NATIONAL GOVERNORS ASSOCIATION

OPENING SESSION

GROWING STATE ECONOMY

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GOVERNOR JACK MARKELL, DELAWARE, VICE CHAIR

GUEST:

JIM COLLINS, AUTHOR

P R O C E E D I N G S

CHAIRMAN HEINEMAN: Good afternoon, governors and distinguished guests. I call to order the 104th Annual Meeting of the National Governors Association.

We have a full agenda for the next two and a half days. Following this session, the Education and Workforce Committee will discuss the reauthorization of the Elementary and Secondary Education Act, with Secretary of Education Arne Duncan and former secretary Margaret Spellings. All governors are encouraged to attend, and it will be in this room here.

Saturday's business agenda begins with the concurrent meetings of the Economic Development Commerce Committee and the Health and Human Services Committee.

We will then have a governors-only lunch and business session followed by the meetings of the Natural Resources Committee and the Special Committee on Homeland Security and Public Safety.

Sunday morning, we will begin with the governors-only breakfast and business session. The annual meeting will conclude on Sunday with a session about growing the next big idea:. Steve Blank, author of the *Startup Owner's Manual* will join us for that session. I know we're all looking forward to all of these.

Let me start today by saying we are very honored to be joined by several distinguished guests from the Canadian Parliament and a delegation of Arab ambassadors.

Would you, please, stand so that we can recognize you.

(Applause.)

CHAIRMAN HEINEMAN: Thank you for being here.

Now, I'd like a motion for the adoption of the rules of the procedure for this meeting. And I would note, governors, as you know now, we have streamlined our policy process and we do not anticipate any new policies at this meeting.

If governors do have questions, however, or want to make changes, please submit them to David Quam of the NGA staff by five p.m. tomorrow.

Is there a motion?

UNIDENTIFIED SPEAKER: So moved.

UNIDENTIFIED SPEAKER: Second.

CHAIRMAN HEINEMAN: Seeing no discussion, all in favor, please say aye.

(All members said aye.)

CHAIRMAN HEINEMAN: All opposed, nay.

Thank you very much.

Now, I would like to announce the appointment of the following governors to the Nominating Committee for the 2012-13 NGA Executive Committee: Governors [Terry] Branstad, [Scott] Walker, [Dan]Malloy, and [Chris] Gregoire. And the chair will be Governor [Steven] Beshear. I'd like to thank all of you for agreeing to do that.

As most of you know, obviously we're here in Colonial Williamsburg, and we owe a debt of gratitude and thanks to Governor Bob McDonnell and his wife, Maureen. We had a great event last night. There are more to come.

I learned this morning--Bob gave us a history lesson about the State of Virginia. As I said at the news conference, it would have been nice if he would have taught me that when I was in high school; I could have got a better grade.

But the fact of the matter is, he has some remarks for us and a very distinguished veteran governor, I believe, who is going to join us.

Governor McDonnell.

GOVERNOR [Robert] McDONNELL: Thank you.

Well, thank you, Governor Heineman, and

my fellow governors.

What a tremendous honor it is to have you here in the Commonwealth of Virginia, the cradle of democracy, the mother of presidents, the Old Dominion, and we're thrilled that nearly over half the nation's governors would choose to travel here to be part of this.

It was really a treat to . . Governor Heineman, you and the Executive Committee accorded this privilege two years ago.

And I want to thank the staff that's been working so hard on this now for over two years, led by Jean Marie Davis, who is here, and also your first lady, Sally Ganem; and my wife, Maureen McDonnell, that are now, I think, out drinking Williamsburg wine, having a great time after their difficult yacht cruise on the York River this morning. And we're delighted that the spouses have also chosen to come.

I can't think of a better place for governors to convene because whether we're Republican or Democrat, no matter what state or territory you come from, we all agree on one thing: And that is that the United States of America is a marvelous country, perhaps the greatest country on earth; the place where more great ideas about human liberty and free enterprise and democracy have sprung. And those things that happened right here in Jamestown and Williamsburg were ideas written in parchment 230-some years ago that are now still alive and well and spreading these ideas about human freedom around the world. And for us in Virginia, it's a real source of pride that that happened here and that you-all are here.

May 14th, 1607, is when those brave 144 men and boys landed after 144 days at sea, leaving England and arriving in Jamestown, Virginia.

Tonight, you're going to be literally right on that spot where the settlers landed. Despite 380 years of trying to figure out where that fort was, it wasn't until 1996 when, using sophisticated technology, they actually found the footings of the original Jamestown fort that you'll see tonight. And we'll have dinner literally on those hallowed grounds. It is literally living history.

The archeology that's taking place there . . they are still digging, still finding artifacts. And you'll be able to see the museum where everything from remnants from the well that was just found to the well-preserved body of what they believe is Captain Bartholomew Gosnald, the commander of the GODSPEED.

So it is a marvelous piece of history, and I hope you'll be able to attend that event tonight.

And then tomorrow night, we'll be in Colonial Williamsburg once again at the Governor's Palace, the place that not only colonial governors ruled for many, many years, but also the first two governors of Virginia, Patrick Henry and Thomas Jefferson.

You also will be able to see the House of Burgesses where we had the press conference this morning where people like George Mason and George Wythe and George Washington and others actually sat as elected members of the House of Burgesses; where Patrick Henry gave his great speech in opposition to the Stamp Act.

So we were so proud that it was selected to be here because governors love the histories of their state, but they also cherish these marvelous foundations of the United States, much of that rich history going back 236 years, the founding of our country right here in Williamsburg and Jamestown.

So thank you very much for coming. I think it's going to be a terrific time. You'll actually get the great music of Carbon Leaf, a great Richmond band that will be playing tonight. Fireworks at the Governor's Palace tomorrow night. And then what I really hope is good fun, good fellowship, where we can talk about the compelling issues of the day on a host of issues dealing with health care and energy and budgets and so forth as we renew friendships with one another, learn from one another, take the best ideas from the states, import them to our states, and then continue those traditions of Jefferson and Henry that have endured now for many centuries.

So with that, while I am merely the 71st governor of Virginia, I do have a special guest, and that is the first governor of Virginia who happens to be with us, so will you, please, with welcome my good friend, Patrick Henry.

(Applause.)

PATRICK HENRY [actor]: Thank you, Your Excellency.

Gentlemen and ladies, as I was accorded the high and very unmerited honor to be appointed as the first Governor of the Commonwealth of Virginia, it thus falls my very happy duty and my very great privilege to bid you, each and everyone, welcome to this truly birthplace of American liberty, as His Excellency has correctly stated.

The seat of government, after all, of the largest, oldest, wealthiest, and most populous of His Majesty's colonies; it was here that good men and good women gathered together to lead the charge towards the erection of a new and very bold experiment, a new nation of united sovereign states conceived in liberty with the honest intention of justice under law for all men.

The very radical notion which guided our feet was that all men are by nature equally free and independent and have certain inherent rights, namely the enjoyment of life and liberty, with a means of acquiring and possessing property, and pursuing and obtaining happiness and safety.

It is our most earnest wish that during your endeavors while here, you will greet with success towards the advancement of American happiness. And I can assure you, too, it is our sincerest wish that we will put forth every effort to provide for you the warm and gracious hospitality and reception for which the Old Dominion has long been famed.

On my own personal note for you, it is my wish that you may be guided while you're here with those fundamental principles, without which I believe no free government or the blessings of liberty can be preserved to any people; justice, moderation, temperance, frugality, and virtue.

Good luck, Godspeed, and welcome to Williamsburg. I'm your servant.

(Applause.)

GOVERNOR HEINEMAN: Governor Henry, thank you very much. Now, I want you to know that Governor McDonnell was concerned that you might stay around forever and resume your role as governor of the Commonwealth, so he wishes you the best of luck in your continued retirement.

At this opening session, along with our discussion about defining great leadership, we're going to hear from Jim Collins in just a moment. We will also honor our outgoing governors and recognize our 15- and 20-year corporate fellows.

Before we do that, however, I want to take just a moment to talk about the initiative I've led over the past year which will hopefully set this up for Jim Collins.

For all the tough issues we face today, economic growth and job creation is fundamental to our nation's future and to each of our state's future.

My initiative, growing state economy, is about providing all of you as governors and state policy makers with better policy options to assess the economic environment in our states and foster business growth.

We've emphasized understanding how a new small business becomes a fast-growing firm and the policies that support that transformation. A growing number of policy makers here and abroad recognize the need to understand the effects of public policy on the entrepreneurial pathway, from startup venture to a high-growth company, to a global corporation.

During this past year, we held four regional economic development summits in Hartford, Nashville, Seattle, and Omaha. And I want to personally thank Governor Malloy, Governor [Bill] Haslam, and Governor Gregoire for hosting these summits in their respective states. And I was honored to do it in my home state.

There were over 10 governors, 35 states represented. We heard from a variety of speakers from those in the private sector to academic researchers to other experts who shared with us the keys to promoting and supporting innovation and entrepreneurships. I appreciate the fact so many governors sent their teams to each one of these regional meetings.

You will see in the reports that are at your desk two different reports that we're sharing with you. One, *12 Actions for Growing State Economies* and a pocket card that goes along with that to determine which of those 12 actions may be appropriate for your individual states.

The other report is entitled, *A Policy Framework*. It's meant to be a resource for you to consider for your own policies and priorities in your individual states.

Finally, NGA is providing each of you with an individual state profile that provides a set of measures and information to give you insights about where are the jobs coming from in your state, who are the entrepreneurs and business owners, and what are the likely future resources of business growth in each of your states.

As governors, there's no question all of us want to strengthen our state's economic performance. We hope these two reports will be helpful to you.

And I want to say a special thank you to the staff and to my co-chair, vice chair, Jack Markell, for assisting me in this effort.

Now, that leads us to today. Our keynote speaker is Jim Collins. He is a student and teacher about great companies; how they grow, how they attain superior performance, and how good companies become great companies.

Having invested nearly a quarter of a century of research into the topic, Jim has authored or coauthored six books that have sold more than 10 million copies worldwide. They include the classic *Built to Last*" a fixture on the *Business Week* best seller list for more than six years.

The international best seller *Good to Great*, translated into 35 languages, and *How the Mighty Fall*, a *New York Times* best seller that examines how great companies can self-destruct.

His most recent book is *Great by Choice: Uncertainty, Chaos, and Luck - Why Some thrive Despite Them All,* coauthored with Morten Hansen. Based on nine years of research, it answers the question: Why do some companies thrive in uncertainty, even chaos, and others do not?

Fortunately, we're not only going to have the presentation from him, he's going to answer every single question for us. And by the end of the day, we will all know what we need to do to go from good to great.

Jim Collins.

MR. COLLINS: Thank you, governor.

Good afternoon. Well, good afternoon. It is a great privilege and honor to be here with the governors.

I thank Governor McDonnell for being such a gracious host in his home state.

I thank Governor Heineman for your leadership in the initiative about growing state economies.

In his letter about the initiative, he focused on the role of new growing and strong companies. As a core engine of economic growth--and I would support that; we need in every state new entrepreneurial enterprises that become great growth companies. We need good companies that make a leap to become great companies, and we need great companies that can endure through wave after wave after wave of creative destruction.

I also after years of studying corporations have come to the conclusion that we need more than that. I've come to see that if we only have great companies--and it is very important that we do--that would not be quite enough. We also must have great K-12 education and great colleges and universities and great police departments and great military units; great cause-driven non-profits, great homeless results, as Governor [John] Hickenlooper and I have crossed paths on, and great government performance, local, state, and federal.

Good is the enemy of great. Good is the enemy of great.

And I have been privileged to be able to spend a quarter of a century of my life on one question: What systematically distinguishes a great enterprise from a good one? A great company from a good one? And what marks the leaders who lead them? What makes them different?

It's a data-driven approach. We have more than 6,000 years of combined corporate history in our research database now. It's a little like Christmas. I love data. It's like opening up packages and seeing patterns inside, and it's like Christmas and therein our concepts.

Across the four major studies that the governor mentioned, *Built to Last*, which looks at enduring great companies and *Good to Great*, which asks can you overcome mediocrity and produce great results; can good become great? And that translated into the monograph which we have given you on good to great in the social sectors, how those ideas extend to a world outside of business.

Great by Choice, with my friend Morten Hansen, which is all about thriving in chaos and something I imagine that many of you in your world wrestle with every single day, thriving in chaos. Why do some thrive in chaos and others not?

And this study put special emphasis on entrepreneurs and small business people, which goes right back to what we were talking about in the growing state enterprises, growing state economies initiative, that can navigate an uncertain landscape--and that uncertainty is not going to go away--to build some of the greatest companies of all time.

How do they go from little tiny startups into the greatest companies of all time? And if you get more of those in your state as pistons of economic growth, they will create jobs, they will create economic results. How do we get more of them?

And then finally my own personal favorite, because I have a dark side and it is a turn to the dark side, how the mighty fall; kind of a forensic analysis of train wrecks; how once great companies brought about their own senseless self-destruction. It's not inspiring, but it is fascinating.

I come to you here today in a spirit of service, a service to you at this table, and in full recognition that I am not an expert on the unique challenges of being a governor; I do not want to come here and try to pretend to have that. I hope, however, to share with you a bit of what we've learned about what makes these great companies tick so that you can think about how to cultivate having more of them in your state, but also to show with you some of what we have learned about how the executive leaders--and governorship, as I understand it, is executive leadership--how these executive leaders who built the great companies led differently than less-than-great leaders who did not build great companies, and to just ask you to consider what might be helpful and what might not be helpful in your own quest to lead as a truly great executive in the role of governor.

Now, as we think about this, I might ask you to consider a question. Think about this as a governor: If you had to allocate a hundred points in terms of what will most define your governorship as to whether it will go down as a truly great governorship into two buckets: bucket "A" is executing with tremendous discipline the plans and goals and agenda that you bring with you; and bucket "B" is successfully responding to big, unexpected events that hit you, that hit your state, as Governor Hickenlooper and I have just experienced in Colorado with fires and now potentially flood.

If you had to allocate a hundred points as to what is going to most define a great governor, how many points do you allocate to executing your plan with discipline and how much is determined by how you respond to the unexpected things that will inevitably hit you along the way?

Now, I will turn to this later about what we learned in how our leaders wrestled with this question.

It is very dangerous to study success, so we don't. We study the contrast between success and failure, between endurance and collapse, between great and good. And that only brings us to one of the biggest lessons from all of our work, which is if you rewind the tape of history and you find enterprises that were in the same spot, same opportunity, same resources, same potential facing the same landscape and yet one becomes great and the other does not, the driving factor of greatness was not their circumstance because they faced the same circumstance. That's how we do our research, we look at those that were in the same starting point but had different outcomes, and it leads inevitably to a key lesson; all of our research comes to one point: Greatness is not primarily a function of circumstance. It is, first and foremost, a matter of conscious choice and of discipline.

So what did we learn? What might be perhaps helpful to you?

First, we learned through the lens of our research--don't know if it's the same for you; we might chat about this--it all begins with people. When we did the good to great research, we sort of expected that the way a good company would become a great company is you would have some kind of charismatic, visionary leader who would ride in and set a new direction and motivate everybody to go there, but actually what we found was they walked in and they said, I'm not going to figure out where to drive this bus until I have first figured out who should be on the bus and who should be off the bus and who should be in the key seats. And once I've got the right people on the bus and the wrong people off the bus and the right people in the key seats, then I'll figure out where to drive the bus.

And as we zoom back from all the years of research data in the business sector--and I realize your world may be different--if I were to step back and say out of the 6,000 years of data what's the single most important executive skill that these great leaders had, it was the ability to make very rigorous people decisions and to make sure that all of their key seats were filled with the right people.

And this is an interesting question--I don't know the answer to this, but I'll pose it to you to reflect on--how would a great governor actualize the idea of the right people in key seats? And how would a great governor do that different than a good governor? And how would a great governor do that different than a business person?

When faced with an okay person in a key seat, would a great governor, A, spend more time trying to develop that person into the right person; or B, act more decisively to replace that person with the right person?

Perhaps later we might chat a little bit about what we learned about what our executives did, but I would imagine every one of you around this table right at this moment have at least one seat question of, do I have the right person in this absolute key seat? Am I right?

And then the interesting question is what do I do about that? How do I lead that? Do I develop? Do I replace? How patient am I? And is it different and how patient can you be in the role of governor as distinct from in business? I don't know the answer to that, but I pose it to you as a question.

Now, we spent a lot of time thinking about leadership; and it's a challenge to speak to great leaders about what we've learned in data about great leadership. But we puzzled a lot on the question of what's the X factor of great leadership through our data, the real X factor?

And through the lens of our research, we found that it's not personality. We can fuse personality and leadership all the time, and we know this because some of the greatest leaders we ever studied, near as we can tell, had no personality. I mean, they had a charisma bypass. People like Darwin Smith, who took over Kimberly-Clark, made it into a great company, and he was reserved and shy and almost nerdy and summed up at the end of his tenure, I was just trying to become qualified for the job.

But then, of course, we find some leaders are very charismatic and were great leaders in our research, like Anne Mulcahy who saved Xerox from oblivion. And she was absolutely magnetic. But, you know, like Darwin Smith, she had a very measured view of herself. I never expected to be CEO, she said; it was a complete surprise to everyone, including myself. But she had the burden of responsibility. And like all the great leaders we studied, she was constitutionally--down to the very depths of her core--constitutionally incapable of capitulation.

So what did we find? What did our data show?

And what we found is that it's not so stark as leadership or not, but we actually sort of saw it as a level of hierarchies; it's like a leadership hierarchy, sort of like a Maslow's hierarchy, where level I is individual capabilities, and level II is good team skills, and level III is effective management, Level IV is leadership.

But what we found of our very greatest leaders, the ones that produced the great companies and the great results over time, they went to a different level. And we came to call this level V leadership. And the difference between the level V’s and the Level IV’s is what we came to see as the true X factor of great leadership. And that X factor surprised us. And the X factor was humility.

Humility combined with an utterly ferocious will, and not humility in a necessarily self-deprecating way; these leaders did have a strong ego and they had confidence and they had ambition and they had drive and they had that sort of relentless, everybody-around-them-exhausted and please-would-you-let-us-sleep energy. They had all this. But the difference between them and those who did not build the great companies is all that ambition and drive and energy and motivation was channeled into being of service to something that was bigger than them. And it was the channeling of that energy into something outward, not to what they would get, but to what they would contribute, and to some cause or goal or purpose or ambition or set of values that was bigger to them and in which they were in service.

And when we turn to looking through the lens of the social sectors, we find something quite interesting. I always find it interesting when people suggest that we should simply import business thinking to the social sectors, but they are very different environments; government is very different than business in certain ways. And those of you who have been in business at this table, who have now come into government recognize how significant those are.

I personally think that leading in government and leading in social sectors is an order of magnitude more difficult than leading in business.

Why is this?

In part, because the power map is different. See, if you're Sam Walton in 1986 and you do a power map of Wal-Mart and you say let's allocate a hundred points to all the bubbles of power and there's one big bubble in the middle named Sam; and if Sam wanted Wal-Mart to go right, it would go right; and if Sam wanted Wal-Mart to go left, it would go left.

You know, when you step outside of that very unusual case of concentrated executive power of the business executive, particularly an entrepreneurial founder, we get what a friend of mine who ran a university summed up, is, he said, I have to wrestle with tenured faculty, and that's leading with a thousand points of no.

And in a diffuse power map environment, very rarely does one executive have enough power by himself or herself to simply make things happen, but a lot of people have enough negative power to stop things.

And, therefore, the leadership becomes true leadership. James MacGregor Burns summed it up that true leadership only exists if people follow when they have the freedom to not follow. And in that sense, the step-up requirement moving from business to government might be a very big step.

Now, Governor McDonnell and I have wrestled with an interesting question, which is, does humility and will apply to elected office? I don't know the answer, but I pose it to you as a question.

Now, when we look at these leaders, we asked a question, like what did they do? When they came in, what did they do different than their comparisons? How did they lead differently? What actions did they take?

Well, one is getting the right people. And their first task was always to say, where are my key seats; and with rigor, do I have every one of them filled with the right person?

But there's another interesting thing; you would think that the great leaders we studied would always just sort of start with a broad, inspiring vision; and they would eventually have that. But where they really began was picking up the rocks, looking at the squiggly things underneath, the ugly, brutal facts, and said our first step is to confront the brutal facts.

We write in *Good to Great* a line from Churchill, "The greatest mistake in public leadership is to hold out false hopes soon to be dashed by events." And our leaders never wanted to have that happen to them.

Now, when we were writing in *Good to Great*, we coined this thing called the Stockdale Paradox. And with the challenges you face as governors, economically and all the challenges we have as a country, I'd like to share with you the Stockdale Paradox, because all of our leaders had it.

It was taught to me by Admiral Jim Stockdale, one of the greatest Americans that I certainly have had the privilege to meet. Admiral Stockdale, for those of you who know his story, was the highest ranking military officer in the Hanoi Hilton, who was shot down in 1967, and had the burden of command from within to 1974.

And he was studying stoic philosophy at Stanford when I was teaching at the business school, and I had the privilege to get to know Admiral Stockdale a bit. And in preparation for my first conversation with Admiral Stockdale, I read his book, *In Love and War,* which is alternating chapters of himself and his wife during the years that he was in the camp.

And I found myself getting depressed reading it because, you know, we can all endure anything if we know it's going to come to an end and we know when, but it began to dawn on me, when he was there, he didn't know if it would ever come to an end, so how on earth did he deal with that? And I asked him, how did you not get depressed?

He said, oh, you have to realize, I never got depressed because I never, ever wavered in my faith not only that I would get out, but I would turn my years in the camp into the defining event of my life that in retrospect I would not trade because it made me what I am.

And we were talking to the faculty club to have lunch and his leg still didn't quite work right--and he's very comfortable with silence. And we walked for a long time and never said anything.

Finally I said, Admiral Stockdale, who didn't make it out as strong as you?

And he said, oh, that's easy, it was the optimist.

I said, I'm really confused, sir. You

sounded really optimistic.

No. I, I was not optimistic. I just never lost faith that we would prevail in the end.

So what's the difference?

He said, the optimist, they are the ones who said we're going to be out by Christmas. And Christmas would come and it would go. And we're going to be out by the next Christmas or Thanksgiving, and it would come and it would go. And when that happened enough times, they died of a broken heart.

And that's when Admiral Stockdale grabbed me by the shoulders and said this is what I learned: you must never, ever confuse the need on one hand for absolute unwavering faith that we can and we will prevail in the end with the utter discipline on the other hand to confront the most brutal facts: We are not going to be out of here by Christmas.

Every one of our leaders had this duality, faith and facts, the ability to put those together and to be able to wrestle with both of them at the same time.

And I'm learning a little bit about your states; and in asking the NGA folks, almost every state has tremendous facts and a long road. And the only way we can deal with it is with the Stockdale

Paradox, to confront the brutal facts without ever capitulating to the idea that we cannot overcome those facts.

I used the word "discipline." Being rigorous about people, having humility and will, living the Stockdale Paradox, these are all forms of discipline. And when we look at the very best performers, discipline oozes through the data.

And I want to be very clear that the notion of a culture of discipline is not a business idea. It's not basically let's explore business discipline in its own way. Actually, disciplined people who engage in disciplined thought and who take disciplined action, this is a greatness idea, not a business idea and will find a culture of discipline.

If you look at a great symphony orchestra when it comes to play and it puts together a perfect Mahler symphony and you feel the notes go in your ears and down your spine and you get goose bumps and you cry and you can't sleep, that's discipline. And we would find discipline in the Dana-Farber Cancer Institute waging war on that indiscriminate disease. And we would find a culture of discipline in any truly great public school that produces outstanding educational results where every kid reads by the end of grade three. And we'll find a culture of discipline in the very best of our armed services and in the inspired young cadets that I see at West Point and in all of our military academies. And you'll find a culture of discipline in the most successful companies and you will not find it in the mediocre.

The critical distinction is not between business and government, but doing great and good, between the disciplined and the undisciplined.

Now, in the second chunk that I want to share with you here, I want to turn to the question of uncertainty and dealing with forces out of our control.

My colleague, Morten Hansen, and I spent nine years asking the question, why do some companies and their leaders really thrive in uncertainty and even episodes of chaos and others don't? And we studied these companies that were young and vulnerable that then went on to become 10 times more successful than others in their industries, so they were huge winners in very uncertain and chaotic environments.

These entrepreneurs faced big forces out of their control, often fast moving, a significant level of uncertainty, and full of unexpected events.

Now, let me just go back to that list. I'm curious what it feels like as a governor. As governor, does it also feel facing big forces, out of control, fast-moving, high degrees of uncertainty? That's our world.

So how did our leaders deal with that kind of world different than those who didn't do well in that kind of world?

And I want to introduce you to sort of a couple of sides of this equation because there's a duality inside it that goes back to the first question I asked about agenda and unexpected and how those played together.

Let's first talk about the agenda side.

In 1911, two teams of explorers set off from the coast of Antarctica to be the first humans in history to reach the South Pole; one led by Robert Falcon Scott, the Brit, and the other led by Roald Amundsen, a Norwegian.

They left for the Pole within days of each other, same year, right, same environment, same conditions, but had radically different outcomes. Uncertain, dangerous environment.

Amundsen and his team got there first. Scott and his team got there 34 days later.

Amundsen and his team made it back to base camp safe. Scott and every member of his team died, 11 miles from a supply depot. Same environment, same goal, same conditions, radically different outcomes. So the difference has to be in the kinds of behaviors and decisions and ways they dealt with things.

In our research, we found that the companies and the leaders that did really well, in fact, looked a lot like Amundsen and not like Scott. And there are multiple ways; they had a fanatic discipline and empirical creativity and something I would imagine might be very real in your world, a very productive paranoia.

What I would like to chat about briefly is the discipline side of it.

This idea called the 20-mile march, imagine that what you have is you have this goal and you want to get to the other side of the country, say walking from San Diego to Maine, and you have two approaches; one is to say when the weather is good, I'll try and go as far as possible; and when the weather is bad, it's hot or it's cold or it's windy, I'll sit in my tent and wait for better conditions. Or you can say, I have a 20-mile march, and it doesn't matter whether it's cold or hot or perfect conditions or wind, we're going to do our 20-mile march and we're going to stay in our 20-mile march; no matter what hits us, we are on our 20-mile march utterly, relentlessly as we move across.

And when we looked at Amundsen and Scott, what we found, in fact, is a 20-mile march philosophy. You had Amundsen who said, I'm going to do 15 to 20 miles a day like clockwork; and you had Scott who would say, I'll do big days and then hold back on other days.

In early December, Scott wrote in his journal about being stopped by a blizzard, I doubt if any party could travel in such weather.

But when Amundsen faced conditions virtually the same, he wrote in his journal, it has been an unpleasant day, storm drift and frostbite, but we have advanced closer to our goal.

What we found is very interesting, is staying on a 20-mile march means on the one hand always hitting your march, whatever it is. Every day we get up and we march, we have our agenda, we have our plans, and we get up every day and we march. But it also means never going to far; there's a point when Amundsen was 45 miles from the Pole; he could have made it in one big push; his team said, let's go to the Pole. And they didn't know where Scott was. He said, no. We'll still do our march today. They did 17 miles because he knew that if he overreached, overextended, overexposed, and then got hit by an unexpected storm, then they could die.

And so the 20-mile march means having this discipline to stay on march like clockwork. And when you look at our companies -- think about this for a moment: What's the number one best performing company from 1972 to 2002 of all companies on major US stock exchanges? And we might think that it would be Wal-Mart or GE or Intel or Berkshire Hathaway. And, in fact, all of those did exceptionally well, but the number one best-performing company of all publicly traded companies was Southwest Airlines. Sixty-three times the market. And an industry that is characterized by forces and disruptions and changes, and yet they marched. And they had a march. We will be profitable every single year, no matter what. Which means when 100 cities are clamoring for our business, we'll only open as many as we can do and retain our systems and our discipline and our culture. That's 20-mile marching.

Now, this notion of discipline--and I

think this is very interesting about government environments--we see tremendous consistency in any truly great enterprise. The signature of mediocrity--in our data, the signature of mediocrity is not an unwillingness to change; a signature of mediocrity is chronic inconsistency.

Now, in a political world, how do we create consistency? There's a puzzle I do not know the answer.

Now, I want to very briefly comment about the relationship between innovation and discipline and then go to the unexpected side, and then we're going to have a chance for a conversation.

It's very interesting if you look at, say, a company like Intel; at critical junctures, Intel did not have the most innovative chip in its industry, and, yet, it beat its industry 46 times. It was plenty innovative, but they didn't always have the most innovative. John Brown at Stryker in Michigan beat the market 28 times and led medical devices, but John Brown's philosophy is, we strive to be one fad behind.

Now, what's very interesting about this is that what we found is that it wasn't that they were uninnovative, it's that they had the ability to blend creativity and discipline. And the real differential if you look at Intel; if you go back and look at Intel's great success early on, what you don't see is that the tag line isn’t Intel innovates; although, they did innovate; it's "Intel Delivers." It's the ability to scale innovation, it's the ability to take an innovative idea and make it grow and build a company around it. And I would argue based on our research data that perhaps we have misread the American strength. We tend to think our American strength is innovation, *per se*.

Our research would suggest that our great American strength is our ability to scale innovation, to take the idea of a microprocessor chip or a memory chip and then scale a great company around it; to take the idea of point-to-point service and scale a company around it; to take the idea of certain medical devices and scale a culture around it, that that is our great strength.

And if that's true, then I would raise a very scary question, which is what happens if we lose our ability to scale and that's our distinctive contribution?

When you think about job creation and you think about inside estate, Intel added four times more jobs in its third decade of life than its first or second decade of life.

Stryker took nearly four decades to create its first thousand jobs. By the early 2000s, it was creating that many in a single year.

What that means from growing state economies is it's not just startups; we have to have startups and we have to have entrepreneurial creation, but it is that great growth comes in those who have the ability to take a creative idea and then to scale it with discipline because that's where tens or hundreds of thousands of jobs will come, not tens or twenties.

And an interesting question, if I were sitting with each of you tonight at dinner, I'd ask, what can you do to help those who are the scalers? Because they are our great engines.

Never forget, most overnight successes are about 20 years in the making.

One quick comment on productive paranoia, before I leave this. It's very interesting, the leaders who built our companies, many things were nightmare memos; they predicted 11 of the last three recessions; when asked, are you a glass-half-full or glass-half-empty person, their view was we have a full glass but it's on the verge of shattering at any moment. I mean, these are really paranoid people.

But what that meant, these people were financially disciplined and they were financially disciplined in good times so that they could weather storms in bad times. And as a result, as uncertainty went up, they built buffers, which meant they carried a greater ratio of cash to assets on their balance sheets than others so that they could weather unexpected storms. That's rational behavior if the environment is extremely uncertain. So if we want to see people allocate capital, they will do so to the extent to which uncertainty goes down.

Okay. Now, in the last few minutes of presenting--are you still with me now to go to the unexpected piece?

Okay, great. So we talked about 20-mile march and we talked about discipline and implementing an agenda, right, but now there's this other side of the coin, this other side of the coin about, okay, I come in, I've got an agenda, I've got plans as a company, we're 20-mile marching, but, you know, fires can happen; you know, an unexpected shake-up can happen; we can have an economic crisis; we can have-- you know, end up with any number of things we can never possibly envision and it raises an interesting question, which is when you think about those allocations between 20-mile marching to achieve our plans and agenda, how many points go to that in defining a great executive, and how many points go to how they deal with the unexpected?

Now, in this last piece of research that my colleague Morten Hansen and I did, we really puzzled on this question. And I'd like each of you, each governor, to think of the following: I'd like you to think of an event that hit you or your state that meets three tests: One, you didn't cause it, your state didn't cause it, it happened to you; two, it had a potentially significant consequence, good or bad; and three, it was in some way a surprise or had some element of uncertainty in it; you couldn't have known for sure that would happen or when it would happen.

So you didn't cause it; it had a potentially significant consequence, good or bad; and some element of uncertainty; you couldn't predict it with certainty what form it would take.

Now, showing hands, how many of you can think of such an event for your state?

Now, here's what's interesting, in this

book *Great by Choice* we studied companies that went on to become the 10X winners of their fields, ten times better, and they were environments characterized by big events, out of their control, uncertain, potentially consequential. I mean, you think about everything that hit the airline industry; fuel shocks, deregulation, interest rate spikes, bankruptcy after bankruptcy; yet, they [Southwest] were 63 times the market and the number one best performing stock.

And it raises a question of just what in the end is the role of luck? I mean, to be a great executive, do you also have to be a lucky executive? And we decided to actually take this question on and we decided to define and quantify and study the relative role of luck in defining great executive leadership.

The key is to see that luck is an event. What I just gave you is the definition of a luck event, any event that meets those three tests: You didn't cause it; it has a potentially different consequence, good or bad; and some element of uncertainty is a luck event; and potentially good consequence is good luck, potentially bad consequence is bad luck.

And then the interesting question is,

okay, when you systematically parse that--you know, we just got hit with bad luck in Colorado. Bad luck. We can't look at it as good luck. It's bad luck.

But when we then spread and we study across the executives and we study across the companies, you ask a question which is, once you can quantify it, are the great winners, the biggest successes, the greatest executives, in fact, luckier or not?

And the answer turns out to be they are not luckier. Lots of luck happens, good luck; lots of luck happens, bad luck, but we find in the companies--remember I said earlier we don't just study success, we study contrast, so we can look at companies going across the same environment and we can look at Southwest Airlines and contrast to Pacific Southwest Airlines and ask, was Southwest Airlines luckier? No. They both got good luck, they both got bad luck.

I would imagine the political world is full of luck events.

So what does it mean? What we found, the question isn't whether we'll get lucky. Think about this, can you calculate a return on investment, a return on equity, a return on assets? What's your return on luck?

And what we find is that the luck events are these distortion moments, and that our very, very best executives recognize when those distortions happen and what happened and big inflection which separated them from others is in the unequal time when a big luck event happened, if it was a good luck event, they grabbed it, they seized it, they executed brilliantly, and they made more of it and that's part of when they pulled ahead. And if it was a bad lack event, these were defining moments that were pivotal in separating them from the others. And it is their performance in those distorting, unexpected luck events that plays a huge role in whether they are a great executive or a good one.

When we look at the comparisons, what's fascinating is they have an amazing ability to squander their good luck, to let it fritter away, and they have a capacity to leave themselves exposed to and to do badly when bad luck happens, and that often kills them.

So to put a little close on this and a chance for us to converse, what's fascinating is the degree of duality in the great executives we studied.

For example--this is the big duality--

is it 20-mile marching or is it defining moments and luck events? It's actually their capacity to do both, 20-mile march and with discipline and superb performance in the defining luck event moments that are out of their control that they did not see coming.

And the interesting question is, why did they do so much better when those come?

In the book *Built to Last*, Jerry Porras and I noticed that over time the great executives wrote what we call people who had the genius of "and" as opposed to the tyranny of "or." They are always looking for how do we have the "and"; it's 20-mile marching and return on luck; it's humility and will; it's confront the brutal facts and retain faith; it is creativity and discipline; it is productive and paranoid.

And when we stand back and look at a truly great enterprise, we see a huge duality that underpins any enduring great enterprise, which is what we call preserve the core and stimulate progress.

No great company, no great social enterprise exists unless on one side it has a core and it is built on a set of core values, but not open for negotiation or change. And on the other hand to stimulate progress, they are willing to change their practices, their approaches, their strategies, their structures, but without compromising their core values. And they understand the difference between their core values and their practices and understand that we will not give up our values, but we must be willing to evolve our practices. And when they put these two together--preserve the core and stimulate progress--and that, of course, is much of the American experience. We began with a set of values, we hold these truths to be self-evident. We translated it into a Constitution, which has a framework, which allows us to preserve the core, but it had this beautiful invention called the amendment mechanism, which allows us under certain circumstances to be able to stimulate progress. It's the whole package.

So you have these two sides working together. And the stimulate progress then is translated while preserving--if we lose our values, we lose our soul; if we lose our soul, we lose it all. But on the other hand, to stimulate progress by translating those values into what we call BHAGs: big, hairy, audacious, goals.

And what would be a BHAG for a state? Can it be done in today's world? And true BHAGs have a long time frame. It could be every kid is going to read by the end of grade three, it could be there will be a computer in everybody's hand, bring the world into the jet age. Whatever it is. But I leave you with a challenge on this: What is your BHAG for your state? One that will outlast your presence as governor? And can that be done?

I'll go back to the moon mission. It's very interesting, put a man on the moon and return him to earth by the end of the decade. Even if Kennedy got a second term, the BHAG was going to go beyond his tenure. And so the interesting question is, how can we set long-term enough goals and set them in place that they will be achieved by your successor? That's a true BHAG, that's preserve the core and stimulate progress.

Thank you.

(Applause.)

MR. COLLINS: I'm in your hands.

CHAIRMAN HEINEMAN: Oh, no. We'll make sure we have time. And, you know, having right leaders in the right seats, I'm going to give the Governor of Colorado the first question because he's engaged in a public/private partnership with us, he is willing to send his best companies to Nebraska, and I really appreciate that.

GOVERNOR HICKENLOOPER: It's true I took a bunch of our top business leaders to Nebraska this last week, and we were stealing every good idea we can. And there were plenty there.

I want to take--and it is worth pointing out, since governors do have a tendency to brag on occasion--that Jim Collins could live anywhere in the world; he's really one of the natural leaders, and he does live in Boulder, Colorado, so I want to make sure we're all clear on that.

MR. COLLINS: It is my home state.

GOVERNOR HICKENLOOPER: As you were talking in the beginning and describing each of us a challenge to put together our teams and that question of who has the right seat on the bus, I just thought I'd first lay off this book that just came out last week, *Leadocracy*, which is by your fellow Colorado author, Geoff Smart, but it's on that very issue of how do we get different people into government who have in many ways the kinds of traits you're talking about, because the traits so often--not always--and there's a million exceptions, but the traits that create this sustainable growth in business, the discipline and the ability to be, you know, productively paranoid, responsibly cautious, that is a constant in business but oftentimes gets lost in government, something we've seen many times.

Anyway, so this book, the idea is to try and figure out how to help inspire more people from private sectors to come serve in cabinets and in high levels in government for that, I think, that very reason.

The question I wanted to ask -- and it's worth reading; it's very short.

MR. COLLINS: Yes, sir.

GOVERNOR HICKENLOOPER: I want to file that away.

Return on luck, were you able to . . did you try to estimate exactly what was the order of magnitude of the event? In other words, because different luck has different numeric consequences,. do you do that just through a kind of bottom-line measure?

MR. COLLINS: It's a nice question. And if you'd like to join our research team, that's a good entry because you're thinking the way we did.

What we did is--and Morten, my colleague and coauthor, was just brilliant in coming up with the methodology on this--What we did was we basically said let's go back over the history of the great winners and the comparisons and determine the really significant luck events. We looked at 230 luck events that were--these were the big ones--over the course of the histories of the companies. And we asked a variety of questions, first simply, you know, are there more good luck events or less bad luck events relative to the comparisons? You know, did Amundsen, using that analogy, have more good luck events and Scott have more bad luck events over the course of the journey?

Then we would also look, for example, at the timing of the luck events. So it could be that actually if you get your good luck early, it puts you ahead. And we found actually that they didn't have more good luck, they didn't have less bad luck, but they also didn't have better timing of luck. Now, that was actually pretty distributed.

And then finally we also found--then we went back and we said, could there be just a single luck spike that is just so big that it dwarfs everything else, that you would look at it and you would just simply say there's no way--that if you got that one right, even if you had all the others wrong, it wouldn't matter. What we actually found is that if you compare, for example, two biotechnology companies, as we did, that the winner had a couple of huge luck spikes, but so did the comparison.

And so what we found is that when you basically stood back and said were they luckier, the answer was no. What they had was an amazing ability.

So when that luck event happens--a bad luck event in our case, in our state--it's the performance in the face of that that became the differential variable.

And we came to a term--and I think that this is a very interesting leadership term--not all time in life is equal. **Not all time in life is equal.** And it is performance in the unequal moments that is the huge swing variable.

Do you want to engage the questions or how would you like to do this?

CHAIRMAN HEINEMAN: No. Go right ahead.

MR. COLLINS: So what I would love to do is . . give me a sense of how much time we have so that I honor your needs.

CHAIRMAN HEINEMAN: Oh, we'll give you another seven or eight minutes; how's that?

MR. COLLINS: Okay. Great.

What other questions can I ask for you?

Yes, governor.

GOVERNOR [Lincoln] CHAFEE: You mentioned Southwest airlines. When I was mayor, we had the airport in our city and Southwest came to our city and we had a breakfast meeting with Mr. Kelleher.

MR. COLLINS: Oh, yes, an interesting character.

GOVERNOR CHAFEE: And at the end of the meeting I said, I'm going to buy stock in that company. So it was personality, the personality just leapt off the breakfast table. And you said personalities and charisma aren't that important in success, but in the most successful company, my impression was it was pure charisma from Mr. Kelleher that drove that company. Am I wrong?

MR. COLLINS: You are--I'm not . .

GOVERNOR CHAFEE: I didn't invest in the company. I should have.

MR. COLLINS: Let me respond to that this way: What's interesting is that if you look over at the comparison company, there was also a point where they had a very charismatic leader, but they didn't become a great company, so now we can cross that out.

The other is that if you look over

Southwest's history, Southwest had a long history; they were founded in the late 1960S and they started as a copy of Pacific Southwest Airlines. The original business plan was copy PSA in Texas and then they scaled it brilliantly.

They have had multiple chief executives. They had an executive named Howard Putnam, who was there in the 1960s during the era of deregulation, was a very different personality than Herb Kelleher. And then you have the Herb Kelleher era and now we have the Gary Kelly era. They are very, very different personalities.

If you look at, for example, Sam Walton to David Glass, at Wal-Mart, Sam Walton was a very charismatic personality, and David Glass had a much more dour personality, and yet Wal-Mart continued to do exceptionally well in the David Glass era.

So we tend to focus on the flamboyant, charismatic leaders because they are just so much more interesting. I mean, how could you not like somebody who resolves a trademark dispute by meeting with the CEO of the other company and resolving the event in a stadium with people in pompons, not in a legal court, but with an arm wrestling contest? It's just not normal, but it's interesting.

And we tend not to write interesting things about people who are really good with their accounting statements. I mean, there's just nothing interesting about it.

But that it's interesting doesn't mean that it is statistically differential. And so what we found is that it is there are lots of personalities. And whether a leader--in our research;. maybe different in your world--whether a leader is charismatic or not;. it's like whether you have blonde hair or brown hair; it's just an attribute but not the essence of leadership.

One last thing on Herb Kelleher, he was one of the great executives that we studied. A friend of mine who spent a long time working with him, Kelleher, summed it up this way: he said, he had the flamboyance of an Irishman, but the discipline of oppression.

governor.

GOVERNOR [Jay] NIXON: I just wondered, we operate in an environment in which there are legitimate players in that environment that don't want to see us succeed, be those the forces that don't want to change an educational enterprise or, quite frankly, sometimes in a legislative setting some less-evolved people, and are also burdened by what you talked about not having full operational control.

In dealing with those forces in our sector that literally don't want to see us succeed and cause then--you know, because a lot of what you're focusing on is getting an operational--you know, getting a vision and accomplishing that vision.

Is there any advice or any insight you might have in dealing with those who legitimately or illegitimately, honestly or dishonestly, but do not want to see us succeed?

MR. COLLINS: Yeah. First, I'm not going to try to extend to your world and say, hey, let me tell you how to do it as a governor; that would be folly, but allow me to show with you two things that.

GOVERNOR NIXON: If you figure I could get a couple of guys I can send . .

MR. COLLINS: What we did learn from watching our companies, and in the good to great study, you learn a lot about this because you had average companies that were doing okay, and there were a lot of forces of resistance within those companies when the leaders tried to make them outstanding because the moment you try to really go from good to great and produce something truly excellent, the standards go up so much that it's exhausting, and there are often people who don't want to go down the path of that exhausting, that intense, that what's required to do something that exceptional, so they resist.

How did they overcome this? Two things that I would pass along.

The first is that they really did begin with asking which seats can I change? And are there key seats that you can decide who sits in that seat? And that when you can do that--a lot of it began with I need to put the right people in the seats where we can have the--now, we can't change every seat, and that may well be the reality, but you start with the question of "who" rather than "what" and where are the key seats that I can change.

The second is--and we're right about this idea called fire bullets then fire cannonballs--and the idea being that you can try to do wholesale change by firing a big cannonball and hope it hits. But what our leaders tended to do was they said, you know, the danger with that is that uncalibrated cannonballs that miss really damage your credibility.

So what they tend to do is they tend to take what gunpowder they have, their resources, their capital, the things that they can draw upon and they fire bullets to get calibration to prove that something can work. And once they have that calibrated, then they will point to that and say it's working. See, we actually have a bullet that's hitting. Now, my argument is let's make this successful thing bigger rather than trying to convince people to accept an as yet, unproven cannonball.

My observation looking at it from the outside is that for whatever sense of reasons we might find in the government side a lot ever uncalibrated cannonballs, but, in fact, bullets then cannonballs tend to work better.

One of the executives that we asked who led a great change in a grocery store company, I said, how did you get people behind the change?

He said, we proved it would be successful with a single store. Then we said, let's now do two stores and then let's do four stores. And then as we let the actual results be the greatest talking point, those who want to be part of something that will work would line up and those that didn't want to be helpful would tend to go into smaller seats.

CHAIRMAN HEINEMAN: Governor [Mary] Fallin, Governor Markell, and then --

MR. COLLINS: And then we got to go, you got it.

Which governor?

GOVERNOR FALLIN: Right here.

MR. COLLINS: My family is from rural northern Oklahoma, so it's very nice to meet you.

GOVERNOR FALLIN: Oh, wonderful. Where at in Oklahoma?

MR. COLLINS: About a hundred miles south of Wichita, about 25 miles north of Enid, and about three miles south of a little town called Pond Creek, yes. You probably know that. There are very few people who do know where Pond Creek --

GOVERNOR FALLIN: It's a small place.

MR. COLLINS: Yes, exactly.

GOVERNOR FALLIN: I appreciate your comments; and thank you for being here.

It's kind of interesting what you're talking about. Two different things I wanted to give an analysis of how it's affected Oklahoma. But you're talking about the cannonball approach --

MR. COLLINS: Yeah.

GOVERNOR FALLIN: -- and the one shot versus the scatter approach but --

MR. COLLINS: Or at least calibration and then going big.

GOVERNOR FALLIN: And then to the bigger one, yeah.

One of the things we did in Oklahoma when I first took over a year and a half ago, I discovered that we had 76 financial accounting systems in state government.

MR. COLLINS: Seventy-six?

GOVERNOR FALLIN: Seventy-six.

So when I started doing the budget and looking at our expenses and our revenue, it was hard to match apples and apples because we had 76 different types of spreadsheets basically and couldn't match information. So we went around talking to our IT people in the different state agency functions trying to convince them they should go to one system that would match. And, of course, that was very challenging because everybody wants to hang on to their own program and their own thing.

So we finally did convince the group, the agencies to do this, but we couldn't get higher education to do it because they want to have their own institution, their own kingdom. And there were 25 institutions of higher education.

So anyway, we got the state done and we

ended up projecting that we're going to save about 25 percent of our IT costs in our state, so I went back this year and I told higher education, look, you're always wanting more money for higher education, you're always talking about tuition increase and keeping--we're trying to keep college costs down. If you would do this IT reform, then you, too, could save money.

And so anyway we got them to do that, but we started out with the one thing and finally convinced the big picture and now we have the whole state of Oklahoma. And we estimate it's going to save about 300 to $500 million on IT costs statewide.

And the second thing you were talking about, another interesting point about we didn't cause it, could go really bad, and uncertainty to be able to predict it, reminded me of our Oklahoma City bombing back in 1995. I had been in office 100 days and certainly didn't expect somebody to blow up a federal building and kill 100-some-odd people in that event, but what I found in leadership was it's how you react to something that happens that's so unexpected, that's so horrendous; and your character and your leadership can be defined by how you react to that. And it can go either really bad or it can go good. And in our case in Oklahoma it went good because of how the governor at that time and his leadership team handled that terrible crisis that was so unexpected.

MR. COLLINS: It would be just a quick question for you. Do you think the ability to do that and to be able to perform exceptionally well in the unexpected is something you can train before it happens?

GOVERNOR FALLIN: Well, I think your life experiences and your work experiences certainly prepare you for that, but we also saw some other states that went through some huge tragedies where things didn't go very well.

You may look at Katrina . .

MR. COLLINS: Yeah.

GOVERNOR FALLIN: You know and some of those measures in those areas.

MR. COLLINS: Interesting. See, I would imagine that in the world of leading within a state over the course of at least one term there will be at least one major event, and it will be a swing, a swing variable.

What I think is puzzling is how do you be prepared for what you can't possibly be prepared for?

GOVERNOR FALLIN: One of the things I did recently, I took my whole cabinet through a Homeland Security disaster training preparedness to think of all the things we might not normally do. We do grass fires, like Colorado; we do tornados, floods, and all that stuff. But the bigger picture things; you know, what do you do if all the communication systems in the whole state go down? What do you do if all of your financial accounting services go down and you got all these different bills you have to pay and then you have to . .

MR. COLLINS: Sounds like some good productive paranoia.

There was one last question.

Yes, governor.

VICE CHAIR MARKELL: So in looking at the top year monograph why business thinking is not the answer, I masked off in what I think the difference is, the biggest difference is between being in business, which I was . .

MR. COLLINS: Yes.

VICE CHAIR MARKELL: . . before I got into government, so between business and government, and the answer I most typically give is that the biggest difference between business and government has to do with the different attitude towards failure; and that in business you have to take risks. If you're not coming up with a better product, if you're not coming up with a new distribution channel, your opposition will and you won't serve.

In government, so many of the incentives work exactly the opposite because if you take a risk and it doesn't work, you read about it in the paper, the state auditor will do a report on it, your next campaign opponent will use it against you.

And it seems to me that one of the biggest challenges and most important things in our job is to help change the culture toward one where people are more willing to take risks, but changing the culture in an environment where many of the folks who work in our state agencies will be there for 30 years and that they know for most of us the most we can be there is for eight.

And so I'm just wondering if you have any thoughts about how to do that?

MR. COLLINS: We can have a long conversation about that, and I'd be delighted to accept a phone call to chat about it.

I would point to two things. One is that in the business side, you're absolutely right. And one of the things I think that entrepreneurs are very comfortable with and one of the things that allows our system to work so well is the fact that if you're a failed entrepreneur that then later succeeded, that's a tremendous badge of honor. I mean, and to some extent took a risk, it didn't work, and then you figured out from that how to be successful.

And what's very interesting about that is when we went back and we looked, we found a negative correlation from being successful right out of the gate and building great companies.

Most of the great companies started with some failures, but then they learned from those failures. And then as a result, by saying, boy, we're in a situation where we can't afford to have this failure, they then were able to make themselves better.

The interesting question is, how do we connect--I think this is a big question and maybe this is a good place to end--if I sort of zoom way, way out, and I ask myself, what are one of the great challenges for us as a country? It's not . .the question is, how do we connect the relationship between decision and consequence of decision systematically across everything?

And when people have the consequence of

decision, they tend to make very clear decisions. And there's- I think one of the really interesting questions for us--by the way, I would welcome from any of you if you ever want to continue a conversation, no one will ever know my politics; it's one of my deliberate strategies in life is to be completely apolitical. I serve leaders. And if any of you ever want to have a follow-up conversation, I am available for any conversation that anyone would like to have.

I wish you well. Set a really big BHAG that your successor succeeds with. And it's a great privilege and an honor. I hope we've contributed you at least one idea that can help your states be even better.

Thank you.

(Applause.)

CHAIRMAN HEINEMAN: Jim, thank you very much. We enjoyed the presentation and the discussion.

I assume we can get from Governor Hickenlooper his personal cell phone so we can contact him.

So, John, thank you very much.

We just want to take a few minutes now and recognize two outgoing governors and several of our corporate fellows.

First of all, we want to recognize the American Samoa governor, Governor [Togiola] Tulafono. He is very well respected in American Samoa, and he has been very dedicated to the NGA.

Faced with a grueling 14,000-mile round trip, he has participated in every NGA winter meeting since he became governor; he served on three NGA committees that span the gamut of issues from health to education to economic development; his membership on the Economic Development Committee, in particular, mirrors his commitment to advancing and protecting the economic well-being of the people of American Samoa.

Governor Tulafono has been a valued member of NGA, and we extend to him his wife, Mary, and their entire family our appreciation and warmest regards.

If you'd come forward, we have a presentation we'd like to make to you.

(Applause.)

GOVERNOR TULAFONO: Thank you.

CHAIRMAN HEINEMAN: I imagine you have more frequent-flier miles than all of us combined, given what you've done.

Finally, we want to recognize Washington

Governor Chris Gregoire. I was honored to serve as her vice chair. She hit the ground running when she joined the NGA, bringing her passion, boundless energy and immense talents to raising the association's profile and representing the interest of states.

During her tenure as the chief executive of her state, Governor Gregoire has served with distinction on six NGA committees and five task force; several of her contributions merit special recognition, including her service as chair of this organization in 2010 and 2011.

As Council of Governors co-chair, Chris has been integral in solidifying the authority of the states in responding to natural disasters and other emergencies. It is in large part because of her leadership and determination that governors have been successful in securing dual status command and in preserving funding for the Air National Guard to continue its critical mission of protecting Americans at home and abroad.

We will miss Chris and the first gentleman, Mike, who must be out there with Maureen and Sally doing something, but we know that great opportunities lie ahead for this governor and the first gentleman of Washington.

And, Chris, if you would come forward, we'd like to present a token of our appreciation.

(Applause.)

CHAIRMAN HEINEMAN: I imagine that she will volunteer even when she's left to head up a special task force or whatever, so we appreciate that, too.

Ladies and gentlemen, we also want to take a moment at this annual meeting to recognize all of our corporate fellows for their collective support and to recognize those companies that have maintained a sustained commitment to governors and the work of the NGA Center for Best Practices.

Founded in 1988, the NGA Corporate Fellows Program promotes the exchange of information between the private sectors and governor on emerging trends and factors affecting both business and state government.

The Corporate Fellows Program comprises more than 100 of America's top companies. We really appreciate their support to our effort.

And I'd like -- where did Governor Markell go? Did he try and sneak out on me?

Okay. Well, Chris, I probably ought to call you back up here to do this, but we want to recognize three companies in particular, and I want to start with for 20 years of membership in the Corporate Fellows Program, Hewlett-Packard. I believe Larry Singer is here to accept this.

(Applause.)

CHAIRMAN HEINEMAN: We also want to recognize for 20 years of membership in the Corporate Fellows, Proctor & Gamble. Pat Hayes is here to accept this award.

(Applause.)

CHAIRMAN HEINEMAN: Finally, we want to recognize Wal-Mart for 15 years of membership in the Corporate Fellows Program. Gerard Dehrmann is here to accept this award.

(Applause.)

CHAIRMAN HEINEMAN: I want to make one more announcement before we adjourn. Following the NGA meeting on Sunday, there will be a special screening of the upcoming informative movie release, "Won't Back Down," a film about two mothers who worked together to transform an inner city school. I want to thank Governor Hickenlooper and others who brought this to our attention. And it will be shown on Sunday in the Rockefeller room, at 12:30 p.m. for those who want to attend.

Before we adjourn, I would just like to make everyone aware the education session begins in this room at three o'clock, so we need to give the staff a little bit of time to reset the room here.

Governor Haslam.

GOVERNOR HASLAM: If I could make a plug for that, Governor Hickenlooper and I will be leading a discussion; we have had Education Secretary Arne Duncan coming, former Education Secretary Margaret Spellings talking about the reauthorization of ESEA. Obviously, former secretary Spellings was vital in implementation of No Child Left Behind. They both obviously think that we should have reauthorization, but they have little different views, so I think it will be a really helpful time. It's stuck in Congress. Our voice could make a difference in how it comes out of there, so I would urge you-all to come at three o'clock.

CHAIRMAN HEINEMAN: Governor Haslam, thank you.

Governor [Gary] Herbert.

GOVERNOR HERBERT: Let me just add to that, too, that we have scheduled at four to five o'clock tomorrow, Saturday at the Jefferson boardroom a digital learning session designed to kind of piggyback on what will be talked about here in education of the use of technology, how we can do more with less and raise the bar academically with use of technology, so we invite people to participate in that tomorrow.

CHAIRMAN HEINEMAN: All right. Thank you very much. We'll reconvene the Education Committee here in about 12 or 13 minutes.

We are adjourned. Thank you.

(The proceedings adjourned at 2:46 p.m.)

COURT REPORTER'S CERTIFICATE

I, Scott D. Gregg, Registered Professional Reporter, certify that I recorded verbatim by stenotype the proceedings in the captioned cause before the National Governors Association, Williamsburg, Virginia, on the 13th day of July, 2012.

I further certify that to the best of my knowledge and belief, the foregoing transcript constitutes a true and correct transcript of the said proceedings.

Given under my hand this day of , 2012, at Norfolk, Virginia.

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Scott D. Gregg, RPR
Notary Public
Notary Registration No. 215323

NATIONAL GOVERNORS ASSOCIATION

CLOSING SESSION

GROWING STATE ECONOMY

Virginia Ballroom
Williamsburg Lodge Conference Center
310 South England Street
Williamsburg, Virginia
July 15, 2012

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GOVERNOR JACK MARKELL, DELAWARE, VICE CHAIR

GUEST:

STEVE BLANK, AUTHOR AND PROFESSOR

P R O C E E D I N G S

CHAIRMAN HEINEMAN: All right. Ladies and gentlemen, thank you for being here for the closing session of the 2012 NGA Annual Meeting.

I think you'll enjoy our speaker today. Our topic today is “Growing the Next Big Idea.”

I think every governor, Steve, would like to know the answer to that one.

And we are joined by author and professor Steve Blank. He cofounded his last company, Epiphany, in his living room in 1996. He has had eight startups, including two semiconductor companies, a workstation company, a supercomputer firm. I can kind of go on and on; maybe most importantly a video game company, too.

After 21 years in high technology companies, Steve took time to reflect on his experiences and wrote a book about building early-stage companies called *Four Steps to the Epiphany*. His latest book, the *Startup Owner's Manual* integrates 10 years of new knowledge.

He's done a variety of things, if you can imagine, from being an entrepreneur, to teaching entrepreneurship at UC Berkley, Stanford, and Columbia. And I asked him I couldn't imagine how he did it at all three, but maybe he'll explain that.

But we are very honored and pleased that he would spend time with us this morning. There will be plenty of time for questions when he's finished.

Ladies and gentlemen, Steve Blank.

(Applause.)

MR. BLANK: Thank you, governor.

CHAIRMAN HEINEMAN: You're welcome.

MR. BLANK: Thank you very much. I'm honored to be here. I should have realized that business casual in a government conference means you wear your blue suit rather than your black suit on a Sunday, so I'm sorry I'm a little underdressed.

But the subject of my talk will be "Growing the Next Big Idea."

And what I want to share with you are some of the things we've learned in both Silicon Valley, working with government agencies, working with small businesses and large corporations on how to build new ventures and create new jobs.

Now, we've learned a whole lot of new things in the last couple of years, and I thought I'd share them with you in the form of four lessons.

Lesson one, the different types of startups.

Lesson two, what a startup ecosystem looks like.

Lesson three—and kind of the most important, at least for me is—we think we know now how to make startups fail less, which is kind of a polite way to say over a large number of them, we actually know how to make startups succeed more.

And then the last question is, can we actually teach what we now know on how to build companies and create jobs?

And I'll share those with you as quickly as I can and then take questions at the end.

So lesson one: Types of startups. You know, one of the things that confused me when I left industry—and I had done startups for 21 years; and to me a startup was a high technology, high growth, you woke up in the morning and your goal was to build a billion dollar company. And I started attending other professors' lectures and heard them start talking about startups in a language and descriptions that I had never heard before until I realized that we were using the same word to describe multiple things.

It turns out that there are different types of startups. Number one, a lifestyle startup, people who work to live their passion; they serve known customers; they have known products. For example, in California, since we're near the beach, the surfers who love to surf hang up a sign on their surf shack that says lessons, 9:30 to 10:45 a.m. They make enough money, they put the closed sign up, and they go out surfing. These individuals are doing startups. They are self-employed, but they are creating jobs maybe for themselves and maybe for one or two assistants.

There's another type of startup, which is really popular in college campuses, social entrepreneurship startups. These are entrepreneurs who want to dedicate their lives to solving pressing social problems. They either want to build a company to do that and make it profitable, Ben & Jerry's, Seventh Generation, *et cetera*, or they want to create new social innovation and new nonprofits. Their goal is to go from a social startup into a large nonprofit.

Another type of startup is the one that my parents actually started. My parents were immigrants to the United States. I'm a first generation American. Their dream in this country was to open up a grocery store. And they worked in sweat shops in New York for 15 years, saving every dime they had. And finally they were able to do that.

What I didn't realize at the time is my parents were entrepreneurs. They did a startup. Their goal in setting up a grocery store was to serve a known customer with known products. And if they were successful, they were able to feed our family. And some days they weren't successful, and we were just eating stuff off the stock of the shelves. But in others, eventually they grew the business.

And what's really interesting is their exit criteria wasn't a billion dollars, wasn't even a million dollars. In fact, if they made $500,000 in their entire lives, it's probably $400,000 too much. Their goal was to build a profitable business and find a business model; that is: Who were their customers? What can they charge? What products should they carry? And they did it with an existing team.

Now, what's interesting is in Silicon Valley we kind of look down on small businesses and say these are lifestyle businesses, and that's a mistake because small businesses are the heart of the US economy. There are 5.7 million small businesses in the US, and they make up 99.7 percent of all companies. They employed about 50 percent of all governmental workers. Small businesses are entrepreneurs. They do startups, and it's the type of startup we actually need to think about and figure out whether the processes we're using in building for technology startups can be applied to them, and I'm going to show you how we can do that.

The other type of startup which gets all the press are what I call scalable startups, sometimes called high-growth startups. These are the ones you see in the news all the time. This is Steve Jobs and Steve Wozniak when they first started.

A scalable startup is designed to grow big. These founders wake up in the morning and say, we're going to build a company that's going to take over the universe.

Now, one or two things are true. Number one is they are visionaries; or two, more than likely they are hallucinating, okay.

But a scalable startup not only is designed to grow big from day one, it typically needs risk capital. And risk capital is a fancy word for venture capital or angel funding or some type of private capital that's used to dealing with risk because what I'll mention multiple sometimes is for this class of startup, over 90 percent of them fail. Let me say it again: Over 90 percent of scalable startups fail.

Now, who would be crazy enough to invest in anything like that? I guess the housing market, but . . but besides the housing market, what we have is a startup class that most fail, but the returns are so large and so huge they attract a special asset class: risk capital.

And so the goal is to sell for unknown customers; and what they are looking for are markets half a billion dollars or greater, and they want to grow to a hundred million dollars a year in revenue.

There's a new type of startup in Silicon Valley and in your states that is emerging only in the last couple of years, and I call these buyable startups. And a buyable startup are typically software companies built around engineers developing applications for mobile phones for the web or for the Cloud. And for the first time, it no longer takes millions of dollars to start these companies; these are being started on credit cards on laptops using resources on the web.

And while you think these just might be small, little companies, Instagram, which was what I would call buyable startup, got sold for a billion dollars to Facebook. There's a new class of startups that don't require large amounts of capital, and their goal typically is to sell to a larger company.

The last type of startups which you wouldn't believe are startups are large companies. Large companies do innovation in your states all the time. And what they mostly do is what a professor in Harvard, Clayton Christensen, called sustaining innovation. Large corporations to stay in business have to continually innovate around their core products; they need to make them faster and smarter and cheaper.

But something has happened in the last two decades that is really changing the nature of large corporations, and that's, in fact, that the cycle time, the amount of time they have to stay on the top of the pack, has been incredibly compressed by globalization, by technology shifts, by regulatory shifts.

And, In fact, large corporations not only now need to deal with existing markets and known customers and known products, they need to deal with disruption. And disruption is when they have a great core business, and some crazy comes along and says, we're going to take out this company.

The best examples of this are two of the smartest companies--anybody ever have a Blackberry?

Yeah. Or Nokia phone?

I was in Finland talking to someone who was at the Nokia board meeting the month the iPhone came out. They passed a copy of the iPhone around at the Nokia board meeting and the fatal quote was, why should we care about this? What's their market share?

On day one to a large corporation, disruption looks like a toy. It's a big idea. A disruptive innovation to a big, existing company always looks like a toy on day one. It has zero share. That's not what Nokia and Rem are thinking now. And I use those as examples because those were smart, great companies that every year were doing great sustaining innovation but didn't understand that they were being disrupted.

And so how large corporations need to deal with disruption is they could either build their own disruptive technology, they could partner with other companies, or they could acquire startup technology, intellectual property, talent, products, customers, their entire businesses. And disruptive innovation inside a large corporation looks exactly like a corporate startup.

So now we kind of have the types of startups. And the summary for this first piece is the policies, funding, and tactics in each of your states to deal with small business startups, scalable startups, corporate startups, the tactics are different, but the techniques I'm going to show you a little later are identical. We now understand what's common between them so just hold on a second.

The second thing I thought I'd share is the history of a startup ecosystem. I spent my last 34 years in Silicon Valley, and I kind of got used to the fact that we have a technology ecosystem, an infrastructure that feeds on itself but never quite understanding where it came from. And, in fact, the reason I'm going to share this with you is I now do a talk called the Secret History of Silicon Valley, which you can find on YouTube.

The reason why is when I asked some of my engineering students where did Silicon Valley come from they said, oh, some old guy named Steve Jobs started it. And I went, well, perhaps--then I asked my other friends, well, you know, what was the government's role? Well, the government had no role. It was all about venture capital.

So I just want to share with you a thumbnail sketch about this ecosystem and more importantly not about the Valley, but what is it that we can extract; what are the rules that we kind of can learn from Silicon Valley?

Silicon Valley was a series of unintended consequences. It was not designed. Number one is it started with Stanford University, an outward facing researching university. By "outward facing," meaning it had deep university, military, and industrial ties from day one building weapons systems.

During the middle of the Cold War, Stanford's engineering department had a secret 400-person weapons lab building electronic warfare and electronic intelligence systems funded by the DoD and all our intelligence agencies.

At the same time, there was massive government R&D in weapons systems. Silicon Valley in the 1950s, '60s, and '70s was not a startup center; it was a defense center. Lockheed Missiles and Space would set up its facility in Sunnyvale, California. In 1956, it had zero employees. In 1960, it had 25,000 engineers working in what becomes Silicon Valley, building the Polaris, Poseidon, and Trident submarine launch ballistic. And at the same time, building all the overhead reconnaissance satellites for the CIA, NSA, and National Reconnaissance Office, CORONA GAMBIT, HEXAGON, and others.

Silicon Valley started by massive government funding by accident. And one professor connected this government, military, and engineering culture into an entrepreneurial culture. It was Fred Terman, professor from Stanford, who ended up as dean of engineering and then provost at the university that said, look, we'll do government research in our labs, but any production of systems, I want my students to spin out and start companies. And, in fact, it's great for the country. This is the 1950s. If my academic researchers, my professors sit on boards, become advisors, invest in all these startups, I want my engineering department to face outward as well as facing inward. And that was a radical shift in the 1950s and '60s. And the culture of Silicon Valley started with this one professor who said it was great to take our inventions and help the country in the middle of the Cold War.

By the way, venture capital that is investing in startups, actually, believe it or not, was started by a response to the launch of Sputnik, the first Soviet satellite in October 1957.

US Congress decided that we were falling behind the Soviets in technology and launched a series of programs, NASA, ARPA, and also launched a program called the Small Business Investment Corporation as part of the SBA that would match 3-to-1 any investments in new companies.

And so the first set of venture capital was actually an unintended consequence of Sputnik. And, in fact, venture capital was, in fact, government funded. By the mid-1960s, three-quarters of all the VC firms in the US were SBIC programs. It was only until the invention of something called the limited partnership in the late '60s and the '70s that venture capital took the form that we needed and we now use which does not use government money.

And then in the late 1970s regulatory changes changed venture capital once again. All of a sudden, pension funds were now allowed through the "Prudent Man Rule" to invest up to 10 percent in, quote, risky ventures. And the amount of capital available to Silicon Valley investors went from millions to billions of dollars literally within a year. And venture capital, as we know it, took off in the late 1970s.

There's two key lessons from this whole soliloquy. One is we built a culture that embraced technology risk. We recognize that 90 percent of startups fail. Imagine in your states if 90 percent of your programs failed.

It turns out in our culture, failure equals experience. We understand that these are the risks. And more importantly the culture embraced financial risk. Investors who invested in these companies understood that 90 percent would fail and so did their limited partners. They also understood that it was the 10 percent that would return unbelievable amounts of capital. And so they were investing to find out of those 10, 20, 30 companies in their portfolio, the one or two that would become the Apples or the Googles or the Facebooks.

And what they brought to Silicon Valley was not just money. And if I emphasize anything here, it's the importance of smart capital if you're trying to build an entrepreneurial culture. By smart capital, it is not writing checks to entrepreneurs. That's dumb money. What you really want is experienced advice, tolerance for risk, and the long-term interest. Startups take years, and some of them decades to come to fruition. And you need people who have had the experience and understand what it takes to coach an early-stage venture from a napkin into a billion dollar company.

So what lessons can we learn to build

innovation without Cold War funding?

One is that it really requires an ecosystem. I won't bore you with a graph, but it requires infrastructure. I mentioned some of the other things in this slide, research universities, economic systems, legal systems, 24/7 utilities. Because when I show this in other countries rather than other states, some of those things on the right really aren't even available there.

But for your states, number one is to think about research universities. That is a place to start thinking about building a core of innovation.

The second is culture. Startup culture is very different than building normal businesses. We take risks, we build on each other's expertise and accelerators and incubators. And we like our universities to learn how to be outward facing.

We've now developed a series of management tools that I will show you in a minute that we've now learned how to make startups fail less -- it's a big idea--and the motivation for the ecosystem is capitalism.

If there's anything to remember about startups, it's not just about the great entrepreneurs;. it's about the ecosystem that's a circle between startups and risk capital who make enormous profit by funding most of them who will fail. And it's building this ecosystem that's critical in getting any entrepreneurial cluster off the ground.

So here's a sum of what it would look like, but let me just point out the lessons.

The lessons are here that we want to understand that entrepreneurship requires a healthy ecosystem of all these pieces. But at the end of the day, unless you have investors who are not acting like bankers but are acting like venture capitalists and experienced angel investors, you will just have a pile of very small entrepreneurs looking around for money. And the best thing that we could do is figure out how to encourage that top part of the ecosystem.

So lesson three, making startups fail less, here's some lessons that we've learned in the last couple of years that I think are fairly critical and are going to be counterintuitive to everything you might know. After 50 years of Silicon Valley history, we now know how to build startups.

First of all, in Silicon Valley we take more technical risk per square foot than probably any other place in the world. More technical risk. And you would think startups would fail because the technology fails. It turns out over 95 percent of startups that fail, fail because they didn't find customers and markets. It's not because their technology didn't work, though it's never on time, I will guarantee you--I guess the engineers in the room are laughing, but it's because they don't find enough customers and markets. It's a big idea.

While we're investing in the technology, the things that don't work for these companies is, oh, we didn't know where our customers work, or we priced it wrong, or we had the wrong distribution channel.

Yet, what's really interesting is how we used to build companies. We used to believe that startups were nothing more than smaller versions of large companies. Now, this is really interesting. I was a business school professor, and I was consulting for a large corporation that had 10, 20, 100,000 people, and I was helping them; I'd say, how hard could it be to, like, give advice to a startup? There's two guys in a garage. You know, these just must be smaller versions of large companies.

So everything that we've learned in the last hundred years about building large corporations, we're just going to tell startups to go do, and that's what we did for 50 years in Silicon Valley. We said, oh, we've got it. They are smaller versions. We now know that they are not, and this is a huge insight.

We now know that startups search for something and the large companies execute. And what that means is startups are searching for who their customers are, what their channel is, how to price the product, *et cetera*. Large companies have been around for a while and they know who their customers are, and they know how to price the product.

This distinction between search and execution is not just a set of words; it's actually the difference in how we would build these things. What we used to believe is that all we have to do is write a business plan. Anybody ever see a startup business plan or a business plan? Yeah, it's a nice document, and it's, you know, big.

Well, we now know we actually have an actual photo of what happens when the plan has first contact with customers. I now found this photo that absolutely represents what it looks like.

All right. What we now know is that there's no possible way that you could write down in a document, sitting in your office or your library or with consultants what the real world looks like. The real world is chaos. But if all we're trying to do is make a plan, we've gotten ahead of ourselves.

And, by the way, if you've ever seen a plan--everybody knows appendix A is the five-year forecast, right? We love forecasts. Tell me what the future is going to be like. And you're sitting here going, I don't even know what tomorrow is going to be looking like, but my investors want a forecast. Okay. I'll type it. I always tell my students there's a secret Excel key code that will auto generate this, and they are still looking for this.

Now, but no one, no one in the history of entrepreneurship ever said, who else used to do five-year plans? And how successful were they? These were the only guys who used to do five-year plans. And we know how this ended up.

And so really if we think about this, what's wrong with this? By the way, I'm not suggesting we never do planning and never do forecasting. I am not suggesting that.

I am suggesting for a startup, what is it that we now know? What we now know is no business plan survives first contact with customers. The reason why is we tend to write it with certainty, but with no facts.

So searching comes before you write this plan. And the question is, searching for what? And this starts by first defining, what the heck is a startup?

So let me give you Steve's definition of a startup, because I never had one. As an entrepreneur doing eight startups, I never even knew what is it am I supposed to be doing other than it's fun serving dinner at night and free food and, you know, you bring your dog to work, but what exactly is a startup?

Number one, which was a real shock for me thinking about it, a startup is a temporary organization. The goal is not to say a startup. In fact, there's no such thing as a 10-year-old startup. There's a 2-year-old startup attached to an 8-year-old failure.

Two is a startup is designed to search for something that's repeatable and scalable. Repeatable means I can do the same thing on Monday and it works on Friday. Scalable says I put a dollar in, I get 1xN dollars out for repeatable and scalable business model.

Now, this is kind of interesting because this all made sense to the word "business model." What the heck is a business model? I thought my job is to build; you know, build a product or to get customers. What do you mean searching for a business model?

So let me give you a quick definition. A business model is how a company creates value for itself and its customers. And it basically says, look, while your company is about your product, it's also about your customers and your channels; that is, how you get your product to the customers; about how you create demand; how you get revenue; how much this stuff costs; you need partners; and what do you need to do? Activities and resources. That is, a business model is all these pieces.

And on that day one, most startups just have guesses because all these guesses are--in fact, at Stanford, because students pay $50,000 a year, I don't use the word "guesses," I use the word "hypotheses" because it actually makes them feel they are getting value for their money. But in other places outside of major universities, we just call them guesses.

If you really think about it on day one, a startup is a faith-based enterprise. It truly is. It's driven by its vision and irrational passion of its founders. The mistake is continuing to operate it as faith-based because what you truly want to do is turn that faith into facts as quickly as possible. And that's the big insight. It's okay to start it with a faith-based hypothesis because you're guessing about a lot of things.

And so what we really want to do is draw this business model on the wall, put Stickies on them, *et cetera*, but now how do we change these guesses into facts? And that's the invention we came up with in the last couple of years, and that's called the customer development process.

It says everything you know or think you know is a guess, so let's get out of the building in a formal process and start testing this a step at a time. And we can test this incredibly rapidly.

Now, the last thing we kind of know--and this is something that took me decades to understand--in a startup, it used to be that when you failed, you made a mistake, you picked the wrong customers, you didn't make your revenue, you fired the VP of sales. And when that didn't work, you fired the VP of marketing. And when that didn't work, you fired the CEO and you shut the company down.

But we now know that most of the time startups go from failure to failure. This is a big idea. Startups don't go from success to success. It only happens in the movies. So the question is, what do you do when the hypotheses don't match reality?

We've come up with a term called "the pivot." The pivot says, look, this is going to happen all the time, so why don't we just embrace the fact that failure will happen; and when it does, we'll change some of our business model. We'll either change the customers or the channel or the pricing. And it's okay as long as we have cash left. And if we embrace the fact that this is part of the process, we'll fire the hypotheses before we fire the founders and executives. And that's a huge insight about early stage ventures.

And so pivots are the result of all these out-of-the-building hypotheses testing and experimentation. And we do this with speed and we do it on a tempo and we do it with a rational focus.

So, in summary, making startups fail less, big idea. Take away, is startups are not smaller versions of large companies. Huge. All the tools and techniques that any of you or your staff has learned in business school for the last hundred years, we've actually taught great tools for execution.

Remember, an MBA, masters of business

administration, not the masters of starting companies. Those tools are excellent for growing large corporations, but we never had our own tools for building early stage ventures; we just kind of tried to adopt these old tools.

What we now know is that before you do a plan, whether it's an operating plan or a financial model, you want to actually run a customer development and business model process before you write the plan.

And so the interesting question is, if you believe any of this, can we teach it?

So we've put together a class in these universities, Stanford, Berkley, Columbia, Cal Tech, and we've also put it together for the National Science Foundation. Within eight weeks, we get teams in front of a hundred customers. We're not talking about doing a survey; we're talking about out of the building, a hundred customers.

Now, you have to be deaf, dumb, and blind not to get some feedback talking to a hundred customers. And not only do I do it for these universities, but last year, the US government adopted this process. The National Science Foundation now uses this; they call this the innovation core to teach the top scientists and engineers in the country to get out of their labs. And we do the same thing, except this time instead of 22-year-olds in hoodies and flip-flops, we're doing it with 45-year-old tenured professors who probably haven't left their labs since their PhD world defense. And we can make them--and we have made them--work as fast as these early-stage ventures.

The National Science Foundation thought this was so productive, they are now scaling this to teach hundreds of teams, of our best scientists in the United States. And other research organizations of the country are adopting the same class. And you'll see other announcements; in fact, NSF will have a major announcement this coming Wednesday.

Because it was the National Science Foundation, they instrumented this class, and they said, Steve, okay, we hear you, we hear this business model customer development stuff, blah, blah, blah, prove to us it works.

So what they did was surveyed students about knowledge coming into the class. What did you know? And the orange bars on the left are essentially we didn't know anything. And if they were successful, we'd move the orange bars to the right to kind of like--some in a great deal. So here is what they knew coming into the class; here is what they knew going out. So, number one, we were able to say we actually taught them a lot about how to build startups. But you know what, that wasn't the goal. That was kind of nice. What we wanted to do, if we could teach them, is how to commercialize their technology and build companies.

So what did the data say about building companies? Again, what did you know about building companies?

Coming into the class, after the class.

And the National Science Foundation kind of said, I think we have something for the first time in 30 years that bridges the gap between basic research and SBIR and STTR grants, which is their funding for commercialization. And they were pretty impressed that we had a process that works.

But for me, I wasn't satisfied. Well, it's nice to teach the elite in our country. If you remember, my definition of entrepreneurship embraces small business, large corporations, and the rest. And because my parents and my background was small business, my question was, well, what about the other 99 percent? Because this same generic process, the same customer development business model design worked for grocery stores, dry cleaners, small businesses trying to get off the ground. Could they use this technique?

Because if you go to the sba.gov site, guess what they tell you to do? How to write a business plan. This was taken this morning. We're still using the same business tools for small businesses from the '50s.

We believe these techniques can now help small businesses fail less. We're working with professors and organizations like Utah--Weber State, in Utah to apply them to small businesses. Other colleges and community colleges are adopting these processes as well. And we believe it will be applicable not just to high-technology, high-growth companies, but to the other 99 percent on Main Street.

So let me close.

What can states do? Let me give you four or five short ideas.

Number one is the culture for entrepreneurship is fail fast and move fast. It's about speed. And it's about not a gotcha game. That we embrace failure as part of the process which, by the way, is counterintuitive when it's a federally or state-funded project, which is why I believe, as you'll hear later, it's something that private capital needs to do. Failure is part of the entrepreneurial process.

Recommendation two is there are incubators and accelerators, that is organizations nationally that are coming into all states who will have them to help concentrate entrepreneurs and give them advice, organization, et cetera.

Startup America happens to be my favorite, along with Startup Weekend. TechStars, a national venture capital firm, links Startup Machine. These are terms that you should all hear about. And, in fact, if you don't have one of these going on in your state, you should figure out how to encourage one or hopefully all of them to set up shop because they add value.

Recommendation three is if you remember my comments about ecosystem, you could have all the smartest entrepreneurs in the world--and I won't tell you which state I travel to which graduates 6,000 world class engineers out of their state university. And at graduation, I swear they must ask, where do you want the plane ticket, East Coast or West Coast? I think that's a waste of enormous talent. What they don't have locally next to that university is a risk capital culture. They have an entrepreneurial culture, but they haven't figured out how to incent private capital to take risks and instead sending their best talent out of the state. I just find that an enormous waste.

And so if you're thinking about investing, it's how to you incent risk capital not by having state replace it, but how do you incent venture capital but grew up in California, or actually was born in your state, worked in California and would love to come back home; or maybe they are on the East Coast. How do you get them? What incentives do you need to have them come back home?

Recommendation four is universities are still teaching how to write a business plan for entrepreneurship. I find that quaint and interesting, and eventually they will all kind of move over to what we've learned, but you can encourage them to do this.

Recommendation five, small business initiatives should be thinking about adopting these same techniques. We now know they work. We now know they are better and more efficient and make startups over a large pool fail less.

So I've open-sourced all this material. "Open source" is a technical term which basically means it's free; it will cost you and your staff absolutely zero. I have hundreds of presentations of my students, the syllabus teaching guides, what we do for the National Science Foundation; this is my way of giving back to the country.

And I'm happy to answer any questions.

So thank you for your time.

(Applause.)

CHAIRMAN HEINEMAN: Steve, don't go far away.

Who wants to ask the first question?

Thank you very much for that excellent presentation.

Jack, go ahead.

VICE CHAIR MARKELL: Thanks for your very interesting presentation. One of your last slides had to do with incenting risk capital to locate nearby entrepreneurial centers. I mean, obviously money will crossover state borders.

I mean, how important is it that the risk capital actually be located, you know, that close or when--you know, if you have good ideas and good entrepreneurs and good companies developing, will they find each other even if it's not located within your borders?

MR. BLANK: You know, in a perfect world, you would hope it was true. It's not. It turns out even in Silicon Valley most VCs think of the East Bay to be a foreign country. And so when you have enough opportunity locally, you tend not to travel.

So I guess the number one priority would be to get a local state set of VCs engaged and interested.

The best model for this actually is not a state, but something the size of one of your states, and it's the country of Israel. I don't know if any of you know, but Israel has more public companies on the stock exchange than all of the European union combined. They are number two to the United States.

There's a book called *Startup Nation* which describes their journey in trying to figure out how to build an entrepreneurial culture. And they got it wrong for 30 years. They started with and socialist model and then they started with a government. Well, the government will fund it. And then they finally realized that the real goal was to give initiatives and incentives to kick start these incubators and venture capital firms and then eventually get out of that business. And that's kind of the model philosophy that I would suggest because venture capitalists don't drive very far. There are exceptions and others will do that, but truly the ultimate is to have a cluster, a small group in your state who know your state, know your culture, know your local universities, know where the talent is, know what the state and the schools are great at and be focused on that.

GOVERNOR [Martin] O'MALLEY: In Maryland, we partnered with--we created an entity called The Maryland/Israel Investment Fund, and it's really been a great partnership, identifying that pipeline to accelerate innovation, create the jobs, fail fast, move fast.

And one of the other things that we found in our ecosystem in Maryland, we were number one in terms of research and development. Per capita does more research and development, and yet we were lagging in terms of commercialization. And in our ecosystem, we identified one of the weaknesses being the lack of venture capital.

So a couple of things that we did this year, we passed something called The Innovation Initiative with a consortium of our great research universities, Mr. Chairman, that are committed--we're a very small amount of money--to move 40 ideas a year out of their labs.

As part of that, they are redoing their culture. So instead of simply rewarding professors in the one path of publication, you get tenure rewards for commercialization--

MR. BLANK: That's great.

GOVERNOR O'MALLEY: --which is a great shift for us. I mean, Johns Hopkins, Maryland, Morgan.

But the other thing we did, I'll share with you, Mr. Chairman--and perhaps it might not be if not a best practice, at least one practice. The year before we created something called Invest Maryland where we held an auction, if you will, for large entities like insurance companies that know they are going to have a tax liability, and we allowed them to forward pay five years of taxes, and that allowed us to create, in essence, a sort of venture fund, if you will, with about $85 million. We thought it would raise 70. It's $85 million. And that's another effort to build on the VC that we have but have a state role in this as well. Not necessarily directly picking the winners and losers, but going through entities that we have that do this, that have boards that are set up.

And I just--you know, in line with some of the things that you were saying, I think every state is a little different when they start off on this, but all of us want to make improvements that allow us to accelerate innovation. And this Invest Maryland is one anyway.

And I'll send it to you, Mr. Chairman.

Have you seen this happening in other states? Have you seen any examples of states that are doing things that the rest of us might copy? We all love being the best at doing something second.

MR. BLANK: Unfortunately, I'm not familiar with all the initiatives in all the states. My last year or two it's been involved with the National Science Foundation, RBE, and DoE, and some DoD initiatives, so I have to apologize, but I'm not, and I'm looking forward to reading this. And the things you describe actually make lots of sense because those are the things we need to move forward.

I just can't emphasize the importance of--one of the things Governor O'Malley said, which was changing the culture inside of the university. And you heard me say the phrase "outward facing." For those of you familiar with universities, academics are inward facing; they worry about publications, they worry about research, they worry about getting grants. They are not worried about starting companies and pushing their graduate students to do that.

In fact, they are happy if their graduate students actually publish more papers and become academics. Well, that's great for the future of research; that's not particularly productive for your state or national economy.

And so what we want is some balance. And I think you've hit on an approach, and others have as well, is how do you incent states to go--research universities to do that? And this might be a great model as well.

GOVERNOR [Tom] CORBETT: Governor O'Malley, we have done for quite a number of years now--since Governor Ridge was Governor of Pennsylvania, we establish two different groups. One on high technology and one on life sciences to do this.

In the life sciences group, we actually took some of the money from the tobacco settlement fund that the attorney's general got back in the early 2000--I think it's 2001-2002--to set up the life science greenhouses. And there's three or four across the Commonwealth of Pennsylvania. And there they are working with successful CEOs of startups who are acting as the mentors that somebody needs to have to take them through this, pretty much as you indicated on there.

And they sit on a board of a new startup company, they actually participate in it. The greenhouse then helps to guide the company from research to commercialization to find who will buy your product.

And at the same time, it helps companies find that venture capital. And what we're seeing is the venture capitalists know where we are.

The same thing on the technology side, we call them the Ben Franklin's--obviously for the reason of Pennsylvania--and there are four locations in Pennsylvania that they exist. Frankly, each one, they are rounding a research university; it could be Penn State University, it could be the University of Penn Drexel, down in Philadelphia. In Pittsburgh, obviously University of Pittsburgh and Carnegie Mellon, which is one, to us in Pennsylvania, one of the greatest startup universities in the country of spinning things out.

It has worked very, very well and we're very pleased. We'll be happy to share with anybody here what we're doing in Pennsylvania.

MR. BLANK: Those are great initiatives. And let me just use that to point out something, which may or may not be obvious. You mentioned life sciences. You know, since the first initial public offering of a life sciences company, Genentech in 1980, life scientists have actually been a segment that venture capitalists have put, you know, billions of dollars in.

But the life cycle of a life sciences company, unlike a software company, takes a decade or more to come to fruition. The problem in the last three years--and I'm just going to tell you the Silicon Valley problem; hopefully it's not Pennsylvania--is that the giant sucking sound you hear is all the money going into social media, where investors are now saying, why should I spend 10 or 15 years waiting for an investment in life sciences or clean tech to come to fruition which needs tens or hundreds of millions of dollars of capital when I could be investing in Instagram or Facebook or hoping I get the next one.

And so that's a risk in all your areas. And, In fact, it's an area where actually states might be able to give incentives where you say, okay, you know what, there's plenty of money going into the next iPhone app. What we want to do is take the best of research of non-iPhone apps or something else which might be an interesting strategy, but you just have to understand how deep those commitments and how long term those commitments are.

And so it's just something interesting that I've seen happening to capital in Silicon Valley. You know, smart money goes where money is being made. And right now the money is being made in Twitter, Facebook, *et cetera*. I think the even smarter money is being the contrarian investors and saying no, no, no, people are still going to need drugs and we're still going to need, you know, clean energy, *et cetera*.

One of the best things we saw come out of the last National Science Foundation happened to be for Pennsylvania for the Marcella shale is how to clean up--produce water from fracked wells where, you know, no Silicon Valley investor would have said, hey, that's something I'm looking to invest in. But when you saw the numbers of how productive that could be, there's some very smart VCs who will be lining up to invest in that. So that was just an aside. I think that's a great program.

CHAIRMAN HEINEMAN: Over there to the

right.

GOVERNOR [Robert] McDONNELL: Steve, I was struck by your comment that programs in our universities, our masters or bachelors in business administration, but not entrepreneurship and startups, and we're seeing some of that change in our universities, but do you have a model program or programs in the country --

MR. BLANK: Yes.

GOVERNOR McDONNELL: -- or at least the elements that you'd see would go into that to change the culture?

MR. BLANK: Yes. And so I just want to . . please don't get me wrong, there are now lots of universities in the last 10 or 15 years who have entrepreneurship programs. And I've taught for my first five years how to write a business plan before I realized that, gee, that's actually the wrong thing we should be teaching, but no one knew what exact . . we kind of knew.

In fact, if any of you ever meet entrepreneurs--right? Anybody ever see them? They are crazy people, right? I mean, they are not normal people. They dress funny. Sometimes you, like, worry, like were they checked for weapons? I mean, they are just--but we kind of knew this and other things about entrepreneurs. But we had no methodology to kind of connect. Well, we know they are different, but why? We know they move at a speed that you don't move in a large company, but why? We know that they write business plans and then ignore them after they get funded, but why?

And so we had no replacement for all this stuff. And it's only in the last couple of years that we put together what we call this Lean LaunchPad curriculum that we now share. And so there's a 100-page teaching guide, we're now training other instructors.

There's a nonprofit called nciia.org which offers training for other universities and colleges interested in teaching this curriculum. All the NSF classes are going online, so by this fall any student or any professor who wants to use all my online material, it's all there. It's being taught at Stanford and Berkley and Columbia. There's even five-day versions of this class instead of semester and quarter versions. I've been experimenting with that. So there's online versions, five-day versions, semester versions, quarter versions. Lots of other people are teaching it, and we're happy to share it.

And, again, it's not because we're

smarter; it's just because we now have learned stuff over the last 50 years. We've learned actually what's the more efficient way to build these things and to realize that, well, we had a hundred years of building a management stack for administering and executing large companies, we never built the equivalent management stack of what it is we do for searching for the business model, and that's what we're doing now. We're just building those tools that we now know if we use those, those are a lot more efficient than the stuff we used to use.

And so the answer is, it's all available. Somebody drop me an e-mail and I'll be happy to send it to your staff and get you connected.

GOVERNOR [Mary] FALLIN: Thank you so much for your presentation. I'm going to check on your Lean LaunchPad because my son is in the School of Entrepreneurship at the University of Oklahoma and I've been to his class presentations where he had to develop a product, worked on a team, did write a business plan, did have his customers. We went to go sell his product, and then we had to report the financial statements of how much he made or didn't make, but that was all fun.

And one of the things we do in

Oklahoma--and probably other states do this--is we have a Governors Cup on entrepreneurship in which we have venture capital, private sector people who will work with our universities and the schools of entrepreneurships and students who have to go through the process, as you were just talking about, and then they actually meet with people who invest in products and services with the students. And it's a big competition. I went and spoke at it recently. There were probably 800 people there--

MR. BLANK: Wow.

GOVERNOR FALLIN: --in teams, but all these teams across the state are very competitive and they get up on stage and do the formal presentation. They weren't real eccentric. I mean, my son had on his business suit and tie and looked good, but they get up in front of adults and basically make their case as to why someone should invest in their product or their service. And it's a great way for a governor to be involved in helping encourage a young person to be involved in the spirit of entrepreneurship.

And if you were to ask my 21-year-old what he's going to do when he graduates from college--he's a senior next year--he'll tell you his three patent ideas and he'll be a millionaire by the time he's 25. And that's had his attitude, but it's just developing that culture of the hope and the dream and the faith that you can do something.

MR. BLANK: Thank you, governor. In fact, you've raised something I just thought I'd share as well.

You know, entrepreneurship--even though the founders might be engineers or business people--actually entrepreneurs, founders of companies, are closer to artists than anything else if you think about it. Artists see something that other people don't. And, in fact, they see it when there's a blank canvas or a blank score sheet or a block of marble, and they are capable of convincing other people with some kind of reality distortion field. They say, no, no, no. Look, it's going to be great, but, you know...

And one of the interesting things about what you mentioned is we've been teaching art for thousands of years, right, and we teach it now in our states and in our schools on multiple levels. We teach art appreciation to everybody, we teach technique, and we teach practice and whatever. I think entrepreneurship in business should be taught in this country the same way. We should teach business appreciation as early as we can. We should teach technique, *et cetera*. We should think of it as teaching artists.

The other thing I'll just mention is not only are we changing the mind of entrepreneurs now, but we're also changing how venture capitalists think about starting companies because right now--you know, Steve, you can say everything, but our local venture capitalists still want to see a business plan. And this is the kind of the golden rule, is he who has the gold makes the rules.

But any venture capitalist who's been exposed to this process--and I should just point out there's one in this room, John Burk, from True Ventures here in Virginia, who actually volunteered his time for the government, the National Science Foundation, and now we can't get him out of the class because--he just realized as he sat through the process that actually we've now discovered a more efficient one. And so if you want to talk to a venture capitalist who has been through their process, there's one here.

So I know my time is short, like over. Can we--

CHAIRMAN HEINEMAN: One more question.

MR. BLANK: Who has the best question?

CHAIRMAN HEINEMAN: That's it.

MR. BLANK: That's the end? Thank you very much.

(Applause.)

CHAIRMAN HEINEMAN: Steve, thank you very much for that presentation and the response to the questions.

GOVERNOR [John] HICKENLOOPER: Mr. Chair, I am a little disappointed that not more governors left the defense of entrepreneurs.

CHAIRMAN HEINEMAN: Well, I was going to say something about you if you just hold off for just a moment.

As a result of your presentation, I now understand how a crazy, successful entrepreneur became an outstanding, respected governor in the State of Colorado.

So if you want to go ahead and respond. Was that good enough?

He liked it when you got to artists. I could see the smile on his face that he was moving up the ladder, but you should talk to Governor Hickenlooper; he's got a great success story in terms of what he did.

So for all of us, if you haven't had a chance to talk to John like I have, you should because what he did in his previous life prior to becoming governor is a great story.

We have a few things we need to do before we shut down this particular meeting.

First of all, I want to take Governor Bob McDonnell and Maureen for absolutely being fantastic hosts.

GOVERNOR McDONNELL: Thank you.

CHAIRMAN HEINEMAN: I truly enjoyed the opportunity last night to talk to Governor Jefferson and Governor Henry. But, again, I assure you they have gone back into retirement, so you're safe, okay.

Secondly, I want to ask Governor [Scott] Walker to come forward. I thought he would be riding a Harley, but apparently not, to talk about the next annual meeting which will be in Milwaukee, Wisconsin, in 2013.

GOVERNOR WALKER: I would have had more, but Hickenlooper ate half my cheese sitting over there. Actually, it's an appropriate connection to entrepreneurs because John before he was mayor--before governor and now before mayor--was a great entrepreneur, still is an entrepreneur, and helped open up a number of brew pubs in Wisconsin. So he's very well connected because you're going to get some good cheese next year, some good beer, both from microbreweries as well as big companies like Miller, which is connected to John as well since we have that joint venture Miller/Coors. We hope that you'll join us.

First of all, I want to add our thanks as well from our family, from Tonette, Matt, Alex, and I, to Bob and Maureen and to the whole team here in Virginia from Williamsburg and Jamestown. It's been an outstanding time.

Our hope next year is not to beat it because we had a great time here, we had a great time with Gary and Jeanette's efforts in Utah last year, but to be just as great as the last two years. We've had an honor of being at the summer meeting of the NGA.

And we hope you all join us. The date is a little bit later. The NGA set it up so it will be Thursday, August 1st through Sunday, August 4th. It will be in Milwaukee, so, again, not only will you get great cheese and beer and brats and outstanding food, but thinking of that beer, one of the spots a lot of you have asked about is our ballpark, Miller Park, in which ESPN just named as the best ballpark in the major leagues, and so we're going to work out an opportunity to do one of the events, one of our activities--ESPN did it Tom. It's not me. And maybe by that point the Pirates will be back where we'd like them to be--but we won't get into that.

But our hope is that you can join us for that. You'll have a fabulous time; it's a great ballpark. We'll spend some time--a little bit of history. I didn't write it in, but you have as one of your--my props, but a gift for all of you to remember--you have at your spot there one of our bandanas from the Harley-Davidson Museum. Obviously very authentic. And we don't have the history that they do in Virginia, but next year is the 110th anniversary of Harley-Davidson and so . . just a few weeks after we'll be there. So one of the things we're going to do is work out an event at the Harley-Davidson museum.

I like it.

See, my staff asked me to put that on, but they didn't think I would be goofy enough to do that. You look like an entrepreneur now.

He looks like an entrepreneur, doesn't he?

Last year you liked that hat and now you're running with this, but I'll bring you a cheese head for our event when we're in Wisconsin.

But we got a little deal and a little bit of a challenge. To make that challenge work out, I was thinking around--you know, unfortunately a couple of the governors I know who ride--one, in particular you wouldn't suspect, Mitch Daniels rides a Harley-Davidson. I ride a Harley-Davidson. I have a 2003 anniversary edition Harley. One of the things we thought would be fun when we're at the Harley-Davidson Museum is to bring a bunch of governors and spouses . . I'm going to work on Wade coming with me because I know it's not a Harley you ride, but we'll find one for you, and maybe some other staff and others out there.

But for any governor who is interested between now and next summer in joining me--it won't be a long ride but a short ride in--we'll work out a deal at the dealership closest to your capital to get you trained in the Harley-Davidson riders-ed course so you can go in the race with us.

And, John, you probably remember former mayor John Norquist in Milwaukee. John and I, 10 years ago--I never rode a bike before the Harley-Davidson 100th anniversary--Norquist and I kind of dared each other to get the course and we led 10,000 bikes going down the street at the start of that. It's an absolute rush. It won't be 10,000 bikes.

But for any of you--and I'm working on Jack--I have to work on your wife more than anything, right? But although you'd be good at it, too, I think. We can get you in that course as well. But we'd love to have you join us, even if you're not riding, just to have you participate in that.

And then one of the other great events we're going to have: a lot of people on the coast don't recognize this, but we have a tremendous shoreline along Lake Michigan and we've got just up from the Summer Fest, the world's largest music festival; we have the Milwaukee Art Museum, the only [Santiago] Calatrava design. First--not the only--the first Calatrava designed art museum in North America, and a number of other great things on the lakefront; we want to show that off. And we're hoping that you can come and join us August 1st through the 4th.

We hope for governors you bring your spouses, bring your families, bring your staff. And for the corporate fellows and the sponsors and others here and everybody else that's interested, we hope you come. And if you're interested, we can also help you arrange a little bit of time to come early and stay late if you'd like.

If you like golf, Kohler is just up the way from Milwaukee; Whistling Straits; and Blackwolf Run. Blackwolf Run just two weeks ago had the US Women's Open. And so there's some great golf in there and we can arrange for you to come a day or two early and participate in that as well.

So hope to see you in February in DC but in a year from now in Wisconsin.

(Applause.)

CHAIRMAN HEINEMAN: Scott, thank you very much. I know Jack is very interested, along with his vice chair, to ride those Harleys into Milwaukee in that event. I'll look forward to cheering them on.

Now, before we move to our new leadership, I want to remind everybody after this meeting concludes, there will be a movie screening of "Won't Back Down." The movie will be shown at 12:30 in the Rockefeller room at the end.

And, Governor Hickenlooper, thank you again for arranging that.

It's truly been my great honor to serve as the chair of this organization the past year. I followed in the footsteps of a terrific chair, Chris Gregoire, who taught me everything that I should know in this job; and it's a tough job on a lot of different days.

But I want to thank all the governors and your staffs for all the hard work. From the NGA to continue to move forward, to do what we do effectively, it can't be done without the support of the governors and your staffs; and we really worked hard to get you more and more involved.

I also want to thank the NGA staff. I want to thank them for their expert advice and counsel, for the technical assistance that you provide to all of our state governments, and for organizing all these meetings which turn out to be very, very successful meetings.

It's been a pleasure for me to get to know the staff better. There's a lot of expertise there that you can call on an individual basis. And I also want to thank my staff personally; we have a small staff. And particularly I want to thank Lauren Kintner of my staff. In addition to all her normal duties, to head up our policy research office, to be my legal counsel for the past year, I made her do a little extra work with the NGA. And none of us can do it without our great staff, and I'm very thankful for their support and their dedication and their commitment. And we all are involved in that every single day.

With that, now I'd like to call on the chair of our Nominating Committee Governor [Steven] Beshear to report the decisions of your committee and to nominate the new leaders of NGA Kentucky.

GOVERNOR BESHEAR: Thank you, Mr. Chairman.

Meeting here in one of our cradles of democracy, the Nominating Committee felt inspired to do some extra effort in our deliberations. They began yesterday at the receptions after the session, they continued at the Governor's Palace last night, adjourned to the Raleigh Tavern, and other venues. And we worked late into the night, but we have come with a unanimous recommendation to nominate the following governors to serve on the 2012-2013 NGA Executive Committee and as NGA leadership:

Governor John Hickenlooper, of Colorado; Governor Mark Dayton, of Minnesota; Governor Mike Beebe, of Arkansas; Governor Dave Heineman, of Nebraska; Governor Chris Christie, of New Jersey; Governor Scott Walker, of Wisconsin; and Governor Gary

Herbert, of Utah.

And as the new vice chair of NGA, Governor Mary Fallin, of Oklahoma; and as chair, Governor Jack Markell, of Delaware.

And so, Mr. Chairman, I move that these nominations be adopted *en blanc*.

CHAIRMAN HEINEMAN: Is there a second?

GOVERNOR BRANSTAD: Second.

CHAIRMAN HEINEMAN: All in favor, please say aye.

(All members said aye.)

CHAIRMAN HEINEMAN: Opposed, no.

The ayes have it.

Before I turn it over to Governor Markell, I'd just like to say a few words personally about Jack.

As many of you know, we've known each other for a long period of time. I have great respect for what he's done as the Governor of Delaware, but more importantly for what he did for me as vice chair. We've had an absolutely terrific partnership. I could talk to Jack about any single issue, we could have a great conversation, and move forward on behalf of the NGA.

My wife, Sally, who actually has walked

in now, we were very honored and pleased to get to know Jack and Carla on an even better basis than we've known them in the past. We want to thank both of you for all that you've done for us.

But, Jack, it is now time for you to take over. Here is the gavel. Good luck and congratulations.

(Applause.)

CHAIRMAN MARKELL: Well, thank you, Dave. And I want to tell Governor Beshear how good it feels to know that it's only after serious drinking that I was actually selected to be the chair of this organization, something that my staff will not be the least bit surprised about.

And I do want to thank my wife, Carla, for being here as well.

So to Governor McDonnell, thank you again to you and Maureen; really, this has really been phenomenal. Thank you so much for your hospitality.

Scott, we look forward to being in Milwaukee. And I'll try and convince Carl that I actually do this little training exercise, yes. That would be interesting, I have to say.

To Dave, I really do want to thank you for your just phenomenal leadership of the National

Governors Association.

As Dave has said, we have known each other for a long time; we served as state treasurers together. I remember going to new treasurer's school back in 1999, and Dave Heineman was the first treasurer that I met. He really helped me a lot then, and he's helped me a lot this year.

You have been just a really great, great leader. I know that Mary Fallin and I look forward to following in your footsteps and to continue to build on the great work that you have done in your role leading NGA.

And on behalf of the National Governors Association, I'm going to give a gavel right back to you. And this one says, "Presented to Dave Heineman, Governor of Nebraska, for his outstanding leadership as chair of the National Governors Association 2011-2012 on the occasion of the NGA Annual Meeting."

So, Dave, thank you very much.

(Applause.)

CHAIRMAN MARKELL: Now, each year the NGA chair gets to choose an initiative to focus on. Governor Heineman's has been about growing state economies. He's given each of us some great tools, some great information. I think the speech today really builds on that. And I want to thank him for doing a great initiative. And I wanted to talk just briefly about my initiative.

My initiative is going to be called “A Better Bottom Line: Employing People with Disabilities.” And I'd like to explain where this comes from.

About eight or nine years ago, I visited a facility in Delaware run by then MBNA. It's now run by Bank of America. This employer has been a great leader for many, many years at employing people with disabilities. And in Delaware they employed about 300. Many of them do make promotional materials, but they do a wide range of jobs.

And I remember that day; I went in and I met a 25-year-old man. He was making T-shirts. And he told me proudly that he had gotten up that morning to come to work. And I asked him what he had done before he had this opportunity to work at MBNA and he told me that he had sat at home for six years watching TV with his parents.

And honestly, a light bulb went off in my head. Understanding the incredible improvement in the quality of life of this man and the improvement in the quality of life for his family--because he, like the rest of us only want every day to wake up, to be able to feel like they are part of something that's bigger than themselves, be part of a team, be productive, and, of course, earn a paycheck as well.

And I focused a lot on this issue over the years. And when I knew I had the opportunity to serve as the chair of the National Governors Association, I knew that this was something that . . this is not a Democratic issue, this is not a Republican issue, and I really believe, and continue to believe, that this is an issue that all governors across the country can embrace and can really make a difference on.

Today, Americans with disabilities face disproportionately high rates of unemployment. Some of these rates are, frankly, staggering. And individuals with disabilities should have, to the extent possible, the same opportunities that all of us do, to live close to family and friends, to live independently and in safe communities, to engage in productive employment, and to participate in community life.

And my initiative, “A Better Bottom Line: Employing People with Disabilities,” simply aims to increase employment among individuals with disabilities.

And specifically my initiative is going to focus on the employment challenges that affect individuals with intellectual and other disabilities, including veterans that return wounded from battle and the role that both of state governments can play as well as the businesses can play in facilitating and advancing opportunities for these individuals to be gainfully employed in the competitive labor market.

Now, successfully achieving that goal will require not only attention to appropriate training and job placement and work-based support, but also best practices and meaningful engagement of the business community.

And that really means engaging with the business community about how productive and loyal and how valuable these individuals can be, both to the company's culture and to the company's bottom line.

And so this initiative is going to provide governors and other state policymakers with better policy options to assess the environments in our own states and to provide strategies designed to support this population.

Major emphasis is going to be on people who have significant intellectual and developmental disabilities and that may require supports like job coaches and personal attendants in order to live and work in the community.

And what we're going to do is we're going to convene governors and businesses, business leaders, disability leaders, and other leaders throughout the year to share ideas and move forward with support for this population. And more specifically this initiative is going to create a blueprint for businesses in states, identifying best practices, outlining steps that can be put in place, to increase employment of people with disabilities, and also heighten awareness and launch a campaign to help governors put in place practices that fit best in our own state's efforts to increase employment for people with disabilities.

I am very excited to start this initiative. It's the right thing to do, it's the smart thing for government to do, and it makes good business sense.

Now, while the initiative is just being formally announced today, I've been talking with people about it for a few months, as we came to decide on it and we got closer to launch. And there is tremendous support out here for this.

Last month, Walgreens hosted the first ever CEO summit on this issue. And I was really pleased. Honestly, I was honored to join Senator Tom Harkin (D-IA) and Congressman Pete Sessions (R-TX) at this meeting. It was in Connecticut and it included senior-level executives, including many CEOs from companies that employ hundreds of thousands of people and, more likely than not, in each of your states.

Companies like Amerigroup, Performance Materials, Best Buy, Clark Companies, Ernst & Young, GE Lighting, IBM, Lowe's, McClain & Company, Merck, OfficeMax, SAP, Proctor & Gamble, UPS, Walgreens, and Wal-Mart. That is to name a few.

Now, those companies don't have a lot in common in what they sell or how they sell it. Each has a different mission and each has a different corporate culture. And I can tell you that having Senator Tom Harkin and Pete Sessions working together, these two really impressive guys don't live anywhere near each other on the audiological spectrum, but when it comes to this issue, they are very much together.

And those companies and those leaders realize the common value and the common purpose behind this issue. And they shared stories about how investing in people with disabilities and giving them a chance for employment--this is not just about what makes social sense; this is good for their bottom line. And that's not just my opinion, that's coming directly from the CEOs themselves.

Walgreens, for example, we were hosted in Connecticut at a tremendous distribution center right near the Hartford Airport. Walgreens, a true leader, 500 people employed at this particular distribution center, half of them people with disabilities. And Walgreens compares their distribution centers across the country, and this one, the performance is just as good, if not better, than all their other distribution centers.

And, for example, they found that their best forklift operators happen to be deaf. This is good not just to social policy, this is what's good for the bottom line.

And I know that our NGA corporate fellows will have their own stories to share.

And the bottom line is that there are so many people with disabilities who have the time, they have the talent, and they have the desire to make meaningful contributions to interested employers.

It doesn't matter whether you were born with additional challenges to face or as in the case of our wounded veterans who return home, whether you have acquired them later in life, what matters is what you have to offer.

And I look forward to working with all of to you find these inspiring stories in your states, to recognizing what's working best to get people back to work, and to helping more and more companies recognize that creating greater economic opportunity for these workers improves their own bottom line as well.

And between them and between our own governments as employers, we can, in fact, ensure that individuals with disabilities will have opportunities for a brighter future.

I want to thank all of you for being here with us for this 104th Annual Meeting, and we are now adjourned.

(The proceedings adjourned at 12:19 p.m.)

COURT REPORTER'S CERTIFICATE

I, Scott D. Gregg, Registered Professional Reporter, certify that I recorded verbatim by stenotype the proceedings in the captioned cause before the National Governors Association, Williamsburg, Virginia, on the 15th day of July, 2012.

I further certify that to the best of my knowledge and belief, the foregoing transcript constitutes a true and correct transcript of the said proceedings.

Given under my hand this day of , 2012, at Norfolk, Virginia.

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Scott D. Gregg, RPR

Notary Public

Notary Registration No. 215323

NATIONAL GOVERNORS ASSOCIATION

CLOSING SESSION

GROWING STATE ECONOMY

Virginia Ballroom

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GUEST:

STEVE BLANK, AUTHOR AND PROFESSOR

P R O C E E D I N G S

CHAIRMAN HEINEMAN: All right. Ladies and gentlemen, thank you for being here for the closing session of the 2012 NGA Annual Meeting.

I think you'll enjoy our speaker today. Our topic today is "Growing the Next Big Idea."

I think every governor, Steve, would like to know the answer to that one.

And we are joined by author and professor Steve Blank. He cofounded his last company, Epiphany, in his living room in 1996. He has had eight startups, including two semiconductor companies, a workstation company, a supercomputer firm. I can kind of go on and on; maybe most importantly a video game company, too.

After 21 years in high technology companies, Steve took time to reflect on his experiences and wrote a book about building early-stage companies called *Four Steps to the Epiphany*. His latest book, the *Startup Owner's Manual* integrates 10 years of new knowledge.

He's done a variety of things, if you can imagine, from being an entrepreneur, to teaching entrepreneurship at UC Berkley, Stanford, and Columbia. And I asked him I couldn't imagine how he did it at all three, but maybe he'll explain that.

But we are very honored and pleased that he would spend time with us this morning. There will be plenty of time for questions when he's finished.

Ladies and gentlemen, Steve Blank.

(Applause.)

MR. BLANK: Thank you, governor.

CHAIRMAN HEINEMAN: You're welcome.

MR. BLANK: Thank you very much. I'm honored to be here. I should have realized that business casual in a government conference means you wear your blue suit rather than your black suit on a Sunday, so I'm sorry I'm a little underdressed.

But the subject of my talk will be "Growing the Next Big Idea."

And what I want to share with you are some of the things we've learned in both Silicon Valley, working with government agencies, working with small businesses and large corporations on how to build new ventures and create new jobs.

Now, we've learned a whole lot of new things in the last couple of years, and I thought I'd share them with you in the form of four lessons.

Lesson one, the different types of startups.

Lesson two, what a startup ecosystem looks like.

Lesson three—and kind of the most important, at least for me is—we think we know now how to make startups fail less, which is kind of a polite way to say over a large number of them, we actually know how to make startups succeed more.

And then the last question is, can we actually teach what we now know on how to build companies and create jobs?

And I'll share those with you as quickly as I can and then take questions at the end.

So lesson one: Types of startups. You know, one of the things that confused me when I left industry—and I had done startups for 21 years; and to me a startup was a high technology, high growth, you woke up in the morning and your goal was to build a billion dollar company. And I started attending other professors' lectures and heard them start talking about startups in a language and descriptions that I had never heard before until I realized that we were using the same word to describe multiple things.

It turns out that there are different types of startups. Number one, a lifestyle startup, people who work to live their passion; they serve known customers; they have known products. For example, in California, since we're near the beach, the surfers who love to surf hang up a sign on their surf shack that says lessons, 9:30 to 10:45 a.m. They make enough money, they put the closed sign up, and they go out surfing. These individuals are doing startups. They are self-employed, but they are creating jobs maybe for themselves and maybe for one or two assistants.

There's another type of startup, which is really popular in college campuses, social entrepreneurship startups. These are entrepreneurs who want to dedicate their lives to solving pressing social problems. They either want to build a company to do that and make it profitable, Ben & Jerry's, Seventh Generation, *et cetera*, or they want to create new social innovation and new nonprofits. Their goal is to go from a social startup into a large nonprofit.

Another type of startup is the one that my parents actually started. My parents were immigrants to the United States. I'm a first generation American. Their dream in this country was to open up a grocery store. And they worked in sweat shops in New York for 15 years, saving every dime they had. And finally they were able to do that.

What I didn't realize at the time is my parents were entrepreneurs. They did a startup. Their goal in setting up a grocery store was to serve a known customer with known products. And if they were successful, they were able to feed our family. And some days they weren't successful, and we were just eating stuff off the stock of the shelves. But in others, eventually they grew the business.

And what's really interesting is their exit criteria wasn't a billion dollars, wasn't even a million dollars. In fact, if they made $500,000 in their entire lives, it's probably $400,000 too much. Their goal was to build a profitable business and find a business model; that is: Who were their customers? What can they charge? What products should they carry? And they did it with an existing team.

Now, what's interesting is in Silicon Valley we kind of look down on small businesses and say these are lifestyle businesses, and that's a mistake because small businesses are the heart of the US economy. There are 5.7 million small businesses in the US, and they make up 99.7 percent of all companies. They employed about 50 percent of all governmental workers. Small businesses are entrepreneurs. They do startups, and it's the type of startup we actually need to think about and figure out whether the processes we're using in building for technology startups can be applied to them, and I'm going to show you how we can do that.

The other type of startup which gets all the press are what I call scalable startups, sometimes called high-growth startups. These are the ones you see in the news all the time. This is Steve Jobs and Steve Wozniak when they first started.

A scalable startup is designed to grow big. These founders wake up in the morning and say, we're going to build a company that's going to take over the universe.

Now, one or two things are true. Number one is they are visionaries; or two, more than likely they are hallucinating, okay.

But a scalable startup not only is designed to grow big from day one, it typically needs risk capital. And risk capital is a fancy word for venture capital or angel funding or some type of private capital that's used to dealing with risk because what I'll mention multiple sometimes is for this class of startup, over 90 percent of them fail. Let me say it again: Over 90 percent of scalable startups fail.

Now, who would be crazy enough to invest in anything like that? I guess the housing market, but . . but besides the housing market, what we have is a startup class that most fail, but the returns are so large and so huge they attract a special asset class: risk capital.

And so the goal is to sell for unknown customers; and what they are looking for are markets half a billion dollars or greater, and they want to grow to a hundred million dollars a year in revenue.

There's a new type of startup in Silicon Valley and in your states that is emerging only in the last couple of years, and I call these buyable startups. And a buyable startup are typically software companies built around engineers developing applications for mobile phones for the web or for the Cloud. And for the first time, it no longer takes millions of dollars to start these companies; these are being started on credit cards on laptops using resources on the web.

And while you think these just might be small, little companies, Instagram, which was what I would call buyable startup, got sold for a billion dollars to Facebook. There's a new class of startups that don't require large amounts of capital, and their goal typically is to sell to a larger company.

The last type of startups which you wouldn't believe are startups are large companies. Large companies do innovation in your states all the time. And what they mostly do is what a professor in Harvard, Clayton Christensen, called sustaining innovation. Large corporations to stay in business have to continually innovate around their core products; they need to make them faster and smarter and cheaper.

But something has happened in the last two decades that is really changing the nature of large corporations, and that's, in fact, that the cycle time, the amount of time they have to stay on the top of the pack, has been incredibly compressed by globalization, by technology shifts, by regulatory shifts.

And, In fact, large corporations not only now need to deal with existing markets and known customers and known products, they need to deal with disruption. And disruption is when they have a great core business, and some crazy comes along and says, we're going to take out this company.

The best examples of this are two of the smartest companies--anybody ever have a Blackberry?

Yeah. Or Nokia phone?

I was in Finland talking to someone who was at the Nokia board meeting the month the iPhone came out. They passed a copy of the iPhone around at the Nokia board meeting and the fatal quote was, why should we care about this? What's their market share?

On day one to a large corporation, disruption looks like a toy. It's a big idea. A disruptive innovation to a big, existing company always looks like a toy on day one. It has zero share. That's not what Nokia and Rem are thinking now. And I use those as examples because those were smart, great companies that every year were doing great sustaining innovation but didn't understand that they were being disrupted.

And so how large corporations need to deal with disruption is they could either build their own disruptive technology, they could partner with other companies, or they could acquire startup technology, intellectual property, talent, products, customers, their entire businesses. And disruptive innovation inside a large corporation looks exactly like a corporate startup.

So now we kind of have the types of startups. And the summary for this first piece is the policies, funding, and tactics in each of your states to deal with small business startups, scalable startups, corporate startups, the tactics are different, but the techniques I'm going to show you a little later are identical. We now understand what's common between them so just hold on a second.

The second thing I thought I'd share is the history of a startup ecosystem. I spent my last 34 years in Silicon Valley, and I kind of got used to the fact that we have a technology ecosystem, an infrastructure that feeds on itself but never quite understanding where it came from. And, in fact, the reason I'm going to share this with you is I now do a talk called the Secret History of Silicon Valley, which you can find on YouTube.

The reason why is when I asked some of my engineering students where did Silicon Valley come from they said, oh, some old guy named Steve Jobs started it. And I went, well, perhaps--then I asked my other friends, well, you know, what was the government's role? Well, the government had no role. It was all about venture capital.

So I just want to share with you a thumbnail sketch about this ecosystem and more importantly not about the Valley, but what is it that we can extract; what are the rules that we kind of can learn from Silicon Valley?

Silicon Valley was a series of unintended consequences. It was not designed. Number one is it started with Stanford University, an outward facing researching university. By "outward facing," meaning it had deep university, military, and industrial ties from day one building weapons systems.

During the middle of the Cold War, Stanford's engineering department had a secret 400-person weapons lab building electronic warfare and electronic intelligence systems funded by the DoD and all our intelligence agencies.

At the same time, there was massive government R&D in weapons systems. Silicon Valley in the 1950s, '60s, and '70s was not a startup center; it was a defense center. Lockheed Missiles and Space would set up its facility in Sunnyvale, California. In 1956, it had zero employees. In 1960, it had 25,000 engineers working in what becomes Silicon Valley, building the Polaris, Poseidon, and Trident submarine launch ballistic. And at the same time, building all the overhead reconnaissance satellites for the CIA, NSA, and National Reconnaissance Office, CORONA GAMBIT, HEXAGON, and others.

Silicon Valley started by massive government funding by accident. And one professor connected this government, military, and engineering culture into an entrepreneurial culture. It was Fred Terman, professor from Stanford, who ended up as dean of engineering and then provost at the university that said, look, we'll do government research in our labs, but any production of systems, I want my students to spin out and start companies. And, in fact, it's great for the country. This is the 1950s. If my academic researchers, my professors sit on boards, become advisors, invest in all these startups, I want my engineering department to face outward as well as facing inward. And that was a radical shift in the 1950s and '60s. And the culture of Silicon Valley started with this one professor who said it was great to take our inventions and help the country in the middle of the Cold War.

By the way, venture capital that is investing in startups, actually, believe it or not, was started by a response to the launch of Sputnik, the first Soviet satellite in October 1957.

US Congress decided that we were falling behind the Soviets in technology and launched a series of programs, NASA, ARPA, and also launched a program called the Small Business Investment Corporation as part of the SBA that would match 3-to-1 any investments in new companies.

And so the first set of venture capital was actually an unintended consequence of Sputnik. And, in fact, venture capital was, in fact, government funded. By the mid-1960s, three-quarters of all the VC firms in the US were SBIC programs. It was only until the invention of something called the limited partnership in the late '60s and the '70s that venture capital took the form that we needed and we now use which does not use government money.

And then in the late 1970s regulatory changes changed venture capital once again. All of a sudden, pension funds were now allowed through the "Prudent Man Rule" to invest up to 10 percent in, quote, risky ventures. And the amount of capital available to Silicon Valley investors went from millions to billions of dollars literally within a year. And venture capital, as we know it, took off in the late 1970s.

There's two key lessons from this whole soliloquy. One is we built a culture that embraced technology risk. We recognize that 90 percent of startups fail. Imagine in your states if 90 percent of your programs failed.

It turns out in our culture, failure equals experience. We understand that these are the risks. And more importantly the culture embraced financial risk. Investors who invested in these companies understood that 90 percent would fail and so did their limited partners. They also understood that it was the 10 percent that would return unbelievable amounts of capital. And so they were investing to find out of those 10, 20, 30 companies in their portfolio, the one or two that would become the Apples or the Googles or the Facebooks.

And what they brought to Silicon Valley was not just money. And if I emphasize anything here, it's the importance of smart capital if you're trying to build an entrepreneurial culture. By smart capital, it is not writing checks to entrepreneurs. That's dumb money. What you really want is experienced advice, tolerance for risk, and the long-term interest. Startups take years, and some of them decades to come to fruition. And you need people who have had the experience and understand what it takes to coach an early-stage venture from a napkin into a billion dollar company.

So what lessons can we learn to build

innovation without Cold War funding?

One is that it really requires an ecosystem. I won't bore you with a graph, but it requires infrastructure. I mentioned some of the other things in this slide, research universities, economic systems, legal systems, 24/7 utilities. Because when I show this in other countries rather than other states, some of those things on the right really aren't even available there.

But for your states, number one is to think about research universities. That is a place to start thinking about building a core of innovation.

The second is culture. Startup culture is very different than building normal businesses. We take risks, we build on each other's expertise and accelerators and incubators. And we like our universities to learn how to be outward facing.

We've now developed a series of management tools that I will show you in a minute that we've now learned how to make startups fail less -- it's a big idea--and the motivation for the ecosystem is capitalism.

If there's anything to remember about startups, it's not just about the great entrepreneurs;. it's about the ecosystem that's a circle between startups and risk capital who make enormous profit by funding most of them who will fail. And it's building this ecosystem that's critical in getting any entrepreneurial cluster off the ground.

So here's a sum of what it would look like, but let me just point out the lessons.

The lessons are here that we want to understand that entrepreneurship requires a healthy ecosystem of all these pieces. But at the end of the day, unless you have investors who are not acting like bankers but are acting like venture capitalists and experienced angel investors, you will just have a pile of very small entrepreneurs looking around for money. And the best thing that we could do is figure out how to encourage that top part of the ecosystem.

So lesson three, making startups fail less, here's some lessons that we've learned in the last couple of years that I think are fairly critical and are going to be counterintuitive to everything you might know. After 50 years of Silicon Valley history, we now know how to build startups.

First of all, in Silicon Valley we take more technical risk per square foot than probably any other place in the world. More technical risk. And you would think startups would fail because the technology fails. It turns out over 95 percent of startups that fail, fail because they didn't find customers and markets. It's not because their technology didn't work, though it's never on time, I will guarantee you--I guess the engineers in the room are laughing, but it's because they don't find enough customers and markets. It's a big idea.

While we're investing in the technology, the things that don't work for these companies is, oh, we didn't know where our customers work, or we priced it wrong, or we had the wrong distribution channel.

Yet, what's really interesting is how we used to build companies. We used to believe that startups were nothing more than smaller versions of large companies. Now, this is really interesting. I was a business school professor, and I was consulting for a large corporation that had 10, 20, 100,000 people, and I was helping them; I'd say, how hard could it be to, like, give advice to a startup? There's two guys in a garage. You know, these just must be smaller versions of large companies.

So everything that we've learned in the last hundred years about building large corporations, we're just going to tell startups to go do, and that's what we did for 50 years in Silicon Valley. We said, oh, we've got it. They are smaller versions. We now know that they are not, and this is a huge insight.

We now know that startups search for something and the large companies execute. And what that means is startups are searching for who their customers are, what their channel is, how to price the product, *et cetera*. Large companies have been around for a while and they know who their customers are, and they know how to price the product.

This distinction between search and execution is not just a set of words; it's actually the difference in how we would build these things. What we used to believe is that all we have to do is write a business plan. Anybody ever see a startup business plan or a business plan? Yeah, it's a nice document, and it's, you know, big.

Well, we now know we actually have an actual photo of what happens when the plan has first contact with customers. I now found this photo that absolutely represents what it looks like.

All right. What we now know is that there's no possible way that you could write down in a document, sitting in your office or your library or with consultants what the real world looks like. The real world is chaos. But if all we're trying to do is make a plan, we've gotten ahead of ourselves.

And, by the way, if you've ever seen a plan--everybody knows appendix A is the five-year forecast, right? We love forecasts. Tell me what the future is going to be like. And you're sitting here going, I don't even know what tomorrow is going to be looking like, but my investors want a forecast. Okay. I'll type it. I always tell my students there's a secret Excel key code that will auto generate this, and they are still looking for this.

Now, but no one, no one in the history of entrepreneurship ever said, who else used to do five-year plans? And how successful were they? These were the only guys who used to do five-year plans. And we know how this ended up.

And so really if we think about this, what's wrong with this? By the way, I'm not suggesting we never do planning and never do forecasting. I am not suggesting that.

I am suggesting for a startup, what is it that we now know? What we now know is no business plan survives first contact with customers. The reason why is we tend to write it with certainty, but with no facts.

So searching comes before you write this plan. And the question is, searching for what? And this starts by first defining, what the heck is a startup?

So let me give you Steve's definition of a startup, because I never had one. As an entrepreneur doing eight startups, I never even knew what is it am I supposed to be doing other than it's fun serving dinner at night and free food and, you know, you bring your dog to work, but what exactly is a startup?

Number one, which was a real shock for me thinking about it, a startup is a temporary organization. The goal is not to say a startup. In fact, there's no such thing as a 10-year-old startup. There's a 2-year-old startup attached to an 8-year-old failure.

Two is a startup is designed to search for something that's repeatable and scalable. Repeatable means I can do the same thing on Monday and it works on Friday. Scalable says I put a dollar in, I get 1xN dollars out for repeatable and scalable business model.

Now, this is kind of interesting because this all made sense to the word "business model." What the heck is a business model? I thought my job is to build; you know, build a product or to get customers. What do you mean searching for a business model?

So let me give you a quick definition. A business model is how a company creates value for itself and its customers. And it basically says, look, while your company is about your product, it's also about your customers and your channels; that is, how you get your product to the customers; about how you create demand; how you get revenue; how much this stuff costs; you need partners; and what do you need to do? Activities and resources. That is, a business model is all these pieces.

And on that day one, most startups just have guesses because all these guesses are--in fact, at Stanford, because students pay $50,000 a year, I don't use the word "guesses," I use the word "hypotheses" because it actually makes them feel they are getting value for their money. But in other places outside of major universities, we just call them guesses.

If you really think about it on day one, a startup is a faith-based enterprise. It truly is. It's driven by its vision and irrational passion of its founders. The mistake is continuing to operate it as faith-based because what you truly want to do is turn that faith into facts as quickly as possible. And that's the big insight. It's okay to start it with a faith-based hypothesis because you're guessing about a lot of things.

And so what we really want to do is draw this business model on the wall, put Stickies on them, *et cetera*, but now how do we change these guesses into facts? And that's the invention we came up with in the last couple of years, and that's called the customer development process.

It says everything you know or think you know is a guess, so let's get out of the building in a formal process and start testing this a step at a time. And we can test this incredibly rapidly.

Now, the last thing we kind of know--and this is something that took me decades to understand--in a startup, it used to be that when you failed, you made a mistake, you picked the wrong customers, you didn't make your revenue, you fired the VP of sales. And when that didn't work, you fired the VP of marketing. And when that didn't work, you fired the CEO and you shut the company down.

But we now know that most of the time startups go from failure to failure. This is a big idea. Startups don't go from success to success. It only happens in the movies. So the question is, what do you do when the hypotheses don't match reality?

We've come up with a term called "the pivot." The pivot says, look, this is going to happen all the time, so why don't we just embrace the fact that failure will happen; and when it does, we'll change some of our business model. We'll either change the customers or the channel or the pricing. And it's okay as long as we have cash left. And if we embrace the fact that this is part of the process, we'll fire the hypotheses before we fire the founders and executives. And that's a huge insight about early stage ventures.

And so pivots are the result of all these out-of-the-building hypotheses testing and experimentation. And we do this with speed and we do it on a tempo and we do it with a rational focus.

So, in summary, making startups fail less, big idea. Take away, is startups are not smaller versions of large companies. Huge. All the tools and techniques that any of you or your staff has learned in business school for the last hundred years, we've actually taught great tools for execution.

Remember, an MBA, masters of business

administration, not the masters of starting companies. Those tools are excellent for growing large corporations, but we never had our own tools for building early stage ventures; we just kind of tried to adopt these old tools.

What we now know is that before you do a plan, whether it's an operating plan or a financial model, you want to actually run a customer development and business model process before you write the plan.

And so the interesting question is, if you believe any of this, can we teach it?

So we've put together a class in these universities, Stanford, Berkley, Columbia, Cal Tech, and we've also put it together for the National Science Foundation. Within eight weeks, we get teams in front of a hundred customers. We're not talking about doing a survey; we're talking about out of the building, a hundred customers.

Now, you have to be deaf, dumb, and blind not to get some feedback talking to a hundred customers. And not only do I do it for these universities, but last year, the US government adopted this process. The National Science Foundation now uses this; they call this the innovation core to teach the top scientists and engineers in the country to get out of their labs. And we do the same thing, except this time instead of 22-year-olds in hoodies and flip-flops, we're doing it with 45-year-old tenured professors who probably haven't left their labs since their PhD world defense. And we can make them--and we have made them--work as fast as these early-stage ventures.

The National Science Foundation thought this was so productive, they are now scaling this to teach hundreds of teams, of our best scientists in the United States. And other research organizations of the country are adopting the same class. And you'll see other announcements; in fact, NSF will have a major announcement this coming Wednesday.

Because it was the National Science Foundation, they instrumented this class, and they said, Steve, okay, we hear you, we hear this business model customer development stuff, blah, blah, blah, prove to us it works.

So what they did was surveyed students about knowledge coming into the class. What did you know? And the orange bars on the left are essentially we didn't know anything. And if they were successful, we'd move the orange bars to the right to kind of like--some in a great deal. So here is what they knew coming into the class; here is what they knew going out. So, number one, we were able to say we actually taught them a lot about how to build startups. But you know what, that wasn't the goal. That was kind of nice. What we wanted to do, if we could teach them, is how to commercialize their technology and build companies.

So what did the data say about building companies? Again, what did you know about building companies?

Coming into the class, after the class.

And the National Science Foundation kind of said, I think we have something for the first time in 30 years that bridges the gap between basic research and SBIR and STTR grants, which is their funding for commercialization. And they were pretty impressed that we had a process that works.

But for me, I wasn't satisfied. Well, it's nice to teach the elite in our country. If you remember, my definition of entrepreneurship embraces small business, large corporations, and the rest. And because my parents and my background was small business, my question was, well, what about the other 99 percent? Because this same generic process, the same customer development business model design worked for grocery stores, dry cleaners, small businesses trying to get off the ground. Could they use this technique?

Because if you go to the sba.gov site, guess what they tell you to do? How to write a business plan. This was taken this morning. We're still using the same business tools for small businesses from the '50s.

We believe these techniques can now help small businesses fail less. We're working with professors and organizations like Utah--Weber State, in Utah to apply them to small businesses. Other colleges and community colleges are adopting these processes as well. And we believe it will be applicable not just to high-technology, high-growth companies, but to the other 99 percent on Main Street.

So let me close.

What can states do? Let me give you four or five short ideas.

Number one is the culture for entrepreneurship is fail fast and move fast. It's about speed. And it's about not a gotcha game. That we embrace failure as part of the process which, by the way, is counterintuitive when it's a federally or state-funded project, which is why I believe, as you'll hear later, it's something that private capital needs to do. Failure is part of the entrepreneurial process.

Recommendation two is there are incubators and accelerators, that is organizations nationally that are coming into all states who will have them to help concentrate entrepreneurs and give them advice, organization, et cetera.

Startup America happens to be my favorite, along with Startup Weekend. TechStars, a national venture capital firm, links Startup Machine. These are terms that you should all hear about. And, in fact, if you don't have one of these going on in your state, you should figure out how to encourage one or hopefully all of them to set up shop because they add value.

Recommendation three is if you remember my comments about ecosystem, you could have all the smartest entrepreneurs in the world--and I won't tell you which state I travel to which graduates 6,000 world class engineers out of their state university. And at graduation, I swear they must ask, where do you want the plane ticket, East Coast or West Coast? I think that's a waste of enormous talent. What they don't have locally next to that university is a risk capital culture. They have an entrepreneurial culture, but they haven't figured out how to incent private capital to take risks and instead sending their best talent out of the state. I just find that an enormous waste.

And so if you're thinking about investing, it's how to you incent risk capital not by having state replace it, but how do you incent venture capital but grew up in California, or actually was born in your state, worked in California and would love to come back home; or maybe they are on the East Coast. How do you get them? What incentives do you need to have them come back home?

Recommendation four is universities are still teaching how to write a business plan for entrepreneurship. I find that quaint and interesting, and eventually they will all kind of move over to what we've learned, but you can encourage them to do this.

Recommendation five, small business initiatives should be thinking about adopting these same techniques. We now know they work. We now know they are better and more efficient and make startups over a large pool fail less.

So I've open-sourced all this material. "Open source" is a technical term which basically means it's free; it will cost you and your staff absolutely zero. I have hundreds of presentations of my students, the syllabus teaching guides, what we do for the National Science Foundation; this is my way of giving back to the country.

And I'm happy to answer any questions.

So thank you for your time.

(Applause.)

CHAIRMAN HEINEMAN: Steve, don't go far away.

Who wants to ask the first question?

Thank you very much for that excellent presentation.

Jack, go ahead.

VICE CHAIR MARKELL: Thanks for your very interesting presentation. One of your last slides had to do with incenting risk capital to locate nearby entrepreneurial centers. I mean, obviously money will crossover state borders.

I mean, how important is it that the risk capital actually be located, you know, that close or when--you know, if you have good ideas and good entrepreneurs and good companies developing, will they find each other even if it's not located within your borders?

MR. BLANK: You know, in a perfect world, you would hope it was true. It's not. It turns out even in Silicon Valley most VCs think of the East Bay to be a foreign country. And so when you have enough opportunity locally, you tend not to travel.

So I guess the number one priority would be to get a local state set of VCs engaged and interested.

The best model for this actually is not a state, but something the size of one of your states, and it's the country of Israel. I don't know if any of you know, but Israel has more public companies on the stock exchange than all of the European union combined. They are number two to the United States.

There's a book called *Startup Nation* which describes their journey in trying to figure out how to build an entrepreneurial culture. And they got it wrong for 30 years. They started with and socialist model and then they started with a government. Well, the government will fund it. And then they finally realized that the real goal was to give initiatives and incentives to kick start these incubators and venture capital firms and then eventually get out of that business. And that's kind of the model philosophy that I would suggest because venture capitalists don't drive very far. There are exceptions and others will do that, but truly the ultimate is to have a cluster, a small group in your state who know your state, know your culture, know your local universities, know where the talent is, know what the state and the schools are great at and be focused on that.

GOVERNOR [Martin] O'MALLEY: In Maryland, we partnered with--we created an entity called The Maryland/Israel Investment Fund, and it's really been a great partnership, identifying that pipeline to accelerate innovation, create the jobs, fail fast, move fast.

And one of the other things that we found in our ecosystem in Maryland, we were number one in terms of research and development. Per capita does more research and development, and yet we were lagging in terms of commercialization. And in our ecosystem, we identified one of the weaknesses being the lack of venture capital.

So a couple of things that we did this year, we passed something called The Innovation Initiative with a consortium of our great research universities, Mr. Chairman, that are committed--we're a very small amount of money--to move 40 ideas a year out of their labs.

As part of that, they are redoing their culture. So instead of simply rewarding professors in the one path of publication, you get tenure rewards for commercialization--

MR. BLANK: That's great.

GOVERNOR O'MALLEY: --which is a great shift for us. I mean, Johns Hopkins, Maryland, Morgan.

But the other thing we did, I'll share with you, Mr. Chairman--and perhaps it might not be if not a best practice, at least one practice. The year before we created something called Invest Maryland where we held an auction, if you will, for large entities like insurance companies that know they are going to have a tax liability, and we allowed them to forward pay five years of taxes, and that allowed us to create, in essence, a sort of venture fund, if you will, with about $85 million. We thought it would raise 70. It's $85 million. And that's another effort to build on the VC that we have but have a state role in this as well. Not necessarily directly picking the winners and losers, but going through entities that we have that do this, that have boards that are set up.

And I just--you know, in line with some of the things that you were saying, I think every state is a little different when they start off on this, but all of us want to make improvements that allow us to accelerate innovation. And this Invest Maryland is one anyway.

And I'll send it to you, Mr. Chairman.

Have you seen this happening in other states? Have you seen any examples of states that are doing things that the rest of us might copy? We all love being the best at doing something second.

MR. BLANK: Unfortunately, I'm not familiar with all the initiatives in all the states. My last year or two it's been involved with the National Science Foundation, RBE, and DoE, and some DoD initiatives, so I have to apologize, but I'm not, and I'm looking forward to reading this. And the things you describe actually make lots of sense because those are the things we need to move forward.

I just can't emphasize the importance of--one of the things Governor O'Malley said, which was changing the culture inside of the university. And you heard me say the phrase "outward facing." For those of you familiar with universities, academics are inward facing; they worry about publications, they worry about research, they worry about getting grants. They are not worried about starting companies and pushing their graduate students to do that.

In fact, they are happy if their graduate students actually publish more papers and become academics. Well, that's great for the future of research; that's not particularly productive for your state or national economy.

And so what we want is some balance. And I think you've hit on an approach, and others have as well, is how do you incent states to go--research universities to do that? And this might be a great model as well.

GOVERNOR [Tom] CORBETT: Governor O'Malley, we have done for quite a number of years now--since Governor Ridge was Governor of Pennsylvania, we establish two different groups. One on high technology and one on life sciences to do this.

In the life sciences group, we actually took some of the money from the tobacco settlement fund that the attorney's general got back in the early 2000--I think it's 2001-2002--to set up the life science greenhouses. And there's three or four across the Commonwealth of Pennsylvania. And there they are working with successful CEOs of startups who are acting as the mentors that somebody needs to have to take them through this, pretty much as you indicated on there.

And they sit on a board of a new startup company, they actually participate in it. The greenhouse then helps to guide the company from research to commercialization to find who will buy your product.

And at the same time, it helps companies find that venture capital. And what we're seeing is the venture capitalists know where we are.

The same thing on the technology side, we call them the Ben Franklin's--obviously for the reason of Pennsylvania--and there are four locations in Pennsylvania that they exist. Frankly, each one, they are rounding a research university; it could be Penn State University, it could be the University of Penn Drexel, down in Philadelphia. In Pittsburgh, obviously University of Pittsburgh and Carnegie Mellon, which is one, to us in Pennsylvania, one of the greatest startup universities in the country of spinning things out.

It has worked very, very well and we're very pleased. We'll be happy to share with anybody here what we're doing in Pennsylvania.

MR. BLANK: Those are great initiatives. And let me just use that to point out something, which may or may not be obvious. You mentioned life sciences. You know, since the first initial public offering of a life sciences company, Genentech in 1980, life scientists have actually been a segment that venture capitalists have put, you know, billions of dollars in.

But the life cycle of a life sciences company, unlike a software company, takes a decade or more to come to fruition. The problem in the last three years--and I'm just going to tell you the Silicon Valley problem; hopefully it's not Pennsylvania--is that the giant sucking sound you hear is all the money going into social media, where investors are now saying, why should I spend 10 or 15 years waiting for an investment in life sciences or clean tech to come to fruition which needs tens or hundreds of millions of dollars of capital when I could be investing in Instagram or Facebook or hoping I get the next one.

And so that's a risk in all your areas. And, In fact, it's an area where actually states might be able to give incentives where you say, okay, you know what, there's plenty of money going into the next iPhone app. What we want to do is take the best of research of non-iPhone apps or something else which might be an interesting strategy, but you just have to understand how deep those commitments and how long term those commitments are.

And so it's just something interesting that I've seen happening to capital in Silicon Valley. You know, smart money goes where money is being made. And right now the money is being made in Twitter, Facebook, *et cetera*. I think the even smarter money is being the contrarian investors and saying no, no, no, people are still going to need drugs and we're still going to need, you know, clean energy, *et cetera*.

One of the best things we saw come out of the last National Science Foundation happened to be for Pennsylvania for the Marcella shale is how to clean up--produce water from fracked wells where, you know, no Silicon Valley investor would have said, hey, that's something I'm looking to invest in. But when you saw the numbers of how productive that could be, there's some very smart VCs who will be lining up to invest in that. So that was just an aside. I think that's a great program.

CHAIRMAN HEINEMAN: Over there to the

right.

GOVERNOR [Robert] McDONNELL: Steve, I was struck by your comment that programs in our universities, our masters or bachelors in business administration, but not entrepreneurship and startups, and we're seeing some of that change in our universities, but do you have a model program or programs in the country --

MR. BLANK: Yes.

GOVERNOR McDONNELL: -- or at least the elements that you'd see would go into that to change the culture?

MR. BLANK: Yes. And so I just want to . . please don't get me wrong, there are now lots of universities in the last 10 or 15 years who have entrepreneurship programs. And I've taught for my first five years how to write a business plan before I realized that, gee, that's actually the wrong thing we should be teaching, but no one knew what exact . . we kind of knew.

In fact, if any of you ever meet entrepreneurs--right? Anybody ever see them? They are crazy people, right? I mean, they are not normal people. They dress funny. Sometimes you, like, worry, like were they checked for weapons? I mean, they are just--but we kind of knew this and other things about entrepreneurs. But we had no methodology to kind of connect. Well, we know they are different, but why? We know they move at a speed that you don't move in a large company, but why? We know that they write business plans and then ignore them after they get funded, but why?

And so we had no replacement for all this stuff. And it's only in the last couple of years that we put together what we call this Lean LaunchPad curriculum that we now share. And so there's a 100-page teaching guide, we're now training other instructors.

There's a nonprofit called nciia.org which offers training for other universities and colleges interested in teaching this curriculum. All the NSF classes are going online, so by this fall any student or any professor who wants to use all my online material, it's all there. It's being taught at Stanford and Berkley and Columbia. There's even five-day versions of this class instead of semester and quarter versions. I've been experimenting with that. So there's online versions, five-day versions, semester versions, quarter versions. Lots of other people are teaching it, and we're happy to share it.

And, again, it's not because we're

smarter; it's just because we now have learned stuff over the last 50 years. We've learned actually what's the more efficient way to build these things and to realize that, well, we had a hundred years of building a management stack for administering and executing large companies, we never built the equivalent management stack of what it is we do for searching for the business model, and that's what we're doing now. We're just building those tools that we now know if we use those, those are a lot more efficient than the stuff we used to use.

And so the answer is, it's all available. Somebody drop me an e-mail and I'll be happy to send it to your staff and get you connected.

GOVERNOR [Mary] FALLIN: Thank you so much for your presentation. I'm going to check on your Lean LaunchPad because my son is in the School of Entrepreneurship at the University of Oklahoma and I've been to his class presentations where he had to develop a product, worked on a team, did write a business plan, did have his customers. We went to go sell his product, and then we had to report the financial statements of how much he made or didn't make, but that was all fun.

And one of the things we do in

Oklahoma--and probably other states do this--is we have a Governors Cup on entrepreneurship in which we have venture capital, private sector people who will work with our universities and the schools of entrepreneurships and students who have to go through the process, as you were just talking about, and then they actually meet with people who invest in products and services with the students. And it's a big competition. I went and spoke at it recently. There were probably 800 people there--

MR. BLANK: Wow.

GOVERNOR FALLIN: --in teams, but all these teams across the state are very competitive and they get up on stage and do the formal presentation. They weren't real eccentric. I mean, my son had on his business suit and tie and looked good, but they get up in front of adults and basically make their case as to why someone should invest in their product or their service. And it's a great way for a governor to be involved in helping encourage a young person to be involved in the spirit of entrepreneurship.

And if you were to ask my 21-year-old what he's going to do when he graduates from college--he's a senior next year--he'll tell you his three patent ideas and he'll be a millionaire by the time he's 25. And that's had his attitude, but it's just developing that culture of the hope and the dream and the faith that you can do something.

MR. BLANK: Thank you, governor. In fact, you've raised something I just thought I'd share as well.

You know, entrepreneurship--even though the founders might be engineers or business people--actually entrepreneurs, founders of companies, are closer to artists than anything else if you think about it. Artists see something that other people don't. And, in fact, they see it when there's a blank canvas or a blank score sheet or a block of marble, and they are capable of convincing other people with some kind of reality distortion field. They say, no, no, no. Look, it's going to be great, but, you know...

And one of the interesting things about what you mentioned is we've been teaching art for thousands of years, right, and we teach it now in our states and in our schools on multiple levels. We teach art appreciation to everybody, we teach technique, and we teach practice and whatever. I think entrepreneurship in business should be taught in this country the same way. We should teach business appreciation as early as we can. We should teach technique, *et cetera*. We should think of it as teaching artists.

The other thing I'll just mention is not only are we changing the mind of entrepreneurs now, but we're also changing how venture capitalists think about starting companies because right now--you know, Steve, you can say everything, but our local venture capitalists still want to see a business plan. And this is the kind of the golden rule, is he who has the gold makes the rules.

But any venture capitalist who's been exposed to this process--and I should just point out there's one in this room, John Burk, from True Ventures here in Virginia, who actually volunteered his time for the government, the National Science Foundation, and now we can't get him out of the class because--he just realized as he sat through the process that actually we've now discovered a more efficient one. And so if you want to talk to a venture capitalist who has been through their process, there's one here.

So I know my time is short, like over. Can we--

CHAIRMAN HEINEMAN: One more question.

MR. BLANK: Who has the best question?

CHAIRMAN HEINEMAN: That's it.

MR. BLANK: That's the end? Thank you very much.

(Applause.)

CHAIRMAN HEINEMAN: Steve, thank you very much for that presentation and the response to the questions.

GOVERNOR [John] HICKENLOOPER: Mr. Chair, I am a little disappointed that not more governors left the defense of entrepreneurs.

CHAIRMAN HEINEMAN: Well, I was going to say something about you if you just hold off for just a moment.

As a result of your presentation, I now understand how a crazy, successful entrepreneur became an outstanding, respected governor in the State of Colorado.

So if you want to go ahead and respond. Was that good enough?

He liked it when you got to artists. I could see the smile on his face that he was moving up the ladder, but you should talk to Governor Hickenlooper; he's got a great success story in terms of what he did.

So for all of us, if you haven't had a chance to talk to John like I have, you should because what he did in his previous life prior to becoming governor is a great story.

We have a few things we need to do before we shut down this particular meeting.

First of all, I want to take Governor Bob McDonnell and Maureen for absolutely being fantastic hosts.

GOVERNOR McDONNELL: Thank you.

CHAIRMAN HEINEMAN: I truly enjoyed the opportunity last night to talk to Governor Jefferson and Governor Henry. But, again, I assure you they have gone back into retirement, so you're safe, okay.

Secondly, I want to ask Governor [Scott] Walker to come forward. I thought he would be riding a Harley, but apparently not, to talk about the next annual meeting which will be in Milwaukee, Wisconsin, in 2013.

GOVERNOR WALKER: I would have had more, but Hickenlooper ate half my cheese sitting over there. Actually, it's an appropriate connection to entrepreneurs because John before he was mayor--before governor and now before mayor--was a great entrepreneur, still is an entrepreneur, and helped open up a number of brew pubs in Wisconsin. So he's very well connected because you're going to get some good cheese next year, some good beer, both from microbreweries as well as big companies like Miller, which is connected to John as well since we have that joint venture Miller/Coors. We hope that you'll join us.

First of all, I want to add our thanks as well from our family, from Tonette, Matt, Alex, and I, to Bob and Maureen and to the whole team here in Virginia from Williamsburg and Jamestown. It's been an outstanding time.

Our hope next year is not to beat it because we had a great time here, we had a great time with Gary and Jeanette's efforts in Utah last year, but to be just as great as the last two years. We've had an honor of being at the summer meeting of the NGA.

And we hope you all join us. The date is a little bit later. The NGA set it up so it will be Thursday, August 1st through Sunday, August 4th. It will be in Milwaukee, so, again, not only will you get great cheese and beer and brats and outstanding food, but thinking of that beer, one of the spots a lot of you have asked about is our ballpark, Miller Park, in which ESPN just named as the best ballpark in the major leagues, and so we're going to work out an opportunity to do one of the events, one of our activities--ESPN did it Tom. It's not me. And maybe by that point the Pirates will be back where we'd like them to be--but we won't get into that.

But our hope is that you can join us for that. You'll have a fabulous time; it's a great ballpark. We'll spend some time--a little bit of history. I didn't write it in, but you have as one of your--my props, but a gift for all of you to remember--you have at your spot there one of our bandanas from the Harley-Davidson Museum. Obviously very authentic. And we don't have the history that they do in Virginia, but next year is the 110th anniversary of Harley-Davidson and so . . just a few weeks after we'll be there. So one of the things we're going to do is work out an event at the Harley-Davidson museum.

I like it.

See, my staff asked me to put that on, but they didn't think I would be goofy enough to do that. You look like an entrepreneur now.

He looks like an entrepreneur, doesn't he?

Last year you liked that hat and now you're running with this, but I'll bring you a cheese head for our event when we're in Wisconsin.

But we got a little deal and a little bit of a challenge. To make that challenge work out, I was thinking around--you know, unfortunately a couple of the governors I know who ride--one, in particular you wouldn't suspect, Mitch Daniels rides a Harley-Davidson. I ride a Harley-Davidson. I have a 2003 anniversary edition Harley. One of the things we thought would be fun when we're at the Harley-Davidson Museum is to bring a bunch of governors and spouses . . I'm going to work on Wade coming with me because I know it's not a Harley you ride, but we'll find one for you, and maybe some other staff and others out there.

But for any governor who is interested between now and next summer in joining me--it won't be a long ride but a short ride in--we'll work out a deal at the dealership closest to your capital to get you trained in the Harley-Davidson riders-ed course so you can go in the race with us.

And, John, you probably remember former mayor John Norquist in Milwaukee. John and I, 10 years ago--I never rode a bike before the Harley-Davidson 100th anniversary--Norquist and I kind of dared each other to get the course and we led 10,000 bikes going down the street at the start of that. It's an absolute rush. It won't be 10,000 bikes.

But for any of you--and I'm working on Jack--I have to work on your wife more than anything, right? But although you'd be good at it, too, I think. We can get you in that course as well. But we'd love to have you join us, even if you're not riding, just to have you participate in that.

And then one of the other great events we're going to have: a lot of people on the coast don't recognize this, but we have a tremendous shoreline along Lake Michigan and we've got just up from the Summer Fest, the world's largest music festival; we have the Milwaukee Art Museum, the only [Santiago] Calatrava design. First--not the only--the first Calatrava designed art museum in North America, and a number of other great things on the lakefront; we want to show that off. And we're hoping that you can come and join us August 1st through the 4th.

We hope for governors you bring your spouses, bring your families, bring your staff. And for the corporate fellows and the sponsors and others here and everybody else that's interested, we hope you come. And if you're interested, we can also help you arrange a little bit of time to come early and stay late if you'd like.

If you like golf, Kohler is just up the way from Milwaukee; Whistling Straits; and Blackwolf Run. Blackwolf Run just two weeks ago had the US Women's Open. And so there's some great golf in there and we can arrange for you to come a day or two early and participate in that as well.

So hope to see you in February in DC but in a year from now in Wisconsin.

(Applause.)

CHAIRMAN HEINEMAN: Scott, thank you very much. I know Jack is very interested, along with his vice chair, to ride those Harleys into Milwaukee in that event. I'll look forward to cheering them on.

Now, before we move to our new leadership, I want to remind everybody after this meeting concludes, there will be a movie screening of "Won't Back Down." The movie will be shown at 12:30 in the Rockefeller room at the end.

And, Governor Hickenlooper, thank you again for arranging that.

It's truly been my great honor to serve as the chair of this organization the past year. I followed in the footsteps of a terrific chair, Chris Gregoire, who taught me everything that I should know in this job; and it's a tough job on a lot of different days.

But I want to thank all the governors and your staffs for all the hard work. From the NGA to continue to move forward, to do what we do effectively, it can't be done without the support of the governors and your staffs; and we really worked hard to get you more and more involved.

I also want to thank the NGA staff. I want to thank them for their expert advice and counsel, for the technical assistance that you provide to all of our state governments, and for organizing all these meetings which turn out to be very, very successful meetings.

It's been a pleasure for me to get to know the staff better. There's a lot of expertise there that you can call on an individual basis. And I also want to thank my staff personally; we have a small staff. And particularly I want to thank Lauren Kintner of my staff. In addition to all her normal duties, to head up our policy research office, to be my legal counsel for the past year, I made her do a little extra work with the NGA. And none of us can do it without our great staff, and I'm very thankful for their support and their dedication and their commitment. And we all are involved in that every single day.

With that, now I'd like to call on the chair of our Nominating Committee Governor [Steven] Beshear to report the decisions of your committee and to nominate the new leaders of NGA Kentucky.

GOVERNOR BESHEAR: Thank you, Mr. Chairman.

Meeting here in one of our cradles of democracy, the Nominating Committee felt inspired to do some extra effort in our deliberations. They began yesterday at the receptions after the session, they continued at the Governor's Palace last night, adjourned to the Raleigh Tavern, and other venues. And we worked late into the night, but we have come with a unanimous recommendation to nominate the following governors to serve on the 2012-2013 NGA Executive Committee and as NGA leadership:

Governor John Hickenlooper, of Colorado; Governor Mark Dayton, of Minnesota; Governor Mike Beebe, of Arkansas; Governor Dave Heineman, of Nebraska; Governor Chris Christie, of New Jersey; Governor Scott Walker, of Wisconsin; and Governor Gary

Herbert, of Utah.

And as the new vice chair of NGA, Governor Mary Fallin, of Oklahoma; and as chair, Governor Jack Markell, of Delaware.

And so, Mr. Chairman, I move that these nominations be adopted *en blanc*.

CHAIRMAN HEINEMAN: Is there a second?

GOVERNOR BRANSTAD: Second.

CHAIRMAN HEINEMAN: All in favor, please say aye.

(All members said aye.)

CHAIRMAN HEINEMAN: Opposed, no.

The ayes have it.

Before I turn it over to Governor Markell, I'd just like to say a few words personally about Jack.

As many of you know, we've known each other for a long period of time. I have great respect for what he's done as the Governor of Delaware, but more importantly for what he did for me as vice chair. We've had an absolutely terrific partnership. I could talk to Jack about any single issue, we could have a great conversation, and move forward on behalf of the NGA.

My wife, Sally, who actually has walked

in now, we were very honored and pleased to get to know Jack and Carla on an even better basis than we've known them in the past. We want to thank both of you for all that you've done for us.

But, Jack, it is now time for you to take over. Here is the gavel. Good luck and congratulations.

(Applause.)

CHAIRMAN MARKELL: Well, thank you, Dave. And I want to tell Governor Beshear how good it feels to know that it's only after serious drinking that I was actually selected to be the chair of this organization, something that my staff will not be the least bit surprised about.

And I do want to thank my wife, Carla, for being here as well.

So to Governor McDonnell, thank you again to you and Maureen; really, this has really been phenomenal. Thank you so much for your hospitality.

Scott, we look forward to being in Milwaukee. And I'll try and convince Carl that I actually do this little training exercise, yes. That would be interesting, I have to say.

To Dave, I really do want to thank you for your just phenomenal leadership of the National

Governors Association.

As Dave has said, we have known each other for a long time; we served as state treasurers together. I remember going to new treasurer's school back in 1999, and Dave Heineman was the first treasurer that I met. He really helped me a lot then, and he's helped me a lot this year.

You have been just a really great, great leader. I know that Mary Fallin and I look forward to following in your footsteps and to continue to build on the great work that you have done in your role leading NGA.

And on behalf of the National Governors Association, I'm going to give a gavel right back to you. And this one says, "Presented to Dave Heineman, Governor of Nebraska, for his outstanding leadership as chair of the National Governors Association 2011-2012 on the occasion of the NGA Annual Meeting."

So, Dave, thank you very much.

(Applause.)

CHAIRMAN MARKELL: Now, each year the NGA chair gets to choose an initiative to focus on. Governor Heineman's has been about growing state economies. He's given each of us some great tools, some great information. I think the speech today really builds on that. And I want to thank him for doing a great initiative. And I wanted to talk just briefly about my initiative.

My initiative is going to be called “A Better Bottom Line: Employing People with Disabilities.” And I'd like to explain where this comes from.

About eight or nine years ago, I visited a facility in Delaware run by then MBNA. It's now run by Bank of America. This employer has been a great leader for many, many years at employing people with disabilities. And in Delaware they employed about 300. Many of them do make promotional materials, but they do a wide range of jobs.

And I remember that day; I went in and I met a 25-year-old man. He was making T-shirts. And he told me proudly that he had gotten up that morning to come to work. And I asked him what he had done before he had this opportunity to work at MBNA and he told me that he had sat at home for six years watching TV with his parents.

And honestly, a light bulb went off in my head. Understanding the incredible improvement in the quality of life of this man and the improvement in the quality of life for his family--because he, like the rest of us only want every day to wake up, to be able to feel like they are part of something that's bigger than themselves, be part of a team, be productive, and, of course, earn a paycheck as well.

And I focused a lot on this issue over the years. And when I knew I had the opportunity to serve as the chair of the National Governors Association, I knew that this was something that . . this is not a Democratic issue, this is not a Republican issue, and I really believe, and continue to believe, that this is an issue that all governors across the country can embrace and can really make a difference on.

Today, Americans with disabilities face disproportionately high rates of unemployment. Some of these rates are, frankly, staggering. And individuals with disabilities should have, to the extent possible, the same opportunities that all of us do, to live close to family and friends, to live independently and in safe communities, to engage in productive employment, and to participate in community life.

And my initiative, “A Better Bottom Line: Employing People with Disabilities,” simply aims to increase employment among individuals with disabilities.

And specifically my initiative is going to focus on the employment challenges that affect individuals with intellectual and other disabilities, including veterans that return wounded from battle and the role that both of state governments can play as well as the businesses can play in facilitating and advancing opportunities for these individuals to be gainfully employed in the competitive labor market.

Now, successfully achieving that goal will require not only attention to appropriate training and job placement and work-based support, but also best practices and meaningful engagement of the business community.

And that really means engaging with the business community about how productive and loyal and how valuable these individuals can be, both to the company's culture and to the company's bottom line.

And so this initiative is going to provide governors and other state policymakers with better policy options to assess the environments in our own states and to provide strategies designed to support this population.

Major emphasis is going to be on people who have significant intellectual and developmental disabilities and that may require supports like job coaches and personal attendants in order to live and work in the community.

And what we're going to do is we're going to convene governors and businesses, business leaders, disability leaders, and other leaders throughout the year to share ideas and move forward with support for this population. And more specifically this initiative is going to create a blueprint for businesses in states, identifying best practices, outlining steps that can be put in place, to increase employment of people with disabilities, and also heighten awareness and launch a campaign to help governors put in place practices that fit best in our own state's efforts to increase employment for people with disabilities.

I am very excited to start this initiative. It's the right thing to do, it's the smart thing for government to do, and it makes good business sense.

Now, while the initiative is just being formally announced today, I've been talking with people about it for a few months, as we came to decide on it and we got closer to launch. And there is tremendous support out here for this.

Last month, Walgreens hosted the first ever CEO summit on this issue. And I was really pleased. Honestly, I was honored to join Senator Tom Harkin (D-IA) and Congressman Pete Sessions (R-TX) at this meeting. It was in Connecticut and it included senior-level executives, including many CEOs from companies that employ hundreds of thousands of people and, more likely than not, in each of your states.

Companies like Amerigroup, Performance Materials, Best Buy, Clark Companies, Ernst & Young, GE Lighting, IBM, Lowe's, McClain & Company, Merck, OfficeMax, SAP, Proctor & Gamble, UPS, Walgreens, and Wal-Mart. That is to name a few.

Now, those companies don't have a lot in common in what they sell or how they sell it. Each has a different mission and each has a different corporate culture. And I can tell you that having Senator Tom Harkin and Pete Sessions working together, these two really impressive guys don't live anywhere near each other on the audiological spectrum, but when it comes to this issue, they are very much together.

And those companies and those leaders realize the common value and the common purpose behind this issue. And they shared stories about how investing in people with disabilities and giving them a chance for employment--this is not just about what makes social sense; this is good for their bottom line. And that's not just my opinion, that's coming directly from the CEOs themselves.

Walgreens, for example, we were hosted in Connecticut at a tremendous distribution center right near the Hartford Airport. Walgreens, a true leader, 500 people employed at this particular distribution center, half of them people with disabilities. And Walgreens compares their distribution centers across the country, and this one, the performance is just as good, if not better, than all their other distribution centers.

And, for example, they found that their best forklift operators happen to be deaf. This is good not just to social policy, this is what's good for the bottom line.

And I know that our NGA corporate fellows will have their own stories to share.

And the bottom line is that there are so many people with disabilities who have the time, they have the talent, and they have the desire to make meaningful contributions to interested employers.

It doesn't matter whether you were born with additional challenges to face or as in the case of our wounded veterans who return home, whether you have acquired them later in life, what matters is what you have to offer.

And I look forward to working with all of to you find these inspiring stories in your states, to recognizing what's working best to get people back to work, and to helping more and more companies recognize that creating greater economic opportunity for these workers improves their own bottom line as well.

And between them and between our own governments as employers, we can, in fact, ensure that individuals with disabilities will have opportunities for a brighter future.

I want to thank all of you for being here with us for this 104th Annual Meeting, and we are now adjourned.

(The proceedings adjourned at 12:19 p.m.)

COURT REPORTER'S CERTIFICATE

I, Scott D. Gregg, Registered Professional Reporter, certify that I recorded verbatim by stenotype the proceedings in the captioned cause before the National Governors Association, Williamsburg, Virginia, on the 15th day of July, 2012.

I further certify that to the best of my knowledge and belief, the foregoing transcript constitutes a true and correct transcript of the said proceedings.

Given under my hand this day of , 2012, at Norfolk, Virginia.

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Scott D. Gregg, RPR

Notary Public

Notary Registration No. 215323