What business model designers can learn from lean startups — and vice versa

Applying lean startup methods to business model design can reduce market risk.

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There are many ways to start a new business (either as a startup or as a corporate venture), but the most effective ones begin with identifying a consumer need and then finding a way to address that need. A company can choose to design and implement different business models according to their aims and context.

Increasingly, the lean startup method is becoming a kind of shorthand for this process. Inspired by the lean manufacturing movement that was begun in the 1950s and 1960s by the Japanese automobile company, Toyota, as a response to shortages after World War II, the lean startup method rests on just-in-time principles, reducing waste and extensive customer consultation in the testing phases before committing to production.

IESE's Christoph Zott and co-author Raphael Amit from Wharton map the overlaps between the lean startup method and business model design more generally in their paper "Business models and lean startup." They argue that combining both approaches could produce a powerhouse framework for entrepreneurs and managers.

Leaning into lean

Business model design and innovation are profoundly entrepreneurial at heart. Clearly, the lean startup model has been taking notes, considering business as a system of interdependent activities aimed at value creation, value delivery and opportunity development, based on needs discovery. The lean startup borrows the business model canvas — a powerful visualization tool that helps entrepreneurs see their companies holistically, as a system made up of interlocking elements that are all important for value creation.

However, while business models provide necessary structure and concepts, lean startup provides some much-needed experimentation and play. The central idea behind lean startup is the systematic identification and testing of key hypotheses underlying a venture. Taking inspiration from agile software development processes for optimum efficiency and minimal waste, the goal is to develop product-market fit rapidly and shorten the product development time.

To do this, it blends a variety of learning-by-doing approaches, including:

- **design thinking:** understanding users, challenging assumptions and reframing problems.
- **bricolage:** learning to improvise and make do with available resources.
- **discovery-driven planning:** articulating knowledge gaps and uncertainties.
- **effectuation:** assessing the resources available and balancing them with goals and actions.

Effectuation, in particular, represents an alternative to the habit of causal or predictive thinking, which tries to plan and control the future, instead allowing entrepreneurs to be more flexible and adaptable in uncertain and risky situations.

In exchange, the science behind business models can inform lean startup thinking by explaining why and how new entrants disrupt incumbents, and offering a way for these same incumbents to invigorate their firms and mitigate the effects of disruption.

Commitment-free search

In combination, the two methods can be powerful tools, allowing business owners and managers to plan and pivot more comfortably in the face of changed circumstances or disappointing customer feedback. Lean startup aims to help businesses avoid getting to that point in the first place, but it can also be used to repivot more established companies.

The key is in articulating important assumptions related to the opportunity, formulating empirically testable hypotheses and then testing the hypotheses systematically with early customers. The results of early market tests allow for a revision of the assumptions, the exposure of hidden premises and the chance to update the entrepreneur's beliefs.

Lean startup employs two options to explore business model opportunities:

- **The classic method** is to pursue one opportunity at a time. However, research shows that in nascent markets, this may not be the best approach. When a market is still in its infancy, committing to a single preferred option too soon can entail opportunity costs and may lead to problems of stickiness down the road.
- **The parallel play option** is where companies conduct an extensive, largely commitment-free search process into different options simultaneously, ultimately committing to the one they find most promising in light of the evidence gathered. This can be the best course of action for nascent markets, but it may be more wasteful in established domains.

Either way, the usefulness of probing, and especially the importance of getting out of the building and talking to customers, should not be underestimated. Similar to the difference between book smarts versus street smarts, testing ideas early on with real customer feedback can put a swift end to faulty assumptions. It can greatly help the company avoid building too much that is untested against market forces.

And last, but not least, through its emphasis on cheap probing, lean startup is also likely to reduce CAPEX and initial funding needs — a very big bonus indeed.

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