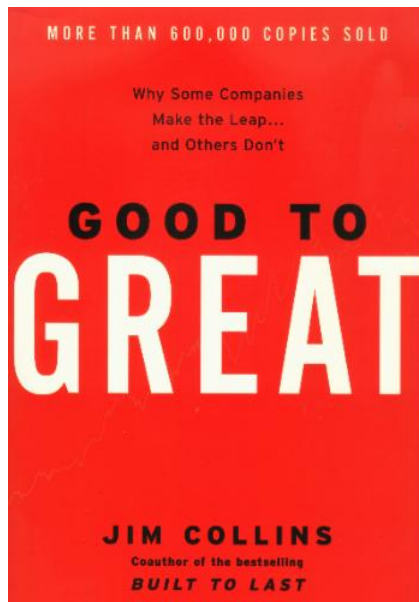


# Are You Confronting the Brutal Facts?



We have had a nice run in the markets over the past few weeks, hitting record highs for seven consecutive days. It would seem like good times ahead and I would so much like to jump on that bandwagon. I have seen this before and it makes me very cautious, given what is probably ahead. With any market and economic difficulties, there is always opportunity. The key signature of the DNA in a real entrepreneur is always being in search of opportunities in any environment, and then acting on them.

When looking for opportunities, we must first practice the Stockdale Paradox, which is coined by Jim Collins in his book [Good to Great](#). In the book, Admiral Jim Stockdale makes observations of those that survived being prisoners of war in Vietnam and those that did not. Admiral Stockdale was there for eight years and endured the most brutal of situations.

When asked "Who did not make it out?" Stockdale replied, "The optimist." He shared that they would say, we will be out by Christmas, Easter, and Thanksgiving, and when those markers came and went, the POWs would die of broken hearts.

He went on to say to Jim "This is a very important lesson. You must never confuse faith that you will prevail in the end – which you can never afford to lose –with the discipline to confront the most brutal facts of your current reality, whatever it may be."

So what are the brutal facts of our reality? We have a huge

amount of debt (\$16 trillion) that is as much as the combined total of all the goods and services transacted in one year for the US economy. Each year the bureaucrats are spending \$1 trillion more than they take in from taxes, so we are adding a trillion to the total debt each year. The worst part is they don't show any desire to stop spending! We have major uncertainties of how all the tax increases, more government controls, and medical health care changes will affect our businesses.

The fear and uncertainty makes people sit and wait it out, for the most part. We are experiencing some positives now because of pent-up demand. Some areas don't have enough new homes to account for the demand. Some businesses are spending on things that they have been putting off for a long time and can't wait any longer.

This is not the environment of record-breaking stock markets that means things will change. I was in the investment world when the Fed flooded the markets during the late 90s and worried about lots of things, but mainly Y2K. This money mostly went into stocks and drove the markets to a massive bubble that soon burst. Sadly, I watched my money and that of so many others lose unfathomable sums.

Because of the brutal facts and my experience, I am being careful about the markets and business investments. I am also keeping an eye on any opportunities that may arise, given major changes that may occur. Remember that companies like General Electric, IBM, Disney, Burger King, Microsoft and Apple, all were founded in major recession or great depression. Opportunities are not limited to the good times.

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# Unearthing the Latent Demand to Grow

Over the past few weeks, we have been discussing the change in the marketplace oversupply. If we are going to grow our companies, we need to figure out how to zero in on the right demand sectors. To do this, you first must figure out your demand profit pools. So, what are those? Demand profit pools are the areas of untapped demand that we as business owners may not be aware of because we haven't dug deep enough.

In "How Companies Win," Kash and Calhoun discuss this and cite an example of the dog food industry. This industry provided bags of food under standard segments based on large, medium, and small dogs. The food was then segmented under dry/bagged or wet/canned. There was very little vision and, as Kash says, "absolutely no proprietary insights."

They finally looked at the demand landscape. This takes a look at everything ahead of you, such as valleys, rivers, towns, hills, and whatever else may be out there. The analysis is done with a variety of surveys, focus groups, market research, and other techniques that break down the demand pools by tastes, customer characteristics, lifestyles, needs, and desires. All these combined create the demand landscape.



After this type of analysis on the dog food industry, demand pools were broken up, not by breed or size, but in the relationship that owners had with their dogs. They were broken down by marketing the dog as a child, the dog as part of the

family, the dog as an active partner, the dog as a pet, and the dog as a farm implement. As you might imagine, the dog as a child was the high profit center, and the dog as a farm implement was the low profit center. This awareness caused the pet food company to align their products with the right demand and create greater distinctions with each brand, so they avoided competing with themselves.

What if you could find the answers to the questions Kash and Calhoun propose in their book?

- Find the high-profit consumers who can raise your margins and revenues
- Understand current, latent, and emerging demand
- Determine which channels are growing and which channels are slowing
- Assess where your competitors are strong and where they are weakest
- Understand the media habits of your most important consumers
- Identify the best potential opportunities for innovation
- Build a financial model for resource allocation to drive faster growth
- Develop insights about the demand of your most profitable customers

Having these answers is the way to deal the increasing oversupply economy that we now have and to create the demand that is needed to grow your business. What are you doing to dig deeper?

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# Our Economy's Transition to Oversupply

Last week, I said we would discuss how to zero in and better handle the demand economy, and we will also look at how to make your offering target the demand that you want to create. We will actually do that next week, so we can first understand how we have transitioned into an economy of oversupply. Let's review why economic demand has changed. In the book "[How Companies Win](#)," [Kash and Calhoun](#) describe four phases of transitions moving from a supply based economy to a demand based one.

The first phase involved [market equilibrium](#), which lasted from 1947 to 1990. After World War II, places that had avoided destruction kicked into a level of prosperity that last for decades. Other areas took longer to adjust but entered the industrial and information economy over time, continuing to create demand as we became more global. With the advent of many different [supply chain management](#) approaches and thinkers like [Edwards Deming](#), we continued to lower cost and improve the supply as more demand was created. These good times stayed in balance for a long time . . . until they didn't.

The period of oversupply started in 1991 and continued through 2007. An aging population in the developed world, the end of the [Cold War](#), and [globalization](#) created this phase. This generated a significantly large number of companies adding their offerings to those of the multitude of businesses already out there. The internet popped up during this period, which also created a medium to communicate and share knowledge. This brought many more companies to the table. Productivity increased. Then, the first bubble hit during the early 2000s and was followed by more, which led to the true slowdown in demand.

The demand contraction of the [Great Recession](#) hit during 2008. This created a global slowdown not seen since the [Depression](#). The housing market was decimated, and unemployment shot up, continuing a reduction in demand that has lasted to present day. This was followed by [stimulus](#), increasing the debt. To solve this problem, the government will need to spend less and possibly raise taxes, which will likely lead to even less demand.

We now have a [Demand Driven Economy](#). A hypercompetitive business environment characterizes this fourth area, and it will continue into the future. This flat demand will put a crunch on profits and drive a lot of businesses to disappear.

The companies that have a better understanding of the demand situation will be able to position themselves for a demand offering that will drive more business. More on that next week.

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## [Does Your Business have a Demand Problem?](#)

Looking at what has been happening in the world with the slow economy, you would think it all has to do with a bad recession or political activity that is less than favorable to the business world. Look a little deeper, and you will see things are changing. We should be aware of all that is going on for the sake of positioning our businesses for the most potential possible.

I believe, as a leader of a company and the one responsible

for putting us in the path of future waves of opportunity, my purpose is to read and learn as much as possible. To achieve this, I participate in the [EO University Conferences](#), attend the [Verne Harnish Fortune Conference](#), and read a large number of books every year. This exposes me to people, speakers, and ideas that help me contemplate what the future may look like.

Back in the early 2000s, I came across a book called "[The New Law of Demand and Supply](#)" by [Rick Kash](#) that was sent to me by the [Williams Inference Center](#), and I have been reading a book more recently called "[How Companies Win](#)" also by Kash and [David Calhoun](#). The first book put some interesting thoughts in my head, but I didn't see really the power of this thinking until the great recession hit us. Why? Because it took the significant decline in business to magnify how the Demand and Supply forces have changed.

☒ In the past, we had huge demand from those who wanted everything businesses could throw at them. For decades, we could grow revenue by adding more offerings and streamlining supply. We globalized the supply chain, reducing costs by making products in China or India or even just down the street if that was most efficient. We were able to buy so many things as our living standards increased and the costs decreasing. We accumulated so much!

Now, things have changed. The demand is simply not there. We have excessive supply from where we increased it so much in the previous decades to meet the high demand, but this terrible economy has taken away our buying power. We now see an economy that has vast oversupply but not enough customers to support the businesses that are out there trying to provide that product or service. This is the new world in which we are living, so decision makers need to know how to deal with this in order to generate growth in their business.

For those that zone out when you hear "supply and demand" due to the brain trauma you received in Econ 101, let me say it

another way. In the past, we desired lots of things (lots of demand) and the business world struggled to make all we wanted and to provide at affordable prices (not enough supply). Now, we have this huge amount of goods (over supply) that companies are trying to sell and not enough people with the desire or resources to buy them (lacking in demand).

There is so much supply for what you are offering, so it is tough to grow business. Can you see this in your business environment?

Supply has vastly outpaced the demand in the economy right now, and the global economy has become unbalanced. We need to grasp this new reality that in order to get customers to want our offerings, we need to zero in on exactly what they are demanding. We will focus on this in next week's blog.

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## [Crowdfunding, the Savior for the Entrepreneur](#)

Something exciting has happened in the entrepreneurial world, and I want to share it with everyone. The [JOBS Act](#), passed by both houses of Congress in March and signed into law on April 5th, will generate big changes for the growth of small and mid-sized businesses. One of the major amendments in this bill would allow [crowdfunding](#). I see this evolving into a significant means for companies to access increased funding, and it is a great way for small investors to find more opportunities to devote their money to companies with which they are more closely involved. Given how connected we are through social media and the internet, this is ripe for the



times!

So what is [crowdfunding](#)? It is the opportunity for your business to use a website and social media to allow others with an interest and small sums of money to invest. Prior to this bill, the [Securities and Exchange Commission \(SEC\)](#) would only let a small number of people invest in one business, but once your business passed that limit, other investors were required to have a large income or net worth, or you would have to register as a security with the SEC. Crowdfunding will eliminate all this red tape and provide the opportunity to truly democratize the investment process.

This can be compared to a New York law which passed in 1811, changing the liability requirements for corporations and making it easier to establish one with minimal requirements. This allowed investors to hold a diversified portfolio of stocks without regard to the debts of the companies in which they invested. This freed up money to move in areas it was needed, which at the time included textile mills due to our challenges with Britain ([War of 1812](#)) reducing trade.

That timely law allowed money to flow where it was needed. Today, we have a similar environment where businesses can't get the funding they need to grow because of all the bank problems. Banks withhold lending because they fear the bad economy, have experienced many losses already, and must hold more money in reserves due to increased government regulation. This starves the entrepreneur from the funding needed to take advantage of various opportunities.

Given my history with investments as well as the historical results when we democratize people, government, business, and investments, I see the start of a new era. Investing in a portfolio of startups will become as common as mutual fund investments! Does your business need capital to grow and could crowdfunding be the advantage you have been looking for to explore new opportunities?

## Is Your Head Stuck In a Recession?

Watching the news these days doesn't leave one with much hope for the future, when all we're hearing is about inflation, unemployment and national debt. Reports are spreading of an ongoing recession and even a possible depression before things get better. So what is an entrepreneur to do? Constantly trying to keep your head above water can get discouraging when you have nothing solid to look towards. As much as I'd like to bury my head in the sand sometimes, I know that's not a viable option. Instead, I practice the [Stockdale Paradox](#), which is to retain faith, regardless of the difficulties, AND confront the brutal facts, whatever they may be.



The fact is, things are not good out there, but this does not mean that there is no money or opportunity.

Let's first consider how we view the world around us. The word recession is defined as two consecutive, negative quarters of economic activity. Does that mean that everyone

stops spending money and the economy comes to a complete halt? Not at all! Now consider this: the [Gross Domestic Product \(GDP\)](#) of the US was at \$14.54 trillion in the 3<sup>rd</sup> quarter of 2008, on an annualized basis, just before the financial meltdown. That number never fell below \$14.24 trillion, even at its lowest point in the first quarter of 2009. So what does this mean to you? There was still over \$14 trillion being spent in the economy every year; money that you could be hustling for a share of.

Even though the overall drop was not significant, some industry sectors took a tragic hit, as much as 50%, while others grew by 20% or 30%. In times like this, the [Clipper Ship Strategy](#) can be useful by positioning yourself to where your money is being spent. This isn't necessarily an easy thing to do, especially with big industrial and manufacturing centers. It's a little more feasible to move towards the money if you're in the service sector, and much easier for information based businesses. The point here is just to keep moving.

Something else to try and practice, and not just when times are tough, but all the time, is to focus on what you do best and hire others to do what they do best. The simplest way to put it is to play to your strengths. For example, we have engaged [Kopp Consulting](#) to go out and do our cultivating of new business for us, since our strength lies in the relationships and solutions, not sales. Obtaining new business is a venture that requires focus and attention. In our experience, when the relationship team is trying to do the job of the cultivation team, we lose focus and don't see optimal results.



Kopp learns about your business and has their own secret sauceto finding the right clientele and getting you in front of them. In the months ahead I will share more of our experience with what Kopp is doing for us.

My last thought on this topic is this question: how hard do we make it for our customers to find us? Go ask everyone in your office if they have used the phone book in the last week, and then ask them the same question about [Google](#). I have seen it done and the difference is eye opening. Content and key words are key to getting found in search engines. Have you Googled yourself lately?

So with a recession in the air, are you keeping the faith, confronting the brutal facts, focusing on what you do best, and can your customers find you?

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## [The Economy Is Alive](#)

Looking at the economy and how it operates can give you insight into a model of reality that helps to make business decisions that keep you alive and evolving instead of dying off and becoming extinct.

Many people think of the economy as a mechanical instrument that you can control and operate with the twist of a knob or a pull of a lever. This seems to come from the Newtonian perspective that the universe is predictable, stationary, and perfectly knowable with its mathematical formulas. This [Newtonian](#) approach was given life by economists of its time.

Interestingly, the players in an economy follow more of a biological approach than a mechanical one, where things change, it is a living organism, history matters, and no eloquent equations predict the future. When have you seen more than a handful of lucky economists predict what was going to happen next?

In the earlier part of the 90's, my former partner in my investment firm had a PhD in biology. He looked at the world as an interconnected group of living organisms, more like a biological complex ecosystem. We invested in companies that were connecting the world at the time because, from this perspective, more connections create more intelligence, ideals and stability. History had shown that more connectivity led to more value creation opportunities, like when shipping, the telegraph, the railroads and the phone connected people. We ended up with the #1 growth and income fund in the country by using this model.

Our thinking was supported by the book [Bionomics](#), which discusses in detail how the economy is a living, self organized, evolving ecosystem, just like any biological system. The author, [Michael Rothschild](#), says in the book that instead of a zero sum process, the economy is "A positive sum process, where the whole is worth more than the sum of its parts – a phenomenon where value is created by the cooperation of diverse economic specialists".

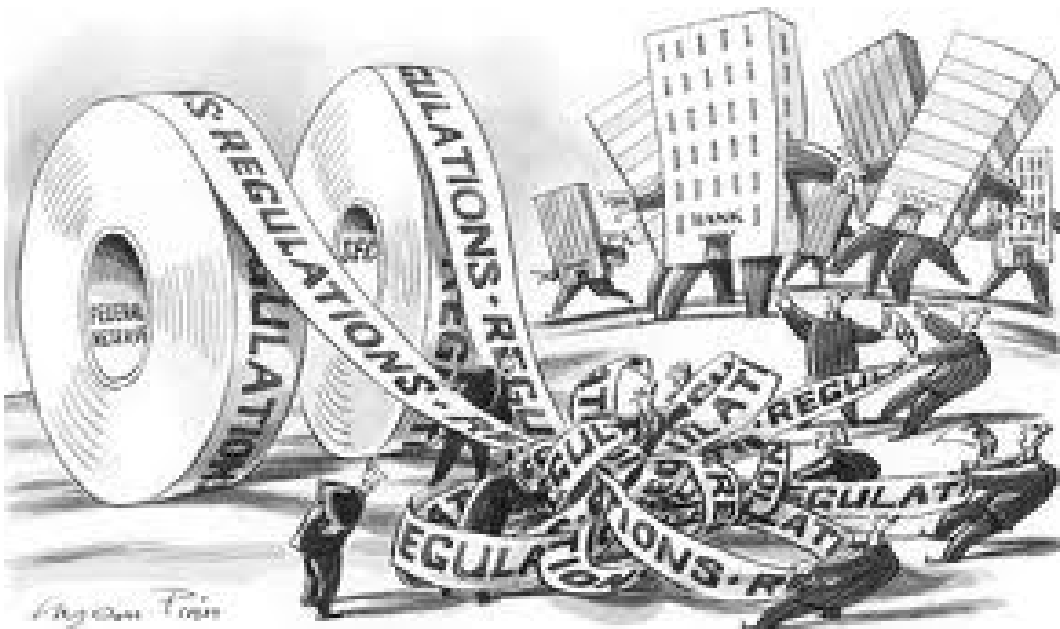
Thinking about the economy biologically is important because, as in life, your surroundings are filled with cooperators, competitors, and innovators. They will change your world

unless you continue to evolve and stay up with the hungry opportunists that will find their niche, which could make yours extinct.

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## Creating a Jobs Economy

Our nation is struggling to create jobs. You've likely heard that regulations have limited businesses' capital, making it difficult for them to hire or expand. Have you wondered what types of changes to these regulations would help this economy create more jobs? Let's discuss a few key changes that have worked in the past to encourage companies to grow and hire more people.



Many regulations create a big problem for the economy. Which regulations and policies are stopping us from creating the

jobs that we are missing? Amity Shlaes writes an interesting article in the Wall Street Journal, [Three Policies That Gave Us the Jobs Economy.](#)”

The first game changer implemented a venture capital investment increase from \$39 million in 1977 to \$570 million in 1978, an increase of 15 times! What policy changed? They cut the capital gains tax rate from 49% to 25%. In the 1960s, the rate had been raised. What happened then? As Amity says, “The mid-1970s were a dead period.” The decrease in the capital gains tax rate generated investments and growth in businesses, which actually brought in more tax revenue for the government.

The second big policy change adjusted the [ERISA law](#), which regulated pension and retirement plans. In 1974, they instituted the prudent man rule, which said that pension plans would be violating their fiduciary responsibility if they invested in risky startup companies like Apple at that time. They relaxed these regulations in the late 1970s, and as a result, more money was invested in small, younger start-up companies that create most of the jobs, as I discussed in an earlier [blog post](#).

The third major policy change centered around intellectual property rights and clarified how ideas in universities and research departments could be sold or used for commercial benefit. Subsequently, so many great ideas surfaced after having been pushed aside on a desk or stuffed into a file cabinet simply because, until that moment, no one had the incentive to go out and reap the benefits.

The lessons here are plentiful! We need to continue to lower the cost of capital transactions and capital gains. When we take from the people with capital, we always get slow growth or dead periods, not more jobs or government revenue. Amity suggests the major regulations of today include [Dodd-Frank](#) and [Sarbanes-Oxley](#). We need to change these policies and reduce

the burdens they place on businesses.

Most entrepreneurs understand this instinctively, but we need to share this data with others. Shout it out loud and clear to the policy makers because this information is vital if their real agenda is to create jobs and improve the economy and not just to maintain power.

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## [A Connection Worthwhile](#)

Did you ever wonder how a website that does nothing but allow you to display your life to all your friends and family and is free to use, could be worth around [\\$11 Billion](#)?? [Facebook](#) is. This valuation comes from the power of connecting...not just people, but things. When connectivity is increased, value goes up exponentially.

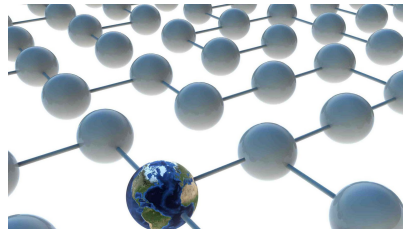
This could best be understood with the explanation of the “fax effect”. The first fax machine that was made cost exorbitant amounts of money during research and development, and was worth relatively nothing. Not until you add another fax machine does their start to be value. Add another and another to the network and you start to create something of real value. Each arithmetic addition allows for the value to be increased by the square of the connections.

In the mid 90’s, I read the book [Out of Control](#), and then in 1999 came the book [New Rules for the New Economy](#) both by Kevin Kelly. From [Out of Control](#) came the understanding that networks with high degrees of feedback create collective intelligence (more on this subject soon). This is what led me to the crazy idea of starting a mutual fund run by the



shareholders called the iFund. We started in 2001, right at the beginning of that nasty down turn in the market and it never took off. An idea before its time, I believe, and we closed down when we sold off IPS Funds.

[Kevin Kelly](#) said in [New Rules for the New Economy](#) that “The dynamic of our society, and particularly our new economy, will increasingly obey the logic of networks. Understanding how networks work will be the key to understanding how the economy works”. This truth is backed by the looking at the success of [Amazon](#), [Ebay](#), [Facebook](#), [Google](#), and the many other beneficiaries of the network effect.



So going back to the beginning, the valuation of [Facebook](#) is based on the power of the [network effect](#). Are you creating a network that is increasing the value of you, your business, and your community? You have a network with the people in your company and all of your suppliers, vendors, and clients. How are you connecting them to build value?

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**Want                      Jobs?                      Grow**  
**Entrepreneurs!**



As I travel around the world, I listen to people talk and read the local papers to get a feel for how others view the global economy. It is interesting to try and see the world from their perspective. It seems that many people are just looking for their economies to get better and waiting for leaders to do something about it.

As I discussed in my last blog, I have a different point of view on changing the world. I see it as you, the individual, who holds the responsibility to change the world. Great leaders simply provide the mindset and inspiration for you to do so. They also create an environment that is conducive to allowing the common man to make a difference.

I left the US, traveled to the Netherlands, made my way around Germany and have now landed in our office in India. People everywhere, not just in the US, are out of work due to a global recession. As I write this, global markets are down 3-5% in one day, with negative outlooks. This is an accumulation of governments worldwide trying to solve problems by spending money in an effort to create jobs. It's not government that creates jobs, that in turn change the world, it's the entrepreneur.

This concept is supported in a soon to be released book called [The Coming Jobs War](#) by [Jim Clifton](#), the Chairman of [Gallup](#). One of our project managers here at Efficiency, Mike Nelson, sent me [an article](#) that discusses the book. In the article he quotes, and I agree that "Nobody is quite sure where jobs come from. We know how chickens are hatched, but not jobs."

Clifton also discusses how job growth comes from new companies, 95% of that being within their first year, and the rest from small to medium sized businesses growing and becoming great companies. A key point that most people don't

understand is that existing big business doesn't create jobs. NONE of the new jobs come from them.

He goes on to say "Here is something that almost nobody knows. These all-important start-ups and shoot-ups don't occur because of new legislation, new rules, more free money or any other government tweaking. They occur during moments of unusually high inspiration. They are created by Americans seeking the great American dream. Freedom."

Think about leaders of our past that created inspiration in others. [Abraham Lincoln](#), in the first paragraph of the [Gettysburg Address](#), said "...dedicated to the proposition that all men are created equal" and in the last sentence said "...that government of the people, by the people and for the people shall not parish from the earth." This inspired a nation to continue the fight to stay together and end enslavement. [Sir Winston Churchill](#)'s comments inspired England to rise up and stand its ground against Hitler. [Gandhi](#) inspired India to rise up without force for its freedom from England.

In business, [Lee Lacocca](#) inspired the people of Chrysler to rise up out of the bankruptcy and become one of the top 3 auto giants in the world. [Bill Gates](#) inspired technology enthusiasts around the world to start businesses. Ronald Reagan reduced the friction of government and inspired a nation to unleash entrepreneurs in the mass.

Let us hope for more inspiring leaders like these so that entrepreneurs around the world can continue to do their thing: create jobs.