

Start-Up as a Service: The Prehype Model

In 2010, the 35-year-old Danish former entrepreneur Henrik Werdelin created the venture development firm Prehype, a new type of company that built start-ups for and with big companies. Working out of his apartment in downtown Manhattan, Werdelin recruited his longtime friend Philip Petersen to the nascent business: the idea was to help corporate clients build new ventures by taking them through a “lean start-up” process, using the client’s own people and covering the full span from ideation to a fully functional, revenue-generating start-up.

Five years later, Prehype was working with a series of high-profile companies including Coca-Cola, Verizon, Lego, Unilever, Mondelez, Wolff Olins and News Corp. It had satellite offices in London and Copenhagen, had seen one of its first companies sold to Facebook and had been featured in *Fast Company* magazine and various other media as a new, cutting-edge approach to corporate innovation. Prehype’s setup, business model and process are described in detail below.

The Origin of the Business Model

Werdelin had created Prehype to cater to his own interest in creating start-ups. Building on his own mixed past as a serial entrepreneur and as a former corporate citizen, Werdelin wanted to combine the two fields by helping big companies act like start-ups. Specifically, he believed that a company such as Prehype, by virtue of being separated from the main business, was ideally suited to help companies develop radical or disruptive innovations more quickly and cheaply. Most companies struggled in this area, compared with the relative ease of doing more incremental (sustaining) innovation.

This case was prepared by Thomas Wedell-Wedellsborg, Senior partner at The Innovation Architects, and Professor Paddy Miller as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. January 2016.

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At the time, there were several other players on the market to serve that need – most prominently in the form of product development agencies, that is, companies that would help define, design or develop a new product or service. Werdelin, however, saw a number of problems with the existing offerings:

“There is an architectural problem in much of the innovation industry’s business model. Creating a start-up is about being agile, resource-constrained, and putting things onto the market very rapidly. But if you are an agency with a business model based on billable hours, you are incentivized to seek out larger, complex projects with bigger budgets – both things that run counter to the start-up mentality. You might embrace the *idea* of lean start-ups but, in a battle between your ideas and the structures created by your business model, the business model tends to win out. To really do something different in the space, I was convinced that the key was to rethink the business model.”

For that reason, Werdelin designed Prehype’s business model to create the right incentive structure for both Prehype and the client. At the heart of the model was the idea that Prehype was all about building successful start-ups, as opposed to offering processes or workshops as its core product. Therefore, Werdelin made the choice of tying what Prehype would be paid to the long-term success of the start-up:

“Typically, the first part of our engagement with a client is a one-week opportunity identification process, and that is a fixed-fee product. We think of that as the dating process. There is limited commitment on both sides. But if the client then decides to go ahead with one of the ideas, we take either an equity stake or structure an earn-out agreement based on performance metrics. As a founding participant, instead of making any money on the production of the venture, we typically take an equity stake that amounts to about \$5 million in an earn-out. The core idea is to align our interests to those of the client company. The equity model ensures that we are as eager to create a real, successful start-up as the company is, instead of focusing on the workshop, the product launch or any of the other stepping-stones on the road to success.”

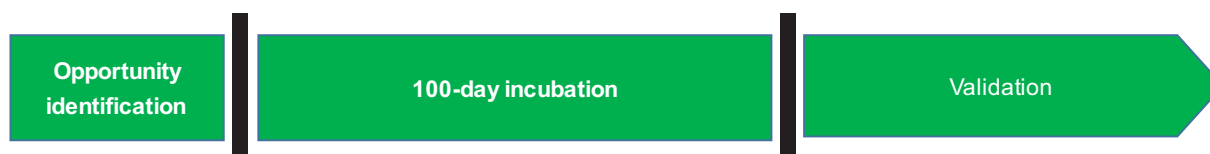
The focus on building a working start-up affected a lot of the practical work done in Prehype. For one, since nobody was selling hours, Prehype had no interest in drawing out the process. They had an incentive to get things done as cheaply and as quickly as possible. Secondly, it meant that Prehype avoided the trap of choosing pie-in-the-sky projects that sounded great on paper but would be impossible to implement in practice. As Prehype partner Philip Petersen put it:

“When we brainstorm on new ventures together with the client the Prehype partners have a strong voice, because we’re the people who will have to build it. That creates a fundamentally different dynamic, not just in the workshop itself but in every part of the relationship.”

For the first two years of Prehype’s existence, Werdelin and his partners constantly worked on making the process work better, eventually arriving at what they called the Prehype model. The model is summarized briefly below.



The Prehype Process – A Summary



While individual projects varied depending on the client’s needs, the typical Prehype process had three distinct stages, with the client making go/no-go decisions for each phase.

1. *A one-week opportunity identification phase.* In what was typically a weeklong workshop, Prehype staff would work with a selection of talented people from the client company to come up with two to four project ideas. These projects were presented in the form of a “lean product plan” – that is, a rough blueprint for what the product and the business model would look like.
2. *A 100-day incubation phase.* Following the workshop, if the client decided to pursue any of the projects, the Prehype team would spend 100 days building the first, very simple version of the product. (Ideas that were not capable of being built in 100 days were deliberately filtered out in phase one to avoid projects that were too big or complex.)
3. *A validation phase.* If the outcome of the 100-day process seemed promising, the team would enter a third phase where the product was further tested, refined and developed and where the organization that should drive the business was put into place. The length of this phase would depend on each project.

Provided the venture worked out as hoped, after phase three the client would have a fully functioning start-up on its hands. For each phase of the process, Prehype offered different ways to either close or continue the collaboration (see **Appendix** for further details).

Selling the Model to Clients

Werdelin told his clients that there were three main strategic reasons for using the Prehype model:

1. To create new growth – by finding and building adjacent businesses;
2. As a defensive measure – effectively getting a foothold in a domain that could conceivably be targeted by new entrants, whether small start-ups or large companies;
3. To make more money by “productizing” existing parts of the business – to use Werdelin’s term for when companies turn existing activities into sources of revenue (like Amazon did with its cloud storage solution).

However, because it was a new approach, the Prehype model differed quite a lot from how the client companies were used to working with external partners. For that reason, one of Werdelin’s biggest challenges was explaining to his clients not just how the model worked



but also why it was better than the alternatives in the market. Werdelin outlined the main benefits of the Prehype model:

1. *Talent retention.* “Companies want to be entrepreneurial – but if they keep losing their entrepreneurial people, they won’t succeed. And it’s gotten increasingly easier for a 28-year-old guy in News Corp, for example, to go solo and get access to funding. The barriers have gotten lower. So the Prehype model is really a way of leveraging your entrepreneurial talent and keep them working for your company. The alternative is that they go out and start their own business – and when it fails, as most start-ups do, the talent tends to be too proud to go back to the company.”
2. *The Google Wave argument.* “Seen in isolation, Google’s big internal project, Google Wave, was a failure. Google had a team working on it for about two years, and the product never took off. But, actually, a lot of the knowledge and tools they invented along the way became tremendously useful for Google. In particular, the Wave team basically invented mainstream real-time collaboration, which subsequently played a huge role in making Google Docs and Gmail a success. Failure is the likely outcome of launching a new venture, but a well-executed experiment can lead to lots of positive effects regardless – and you don’t tend to get to those things during regular projects that are closer to the core business.”
3. *Absorptive capacity.* “Absorptive capacity is an academic term that means your ability, as a company, to listen to the market and absorb new input – something that a lot of incumbents fail to do, simply because they are disconnected from the things that are happening on the ground in their industry. By experimenting and doing new things, companies learn to listen to the market in a new way and spot trends and tendencies. BetaWorks, an incubator here in New York, has arguably been more successful as an investor than as an incubator – simply because their work in the start-up space gives them the ability to understand the market and tell the good investments from the bad.”
4. *Clear cost of closure.* “We know from research that the majority of projects don’t fly, and we front that very strongly with our clients – in part, by having clearly defined closing processes. Normally, if you set some project in motion inside a company, it can be very difficult to predict what it will cost to stop the project again. Extra hires and similar questions make it messy. But if you decide to close down a Prehype project, you know from the outset what that will cost you.”

Closing down a Prehype project was simple and entailed no additional cost for the client. If, however, the company decided to proceed with the project without Prehype, it would pay Prehype a “success fee” to compensate for the shared work that went into the creation of the product. This effectively meant that Prehype would sell back its equity share to the company at a previously agreed-upon price – typically double the total budget for the incubation phase. Notably, Prehype did *not* promise clients that they would have a successful venture at the end of the process. Werdelin said:

“We are very open about the fact that most new companies fail and that those statistics apply to us as well. What we are saying is we are cheap enough that the above benefits



more than justify the cost of trying the model. And if you're lucky, you might get a successful new venture out of it as well – but that's just an added upside, not the core sales argument. That's a very different way of pitching a project, compared to your usual cost-benefit analyses.”

Prehype's equity requirement was a frequent bone of contention with clients. According to Werdelin:

“Many companies find it annoying to have to give us equity. Some of my clients have literally said, ‘Hey, why don't you just charge us more money so we can drop all the equity stuff?’ But the equity stake is a fundamental part of the business model. It aligns our interests and focuses us on the long term. And, crucially, it allows us to keep the costs of phases one to three low. Start-ups are a numbers game, and we believe that the key to success is for the company to run multiple projects with us. The relatively low fee makes a lot of things possible that wouldn't happen if we charged more up front. The equity model really embodies our philosophy of having both low initial costs, shared risk and shared upside.”

In selling the Prehype model to clients, Werdelin was very clear on the question of how the company positioned itself:

“We are very deliberate about framing ourselves as experts in start-ups as opposed to, say, innovation or design experts. We've found that the framing of our expertise around start-up processes give us more legitimacy when we work with our clients. If you position yourself as an innovation expert, well, you'll see many clients who believe they're also experts on innovation. But people working in a big company *know* that they aren't experts in lean start-up processes, so they have an easier time taking our advice. We can legitimately say to our clients, ‘You can tell me everything about how your business works – but don't try to tell me anything about how to build new ventures.’ That role distribution works really well. And everything about Prehype as a company is aligned with that identity: we are staffed by proven entrepreneurs, we're based in a scruffy area in Chinatown, and our culture and dress code are very entrepreneurial.”

Reflecting on the power of framing to impact the business, Petersen also mentioned a specific area that Prehype deliberately avoided, namely corporate learning:

“Obviously, there is a strong learning and development component in what we do. People who go through our process become adept at user-centric design thinking, minimum viable product design, and how to run a lean start-up process. But, actually, we don't like to position our value-add around the concept of learning. The problem with that framing is that you suddenly get to work with corporate people and functions who are very focused on learning, as opposed to being focused on building a new venture. We're here to build new things that have a measurable impact – and the personal learning is a by-product of that, not the main purpose.”



Prehype's Partnership Model

Prehype's novel client-facing business model was only one side of the coin: Prehype's own structural setup was also different from the way most agencies worked. For one, Prehype's partners were hired on a project basis, allowing Prehype to avoid large overhead costs, and they were paid out of the project revenues. On a typical project, the revenue was divided as follows:

- 30% to Prehype;
- 50% to the lead partner (the Prehype partner who ran the process);
- 20% to the person who sold the project (if different from the lead partner).

From the perspective of the Prehype partner, the 30% fee that Prehype took bought a number of things: a brand, a structured process, office space, colleagues, case studies, legal assistance and access to a network of freelancers – in short, a strong supporting architecture that allowed the partners to focus on what they liked the most, namely building new companies.

“A 30% cut can seem like a lot. Our argument to prospective partners is that they can charge maybe three times as much as if they were to sell their services as individuals – and that they also get equity as part of the package. Best of luck selling that model as an individual. We can do it because it's part of a package. And of course, there is a lot of enjoyment from being part of a team, compared to having to work on your own, as many of the partners have tried. The partnership model has been successful insofar as we haven't lost any partners yet – in part, because the fees paid to Prehype have allowed us to build more robust tools to help the partners build start-ups more effectively. Finally, via our internal Prehype entrepreneur fund, we give Prehype partners the opportunity to participate in all the projects that are being done under the Prehype umbrella.”

Werdelin commented on how he identified new partners for Prehype:

“I have a tendency to pick former start-up founders for the partner roles. People who have been through a couple of smaller start-ups, whether failures or successes, are the ideal people to drive the process for others – and, importantly, they are more realistic about how difficult it is to build a new venture. So most of our partners are in their mid-thirties; they still want to build companies, but they are also savvy about the process and they see the benefit of working under the Prehype umbrella. Our entrepreneurs in residence – that is, the people who run the projects day to day under guidance from the partners – are younger, but also tend to have done at least one start-up and are looking to get more experience and learn from more seasoned entrepreneurs.”

The partnership model also meant that Prehype was not saddled with big overhead costs. There was no need to fire people either. If partners could not generate business or if they were not good enough to get invited onto Prehype projects that were run by some of the other partners, they would just stop working for Prehype.



The need to attract the right caliber of partners was another reason Prehype insisted on the equity model:

“There is an argument that the Prehype model is a way for companies to get access to top-tier entrepreneurial talent. The most talented people in the start-up world simply won’t come to work for big companies – that’s not who they are. They value freedom and flexibility over a fixed salary. But they *do* come to work for Prehype because we offer them the benefits of entrepreneurship, combined with the safety of a (more) steady salary, a cohort of peers and access to some really interesting problems that most entrepreneurs don’t get to see or work on. So when the client companies start questioning why they would give equity to the lead intrapreneur (whether a Prehype person or one of their own people), we say that that’s the level you need to stay competitive with the venture industry. After all, the entrepreneurs can go out and do their own start-up, and sell 25% for maybe \$750,000 at a \$3 million valuation – keeping 75% and getting all the funding they need. The first phase [opportunity identification] can be done without paying people extra – but once you want serious commitment, you need to deliver competitive incentives in return.”

Prehype’s model was also based on the belief that, since it is more or less impossible to predict success, you have to make sure that an eventual negative outcome will not be too catastrophic for the entrepreneurs.

“In my personal view, a lot of the rules of the start-up world – ‘go all in,’ dedicate all your energy to your start-up and so on – those rules of thumb really serve the venture capital industry more than they serve the entrepreneurs. Venture capitalists have to make one of their 10 investments succeed, so of course they want their founders to invest everything and run huge risks on their behalf. We believe in a more risk-balanced model where the client company, Prehype and the individual entrepreneurs share the risks, and we are open about the fact that most of our start-ups fail. The trade-off we accept is that, in return for more security early in the process (via the fees), we accept a lower return or even a cap on the eventual upside we can get. That means that if we ever come up with a Facebook or a Twitter – statistically speaking a very unlikely occurrence – we don’t get the full upside. But that’s the trade-off we’ve chosen in order to even out the risk profile and get more stable income from a wider portfolio of projects.”

Four Prehype Projects: Betabox, Newsmart, BarkBox and Whtespace

Four Prehype projects are described in detail below:

1. Newsmart, a platform for learning languages (built together with News Corp).
2. Betabox, a solution for product sampling (built together with Mondelez).
3. BarkBox, a provider of toys and treats for dogs (built as an internal Prehype venture).
4. Whtespace, a newsletter service (built with the advertising agency Wolff Olins).



1. Newsmart – Better Language Learning

In May 2013, Prehype was engaged by News Corp Chief Creative Officer Will Lewis and Chief Strategic Officer Anoushka Healy to run a number of projects, with the winning projects being judged by CEO Robert Thomson and Chairman Rupert Murdoch. One such project was Newsmart, a venture that aimed to provide a better approach to learning new languages. Prehype partner Philip Ingemann Petersen explained:

“The traditional way of learning languages centers on teaching ‘standard’ phrases like ‘What is the time?’ and ‘Which way to the beach?’ Most language learning is based on this format, which teaches through a structured learning path, where the learning is explained through simple content. As an adult, it is hard to find relevancy in this content, and therefore many people struggle to get it done. So we came up with a new approach: learning based on relevant content for the reader. With Newsmart, you can read the *Wall Street Journal* online every day, only we have integrated small language exercises in the articles. So as you read, you might get a sentence exercise saying, ‘Today, Scotland’s voters narrowly [chose/choose] to remain part of the United Kingdom.’ Newsmart is a good example of how we try to leverage the client’s corporate assets – in this case, the *Wall Street Journal* – in building the start-ups.”

The project was staffed by two Prehype partners, Saman Rahmanian and Dan Teran. In September 2013, they launched an open beta version of Newsmart in Latin America while also conducting conversations with various stakeholders such as language schools and corporate training providers. Reactions from the stakeholders were positive and as Petersen explained:

“Through the beta version, we learned that people really liked the points system and seeing how they had fared against other users, so we tweaked the site to highlight that aspect more. More importantly, people started posting their scores on Facebook and similar platforms, giving us a good viral effect. A few months in, Newsmart had gained around 6,000 users – which is really great for a beta site, especially considering that we had done very little to market it.”

After six months in beta, the project had gained enough traction to convince the News Corp leadership team that it was a viable project so, in April 2014, they exercised the right to buy Newsmart back, paying Prehype the contractually agreed success fee. By June 2015, Newsmart – which is available on www.getnewsmart.com – was being run out of London as a business unit inside the News Corp subsidiary Dow Jones.

2. Betabox – Better Product Sampling

In 2013, Prehype was hired by the international food giant Mondelez to run its one-week opportunity identification workshop. One of the projects that emerged was Betabox, a service that aimed to boost the process of product sampling (that is, when companies hand out free samples in order to drive sales). Petersen, who was the lead Prehype partner on the project along with Sonny Bird, the entrepreneur, explained:

“Traditionally, sampling has been a pretty scattershot exercise for companies: distribution is costly, audience targeting is imprecise and there’s little in the way of either ROI data or postsample engagement with the customers. So we came up with the idea of collaborating with existing e-retailers to create a better way to conduct, manage and measure product sampling.”

In March 2014, to test the idea, Petersen and Bird set up a trial run using Mondelez’s Sour Patch Kids brand. The chosen e-retailer was BustedTees, a company that sells T-shirts to an audience consisting mostly of college students. In the test, 5,000 of the T-shirt packages the company shipped included a small sample of a new Sour Patch Kids product, namely Sour Patch Kids chewing gum. The sample came in a nicely designed box and included a note explaining that people could sign up for a competition to win movie tickets.

“The audience was spot on – college kids like candy, and Sour Patch is a retro brand that they remember from their childhoods, only this was a new version of it. We had expected an active engagement rate of about 1% to 2%, which is what you get if you design a really good online banner ad. However, we saw much bigger engagement: between 12% and 15% of the recipients dug out their phones and entered the competition. A second test with healthy snack bars, done in collaboration with the nutrition e-retailer Belvita, yielded an 8% engagement rate, which was still a great number.”

Figure
Illustrations of the Betabox concept and the Sour Patch Kids sample





Petersen commented:

“The business model worked for everyone. The company got a better way to do sampling that allowed them to target audiences more precisely, create postsample engagement and get better data on the recipients. The e-retailer was paid for each sample they sent out, typically from 50 cents to \$2 to \$3 per package depending on the audience, which was a great incentive for them. And consumers like to get samples, provided that they are relevant and delivered in a well-designed experience.”

However, Mondelez’s own brand portfolio would not be big enough to sustain the venture – and to scale the business quickly enough, it was imperative to have an existing network of connections to other big brands. So at the end of 2014, Mondelez and Prehype agreed to sell Betabox to VaynerMedia, a social media company founded by the well-known marketing expert Gary Vaynerchuk. The money from the acquisition was split between Mondelez, Prehype and the entrepreneur (Bird), who joined VaynerMedia as part of the deal to drive the project.

3. BarkBox – Treats for Dogs (and Their Parents)

Not all of Prehype’s ventures were built together with client companies. If an idea seemed attractive enough but did not have a client attached, Werdelin would create or attract an internal team to build it.¹ One such side venture was BarkBox, a subscription service for dog owners that was modelled on Birchbox, a beauty product subscription service.



BarkBox’s core offering was a box of four to six dog toys that was sent to the dog every month. While it was started as an internal passion project, the idea soon proved to have a lot of traction. By the start of 2014, BarkBox served more than 100,000 customers (or “dog parents” as the company called them) and had added a content website (BarkPost.com) and an e-commerce site (BarkShop.com) to the product portfolio. Werdelin commented:

“BarkBox was the perfect lesson in our inability to predict success. I had no clue this was a big project when I started it together with my two cofounders, Matt Meeker and Carly Strife. Personally, I was convinced it was a rather small idea – and we really only decided to do it because we liked it as a side project.

“This highlights something crucial. Most people in this business think they are better than others at predicting which businesses have potential. I fundamentally believe that we aren’t. You can perhaps filter on a macro level – you can play in an industry that has a decent size or has growth supported by a macro trend – but, beyond that, you just can’t

¹ As Werdelin mentioned, “The fact that we build our own ventures – and that several of them have been successful – evidently also serves to give us a lot of credibility with prospective clients.”



predict what will work. You have to go out and try stuff, launch experiments and do new things, in order to find your way to the hits. So I spend a lot of time saying, ‘I have no clue if this project will succeed – so let’s try it out as cheaply as possible and make sure we learn a lot while doing it.’”

In June 2015, BarkBox was valued at more than \$200 million and employed close to 100 people.

4. Whitespace

An early Prehype project was Whitespace, a one-click newsletter automation product built in collaboration with the branding agency Wolff Olins. The idea was to give people a very easy way to build and send out newsletters, using content they had found online. At the click of a button, the content would be formatted automatically and added to the next newsletter. The business model was based primarily on charging companies that wanted their people to use the service. At the launch, the Wolff Olins CEO Karl Heiselman said, “We want to do something that allows us to learn how to launch a digital business and experiment with our business model.”²

However, after six months in phase three, Whitespace had not attracted enough paying customers to sustain itself as a business and, with that, the project was closed down.

At the time of closure, Whitespace had 534 active accounts and had generated 20,324 newsletters. Of the three people from Wolff Olins who worked on the project, one subsequently left the company to create his own start-up, and another was promoted to run all the Wolff Olins start-up initiatives. Prehype’s relationship to Wolff Olin remained positive. As Heiselman explained, “It didn’t require an enormous investment and it was a way for us to put a new business into the world.”³

Perspectives

Werdelin reflected on the success of the Prehype model from the vantage point of the stakeholders:

“The first question is: Does this make sense for our clients? And to be honest, I don’t know if we can fully and conclusively prove that yet. But, as we sometimes say, the real job we have is not to succeed – it is just to suck less than the rest. And on that metric, I think we’re clearly ahead of the other offerings in our field. Most of our clients have tried other approaches to radical innovation – trying to do it in-house, hiring regular agencies to develop products, or buying companies – and have found that they are less useful than our model. We see evidence of that in the fact that even the clients we’ve had where the product *didn’t* take off – e.g., Whitespace at Wolff Olins – want to do more work with us. After all, if you run a project like Whitespace, launching a full product for a total of

² Courtney Boyd Meyers, “Prehype: An Incubator That Helps Corporations Innovate Like Startups,” May 21, 2011, <http://thenextweb.com/entrepreneur/2011/05/21/prehype-an-incubator-that-helps-corporations-innovate-like-startups/>.

³ Ibid.





maybe \$200,000, and it fails, well: Is that a lot to pay for having tried? For most companies, that's a very cheap way of trying new things.

“From the perspective of the individual Prehype partners, the model has proven to work as well. In 2014, each of the main partners took out maybe \$250,000 per person, which is arguably more than what they would have made working on their own. And that is before counting the value of the equity holdings they have in the various projects. The people who deliver value as partners tend to stick around, at least until their own incubation projects take off or they decide to stick with a client venture. If they do, we applaud that and try to make Prehype into a firm that will be ready for them when they exit those ventures and need a platform to find their next thing.

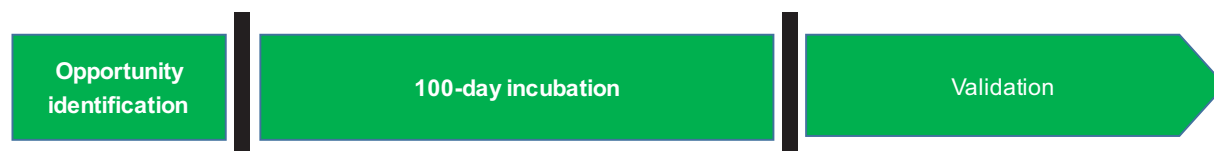
“Finally, from Prehype's perspective as a company, I think it's pretty clear the model is working. I have personally invested maybe \$150,000 in the company, not counting my opportunity cost. In year one, looking at our management fees, we made half a million dollars in revenue; in year two, \$1 million; and in 2014, we reached about \$3.5 million. That's decent, of course, but the real payoff is in the equity stakes, which comes to maybe \$50 million, conservatively estimated. If you think of Prehype as a bootstrapped venture capital firm, only our management fee comes from clients, then I think it's clear that we are doing something right.”



Appendix

The Prehype Process

Below, the Prehype process is described in detail, along with some reflections on the setup.



Phase One: Opportunity Identification

The initial engagement typically took the form of an intensive one-week workshop, run by Prehype, in which eight to 16 of the client’s most talented people from across the organization brainstormed and prototyped their way to between two and four good ideas.⁴ Werdelin explained:

“The first success criterion, once you have alignment with the senior executive who sponsors the project, is to get the right people into the room – the people from the client organization who will become the intrapreneurs. So when we need to identify the talent, I tell the executives to pick the people in their organization who are entrepreneurial and who they think will leave the company within a year to start their own business. That tends to be a very useful way to identify the people who will feel passionate about the project and who the senior leaders think of as rising stars.”

Once the intrapreneurs were chosen and brought together, the Prehype team – typically consisting of three or four partners who each head a team – facilitated the opportunity identification process, as Werdelin explained:

“Our search for new venture ideas is very focused on finding *value-adding problems*. In essence, we ask people to identify a problem that exists in their industry and that either the company *or* the individual intrapreneurs are well positioned to deliver on. Intrapreneurs – meaning people working in companies – have an advantage over Silicon Valley entrepreneurs because they have special access to problems that your typical 18-year-old Stanford graduate doesn’t even know about. When you can identify a good problem that the company is in a good position to act on, that’s where the potential often lies hidden.”

⁴ The workshop was the predominant model, with about 80% of the phase one projects being run in this way. The executive sponsors for these tended to be either chief strategists or chief innovation officers. In about 10% of cases, the client already had an idea and used Prehype primarily to build on it. The last 10% made more intensive use of Prehype’s staff rather than using internal people. Typically these cases were framed as research and development projects and initiated by chief technology officers. All three models were oriented toward creating a lean product plan.





After an initial brainstorm, the teams would quickly narrow down the scope. Already on day two of the workshop, the teams would pick three or four ideas and form teams around them, spending the remaining three days exploring and solidifying their ideas. Werdelin said:

“We narrow down the ideas very quickly. If you let them, people will spend ages discussing the ideas that come up. The problem is, the length of the discussion is not necessarily correlated with the success of the projects. You simply can’t analyze your way to a better idea. You just have to pick a few likely candidates and start moving forward, tweaking them along the way. And while the idea selection is done primarily by the intrapreneurs, the Prehype partners typically have a strong voice in the discussion as well. We are not just facilitators, but also experts at understanding which projects can actually be built and which might harbor pitfalls that first-time entrepreneurs don’t see. We tend to have the internal rule of thumb that if you, as a partner, would not be willing to invest \$10,000 of your own money in an idea, then that idea needs to be rethought, scrapped or further developed.”

In practice, Prehype asked people to evaluate their ideas according to three criteria:

1. *Is it doable in 100 days?* If you can’t build a first working prototype in 100 days or less, the project is simply too big, with all that implies in terms of extra risk.
2. *Is it radical enough?* Prehype deliberately took aim at more radical innovations, or what it called “Box 3” ideas: higher-risk projects with the potential to really move the business if they succeeded. Projects that were too modest in scope would not benefit enough from Prehype’s model. Also, ideas that were too close to the company’s current operations would require constant coordination with the main business, making it impossible to meet the all-important need for extreme speed and flexibility.
3. *What is your gut feeling?* Finally, Prehype placed great emphasis on people’s gut feeling. This came in part from the realization that, beyond simple back-of-the-envelope calculations, quantitative analysis was less useful as a decision-making tool when it came to start-up ideas. In addition, Prehype knew from experience that passion was crucial – an idea can sound great on paper but, if nobody feels strongly about it, it won’t fly.

To handle the idea selection process, Prehype borrowed a technique from the nonprofit initiative called Startup Weekend, where people “voted with their feet.” Once the ideas were all up on the wall, the participants were simply asked to go up and put their name next to the idea that they personally felt most passionate about and wanted to work on – allowing the team to quickly zoom in on a few ideas without having to spend time discussing why the other ideas were not viable.

The Lean Product Plan

With the help of a team of designers, the chosen ideas would be turned into the core deliverable for phase one: the lean product plan, a professionally designed slide deck with 20 to 30 slides that explained the rational and emotional arguments for the idea, along with photorealistic prototypes of what the future product or service would look like. At the end of



the week, the lean product plans would be presented to the corporate sponsors, who would then decide which ones to move ahead with (if any). The Prehype partners would be in the background during this phase. The actual presentations were made by the intrapreneurs themselves, and a lot of effort was put into designing the presentations, as Werdelin explained:

“Compared to the kind of business plans people are taught to prepare in MBA programs, we don’t have a lot of models and forecasts. That part is deliberately very superficial. That is the case because detailed forecasting of start-ups is essentially fiction. Everything we know from research is that we can’t predict the future well enough to model it reliably. So we focus instead on the *unit economics*: What do we think we can sell the product for? Then the people watching the presentation can decide for themselves how big they think the market might be and multiply the price by that.

“Second, we give people a clear and compelling vision of what the product will look like, to create a strong emotional case for the idea. When you can’t model things accurately, as is the case for new ventures, you can’t really sell ideas on the cold, hard logic of the underlying business case. So it is crucial to sell to people on an emotional level, to make them fall in love with the project. That happens automatically with the people who are in the workshop but you also have to get the executive sponsors on board. The way we conclude the workshop, having some of the company’s rising stars present these really impressive-looking ideas to their sponsors, creates a very strong emotional hook or commitment that makes it much more likely that some of the projects will be green-lighted.”

At the end of the phase one workshop, Prehype outlined three main ways to proceed:

1. The product could be killed or postponed;
2. The product could be built by the company, perhaps using another agency;
3. Or the product could be built with the continued assistance of Prehype, going into phase two.

The price of a phase one project was typically in the range of \$100,000 to \$200,000. Werdelin explained how Prehype saw the phase one projects:

“We speak of phase one as ‘dating’ but we have no interest in the professional equivalent of a one-night stand. We’re looking for someone who’s in it for the long term. What is important about our workshops is that they are not the primary product for us. Rather, they are a means to an end, namely to get to a successful venture that we can build. What we want to do with phase one is to get aligned with the client on a good idea that can be taken forward. That means we say ‘no’ to clients if we believe that they don’t have the corporate motivation or position to go forward with at least one of the projects. The longer-term equity model we use allows us to keep the price on phase one relatively low, compared to the average price of a one-week workshop – so it makes little sense to invest our time in projects where we don’t think there’s a good chance of a venture being formed.”





Historically, about 60% of Prehype's workshops led to a phase two engagement. An additional 20% of the workshops were continued by the client without Prehype's involvement. The remaining 20% were terminated – some of them by Prehype, as they were perceived to be too close to the client's current business or not a good match with Prehype's setup. In other cases, projects died when the company hesitated to pursue them – typically with the words: "We'll have to look into that idea some more before we move forward."

Phase Two: 100-day Incubation

The incubation phase aimed at building the first rough version of the product, putting it into the market in 100 days or less. The project would often be set up as a separate legal entity from the main business, both so the new venture was free from the bureaucratic processes of the existing company and so the start-up would not risk damaging the existing brand. Also, the product team would be restaffed. While bigger projects had up to 12 people on the team, a core team would include:

1. A Prehype partner who would oversee the process;
2. A Prehype entrepreneur in residence who would act as the product manager and drive the daily operations;
3. Two full-time programmers, hired on a project basis, as well as a number of task-based freelancers, drawn from Prehype's network of designers, legal experts, etc.;
4. One or two intrapreneurs from the client company, as well as an executive sponsor.

In most cases, the client's people would have to go back to their day jobs, limiting how much they could be involved, so the incubation phase was deliberately anchored around Prehype's staff as the core drivers. The workflow, called the "glass factory" internally, was designed to be fully transparent, so the client's people could choose to what extent they wanted to be part of the process. For instance, all communication was run via a Web platform to which clients had full access, and daily "stand-ups" – a process borrowed from agile development where team members would gather each morning to share what they were working on – were transmitted live via webcams.⁵ In about 25% of the cases, an intrapreneur from the client company would become so involved that he or she would become the de facto leader and daily manager of the project. In the remaining cases, the intrapreneurs spent maybe two days a week in Prehype's offices, with the executive sponsor checking in once a month or so.

The 100-day window was an important tool, not least when it came to guiding the product decisions. Werdelin explained:

"The start-up world has introduced the idea of the MVP – the minimum viable product – which is effectively the most bare-bones, incomplete, only-60%-ready version of the product that you are capable of putting into the market. The problem is, that's a very difficult concept to work with in practice. When you work with corporate clients who are

⁵ Prehype used many different external tools in its processes. The abovementioned communication platform was a service called Basecamp, and the stand-ups were shared with Google's Web meeting tool Google Hangouts.



used to bigger projects, there is constant pressure to include more features and functions in the first version of the product. The 100-day limit gives us a great way to prevent feature creep. Instead of having to argue for or against the value of a given feature, we can simply say ‘we don’t have time to build that in 100 days.’ We very often end up saying, ‘Great idea, we’ll include that in version 1.2.’ And by the time version 1.0 has been in the market for a bit, we have a much better basis for determining which features to keep, kill or develop.”

Significantly, going into phase two meant a shift to a different business model. Phase one would cost a one-off fee that let the client keep all intellectual property rights to the projects. As Werdelin said, “We charge enough so that when we get the usual contracts from the client’s legal department, saying that they own everything – well, that’s fine, you paid for that. We basically believe that ideas aren’t all that valuable. It’s the execution that makes it a venture.”

From phase two onward, however, the relationship changed to become more of a shared commitment. Prehype received an equity cut in the start-up, along with a monthly management fee of \$35,000, which was shared between Prehype and Prehype’s partner. Depending on the client, the intrapreneurs (from the client) would sometimes get a success bonus or even part of the equity – but, according to Werdelin’s experience, this did not necessarily lead to better ideas. On top of this came the costs for the project – such as freelance programmers – bringing the total cost of phase two to an average of around \$250,000 to \$400,000.

At the end of phase two (the incubation phase), the client would once again choose between three different options:

1. Close down the project;
2. Continue working with Prehype, moving into the validation phase;
3. Continue the project internally or with a different partner.

Phase Three: Validation

If the client decided to keep working with Prehype, the project would enter the validation phase, as Werdelin explained:

“Phase one is about identifying a problem and a solution to that problem, and phase two is about building enough of a product to test the thesis. Phase three is really about making sure that the customer understands the product, finds it useful and is willing to pay what it has to cost to be viable.”

The idea of the validation phase came from the entrepreneurship expert Steve Blank, who emphasized the idea of “customer development”: before a start-up can be scaled up, the team members have to figure out exactly who their customers are, what they value and what they are willing to pay for that value. In practice, in this phase, the team would make constant



small adjustments to the product and would sometimes end up making more significant changes in direction – what Silicon Valley calls “pivots.” Werdelin said:

“This is another place where I felt the traditional agency model failed. As an agency, you are very focused on the launch itself: that’s when the big boss is in the room, so you are naturally driven towards launching something really flashy and spectacular. The focus becomes on doing something that looks impressive, rather than building something that actually meets the needs of the customers. And if you hold off on launching projects until they are 95% ready, that’s far too late to get the feedback from the market.”

From a business perspective, in phase three, Prehype’s active involvement would decrease, with the Prehype partner entering a more advisory role to the now fully constituted project team. As a consequence, the management fee would go down to about half of what it was in phase two. The validation phase did not have a prespecified end but would keep running until either the project took off or the client decided to stop the project.