital probably would not even have been available in India in the mid-1990s. But by funding the early growth of their business with their customers' cash, they were simply doing what most entrepreneurs did before business angels and venture capital investors grabbed the entrepreneurial finance spotlight more than a generation ago in the West, and today nearly everywhere else.

> **"The Vermas weren't doing anything radically new in shunning venture capital."**

Customer Funding: The Vermas Are Not Alone

What the Vermas accomplished with customer funding is neither unique to India nor to the 1990s. Anyone who has booked a hotel room on Expedia.com, for example, might be surprised at the role they were playing in funding Expedia's operations and growth. Not only didn't Expedia pay the hotel for your stay until after you arrived—despite the fact that you probably paid Expedia when you booked the room—but in many cases they paid the hotel as many as six weeks *after* your stay. What is Expedia doing with your money—their customers' money—for all those weeks, or sometimes months? Running and growing their business, of course! "Sitting on the float" with the customer's money is a time-honored principle that runs throughout this book.

As we'll see in Chapter 2, starting, financing, or growing your business with your customers' cash isn't novel. It's a fundamental principle—a mind-set, really—by which many entrepreneurs live. It's how Michael Dell created one of the twentieth century's most prominent success stories and how Mel and Patricia Ziegler created Banana Republic, another customer-funded phenomenon. In the five chapters that then follow, equally remarkable are the stories, all customer funded, of Airbnb (Chapter 3), Threadless (Chapter 4), India's TutorVista (Chapter 5), Gilt Group (Chapter 6), Denmark's GoViral (Chapter 7), and nearly a dozen other inspiring companies—plus some failures as well—and the entrepreneurs who created and drove them. Whether you're an entrepreneur or a leader in an established business that wants to grow faster, you get the drift: The customer-funded business has been a widely practiced phenomenon, but has been underobserved and underdiscussed. But not any more!

A Problem: Financing Your Startup

Later in this chapter, I'll explore in some depth why I believe raising equity at the outset of a new venture's journey is, at least most of the time, an exceedingly bad idea—for both entrepreneurs and investors alike. For now, though, think of it this way:

- Most of the time, the Plan A that you have so lovingly conceived is unlikely to work, as most any experienced early-stage investor, whether a VC or a business angel, will tell you. Do you look forward to explaining to your investors why your Plan A didn't work, as you ask them for more money for your newer, brighter, and inevitably still-optimistic Plan B? I don't think so! As Peter Drucker, arguably the leading management thinker of the twentieth century, observed, "If a new venture does succeed, more often than not it is
  - in a market other than the one it was originally intended to serve
  - with products and services not quite those with which it had set out
  - bought in large part by customers it did not even think of when it started
  - and used for a host of purposes besides the ones for which the products were first designed."[2]

"Do you look forward to explaining to your investors why your Plan A didn't work?"

- There are material drawbacks to raising capital too early. Among the most daunting of them is that raising capital—whether by pandering to VCs or groveling to your CFO, if you're seeking to start something inside an established company—is a full-time job. Getting your venture underway is a full-time job, too. If you try to do both, one of them will inevitably suffer.
- As you'll see later in this chapter, the evidence is compelling that the odds of success for VC-backed companies are far worse than most entrepreneurs realize. Is joining tomorrow's

failure statistics what you had in mind in pursuing your venture? Definitely not!

A Solution: The Magic of Traction

Fortunately, with the cost of technology declining ever more rapidly, it's easier and cheaper to get into a customer-funded business than ever before. As this book will make clear through the companies whose stories it tells, there are numerous benefits that all five customer-funded models provide, to entrepreneurs and their backers alike.

- First, waiting to raise capital forces the entrepreneur's attention toward his or her customers, where it should be in the first place. Customers matter, and as Peter Drucker also noted, if there's no paying customer—at least eventually—there's no business, either (the protestations of some dot-com entrepreneurs to the contrary).

"if there's no paying customer—at least eventually—there's no business, either"

- Second, winning customer orders often gives your customer a vested interest in your success. If they are happy to buy from you, they'll want you to stick around, either so they can buy again later, or so you will service what you've sold. For an entrepreneur, having your customers on your side is a good place to be. For angels, having customers rave about the company in which you are thinking of investing is a very good sign!
- Third, making do with the probably modest amounts of cash your customers will give you enforces frugality, rather than waste. Having too much money can make you stupid and lets you ignore your customer! Having less money will make you smarter, and will force you to run your business better, too.