The Customer Development Methodology

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Goals of This Presentation

- A new model for startups
- Introduce the Customer Development model
- Translate this knowledge into a better Company
Product Development Model

- Concept/Seed Round
- Product Dev.
- Alpha/Beta Test
- Launch/1st Ship
What’s Wrong With This?

Concept/Seed Round → Product Dev. → Alpha/Beta Test → Launch/1st Ship

Marketing
- Create Marcom Materials
- Create Positioning

- Hire PR Agency
- Early Buzz

- Create Demand
- Launch Event
- “Branding”
What’s Wrong With This?

Product Development

- Concept/Seed Round
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Marketing
- Create Marcom Materials
- Create Positioning
- Hire PR Agency
- Early Buzz
- Create Demand
- Launch Event
- “Branding”

Sales
- Hire Sales VP
- Hire 1st Sales Staff
- Build Sales Organization
What’s Wrong With This?

Product Development

- Concept/Seed Round
  - Hire Sales VP
  - Hire 1st Sales Staff

- Product Dev.
  - Create Marcom Materials
  - Create Positioning
  - Hire First Bus Dev

- Alpha/Beta Test
  - Hire PR Agency
  - Early Buzz

- Launch/1st Ship
  - Create Demand
  - Launch Event
  - “Branding”
  - Do deals for FCS

Marketing

Sales

Business Development

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Build It And They Will Come

- Only true for life and death products
  - i.e. Biotech Cancer Cure
  - Issues are development risks and distribution, not customer acceptance
- Not true for most other products
  - Software, Consumer, Web
  - Issues are customer acceptance and market adoption
Chasing The FCS Date

- Sales & Marketing costs are front loaded
  - focused on execution vs. learning & discovery
- First Customer Ship becomes the goal
- Execution & hiring predicated on business plan hypothesis
- Heavy spending hit if product launch is wrong
- Financial projections, assumes all startups are the same

= You don’t know if you’re wrong until you’re out of business/ money
If
Startups Fail from a Lack of customers not Product Development Failure

Then Why Do we have:
- process to manage product development
- no process to manage customer development
An Inexpensive Fix

Focus on Customers and Markets from Day One

How?
Build a **Customer** Development Process

**Product Development**

- **Concept/Seed Round** → **Product Dev.** → **Alpha/Beta Test** → **Launch/1st Ship**

**Customer Development**

- **?** → **?** → **?** → **?** → **?**

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Customer Development is as important as Product Development
Customer Development: Big Ideas

- Parallel process to Product Development
- Measurable Checkpoints
- Not tied to FCS, but to customer milestones
- Notion of Market Types to represent reality
- Emphasis is on learning & discovery before execution
Customer Development Heuristics

- There are no facts inside your building, so get outside
- Develop for the Few, not the Many
- Earlyvangelists make your company
  - And are smarter than you
- Focus Groups are for big companies, not startups
- The goal for release 1 is the minimum feature set for earlyvangelists
Customer Discovery: Step 1

- Stop selling, start listening
  - There are no facts inside your building, so get outside

- Test your hypotheses
  - Two are fundamental: problem and product concept
Customer Discovery: Exit Criteria

- What are your customers top problems?
  - How much will they pay to solve them?
- Does your product concept solve them?
  - Do customers agree?
  - How much will they pay?
- Draw a day-in-the-life of a customer
  - before & after your product
- Draw the org chart of users & buyers
Sidebar

How to Think About Opportunities
“Venture-Scale” Businesses

- Create or add value to a customer
- Solve a significant problem/want or need, for which someone is willing to pay a premium
- A good fit with the founder(s) and team at the time
- Can grow large (≥$100 million)
- Attractive returns for investor
Ideas

- Technology Driven
  - Is it buildable now? How much R, how much D?
  - Does it depend on anything else?
  - Are there IP issues?

- Customer Driven
  - Is there an articulated customer need?
  - How do you know?
  - How big a market and when?
  - Are others trying to solve it? If so, why you?
  - Does it solve an existing customer problem?

- Opportunity Driven
  - Is there an opportunity no one sees but you do?
  - How do you know it’s a vision not a hallucination?
Facts Vs. Hypothesis

- Opportunity Assessment
  - How big is the problem/need/desire?
  - How much of it can I take?
- Sales
- Distribution Channel
- Marketing
- Engineering
End of Sidebar
Customer Validation: Step 2

- Develop a repeatable sales process
- Only early evangelists are crazy enough to buy
Customer Validation: Exit Criteria

- Do you have a proven sales roadmap?
  - Org chart? Influence map?

- Do you understand the sales cycle?
  - ASP, LTV, ROI, etc.

- Do you have a set of orders ($’s) validating the roadmap?

- Does the financial model make sense?
Customer Development Engineering
And Agile Development Methodologies
Traditional Agile (XP) Tactics

- **Planning game**
  - programmers estimate effort of implementing cust stories
  - customer decides about scope and timing of releases
- **Short releases**
  - new release every 2-3 months
- **Simple design**
  - emphasis on simplest design
- **Testing**
  - development test driven. Unit tests before code
- **Refactoring**
  - restructuring and changes to simplify
- **Pair Programming**
  - 2 people at 1 computer
Unit of progress: Advance to Next Stage

Waterfall

Problem: known
Unit of progress: Advance to Next Stage

Waterfall

Problem: known

Solution: known
Unit of progress: Advance to Next Stage

Problem: known

Solution: known
Agile Development

• “Our highest priority is to satisfy the customer through early and continuous delivery of valuable software.” [http://agilemanifesto.org/](http://agilemanifesto.org/)

• Embrace Change
  – Build what you need today
  – Process-oriented development so change is painless

• Prefer flexibility to perfection
  – Ship early and often
  – Test-driven to find and prevent bugs
  – Continuous improvement vs. ship-and-maintain
Unit of progress: Working Software, Features

Agile (XP)

“Product Owner” or in-house customer

Problem: known
Unit of progress: Working Software, Features

Agile (XP)

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Unit of progress: Learning about Customers

Customer Development Engineering

Customer Discovery → Customer Validation → Customer Creation → Scale Company

Problem: unknown

Hypotheses, experiments, insights

Customer Development in the High-Tech Enterprise  September 2008
Unit of progress: Learning about Customers

Customer Development Engineering

Problem: unknown
Solution: unknown

Hypotheses, experiments, insights
Unit of progress: Learning about Customers

Customer Development Engineering

Customer Discovery → Customer Validation → Customer Creation → Scale Company

Problem: unknown

Solution: unknown

Hypotheses, experiments, insights

Extreme Programming Project

Source: extremeprogramming.org

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Unit of progress: Learning about Customers

Customer Development Engineering

Customer Discovery → Customer Validation → Customer Creation → Scale Company

Problem: unknown → Solution: unknown

Data, feedback, insights → Hypotheses, experiments, insights

Customer Development in the High-Tech Enterprise  September 2008
Unit of progress: Learning about Customers

Customer Development Engineering
Incremental, quick, minimum features, revenue/customer validation

Problem: unknown
Solution: unknown

Hypotheses, experiments, insights

Data, feedback, insights

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Customer Development

*Engineering Tactics*

- Split-test (A/B) experimentation
- Extremely rapid deployment
  - Continuous deployment, if possible
    - At IMVU, 20-30 times per day on average
- Just-in-time architecture and infrastructure
  - Incremental investment for incremental benefit
  - Software “immune system” to prevent defects
- Five why's
  - Use defects to drive infrastructure investments
Five Why's

- Any defect that affects a stakeholder is a learning opportunity
- We’re not done until we’ve addressed the root cause…
- … including, why didn’t any of our prevention tactics catch it?
- Technique is to “ask why five times” to get to the root cause
Five Why's Example

- For example:
  - Why did we change the software so that we don't make any money anymore?
  - Why didn’t operations get paged?
  - Why didn’t the cluster immune system reject the change?
  - Why didn’t automated tests go red and stop the line?
  - Why wasn’t the engineer trained not to make the mistake?

- We’re not done until we’ve taken corrective action at all five levels
Customer Development Engineering

- How do you build a product development team that can thrive in a startup environment?

- Let's start with the traditional way... Waterfall
  - “The waterfall model is a sequential software development model in which development is seen as flowing steadily downwards through the phases of requirements analysis, design, implementation, testing (validation), integration, and maintenance.”
End of Sidebar
Customer Creation
Step 3

- Creation comes after proof of sales
- Creation is where you “cross the chasm”
- It is a strategy not a tactic
Customer Creation

- Big Idea 1: Grow customers from few to many

- Big Idea 2: Four Customer Creation activities:
  - Year One objectives
  - Positioning
  - Launch
  - Demand creation

- Big Idea 3: Creation is different for each of the three types of startups
New Product Conundrum

- New Product Introduction methodologies sometimes work, yet sometimes fail
  - Why?
  - Is it the people that are different?
  - Is it the product that are different?
- Perhaps there are different “types” of startups?
Three Types of Markets

- Existing Market
- Resegmented Market
- New Market
Three Types of Markets

- Existing Market
- Resegmented Market
- New Market

- Who Cares?
- Type of Market changes EVERYTHING
- Sales, marketing and business development differ radically by market type
- Details next week
Type of Market Changes Everything

Existing Market | Resegmented Market | New Market

- **Market**
  - Market Size
  - Cost of Entry
  - Launch Type
  - Competitive Barriers
  - Positioning

- **Sales**
  - Sales Model
  - Margins
  - Sales Cycle
  - Chasm Width

- **Customers**
  - Needs
  - Adoption

- **Finance**
  - Ongoing Capital
  - Time to Profitability
### Definitions: Three Types of Markets

<table>
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<tr>
<th>Existing Market</th>
<th>Resegmented Market</th>
<th>New Market</th>
</tr>
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<tbody>
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<td>Faster/Better = High end</td>
<td>Niche = marketing/branding driven</td>
<td>Cheaper/good enough can create a new class of product/customer</td>
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- **Existing Market**
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- **Resegmented Market**
  - Niche = marketing/branding driven
  - Cheaper = low end

- **New Market**
  - Cheaper/good enough can create a new class of product/customer
  - Innovative/never existed before
Existing Market Definition

- Are there current customers who would:
  - Need the most performance possible?
- Is there a *scalable* business model at this point?
- Is there a *defensible* business model
  - Are there sufficient barriers to competition from incumbents?
Resegmented Market Definition (1)
Low End

- Are there customers at the low end of the market who would:
  - buy less (but good enough) performance
  - if they could get it at a lower price?
- Is there a business profitable at this low-end?
- Are there sufficient barriers to competition from incumbents?
Resegmented Market Definition (2)

Niche

- Are there customers in the current market who would:
  - buy if it addressed their specific needs
  - if it was the same price?
  - If it cost more?
- Is there a defensible business model at this point?
- Are there barriers to competition from incumbents?
New Market Definition

- Is there a large customer base who couldn’t do this before?
  - Because of cost, availability, skill…?
- Did they have to go to an inconvenient, centralized location?
- Are there barriers to competition from incumbents?
Hybrid Markets

- Some products fall into Hybrid Markets
- Combine characteristics of both a new market and low-end resegmentation
  - SouthWest Airlines
  - Dell Computers
  - Cell Phones
  - Apple IPhone?
Company Building: Step 4

- (Re)build your company’s organization & management
- Re look at your mission
Company Building: Big Ideas

- **Big Idea 1:**
  Management needs to change as the company grows
  - Founders are casualties
  - Development centric $\Rightarrow$
  - Mission-centric $\Rightarrow$
  - Process-centric

- **Big Idea 2:**
  Sales Growth needs to match market type
Company Building: Exit Criteria

- Does sales growth plan match market type?
- Does spending plan match market type?
- Does the board agree?
- Is your team right for the stage of company?
- Have you built a mission-oriented culture?
New Product Conundrum

- New Product Introduction methodologies sometimes work, yet sometimes fail
  - Why?
  - Is it the people that are different?
  - Is it the product that are different?
- Perhaps there are different “types” of startups?
## A Plethora of Opportunities

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What Vertical Market am I In?

- Web 2.0
- Enterprise Software
- Enterprise Hardware
- Communication Hdw
- Communication Sftw
- Consumer Electronics
- Game Software

- Semiconductors
- Electronic Design Automation
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## Market Risk vs. Invention Risk

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Startup Checklist - 2

- Market Risk?
- Technical Risk?
- Both?
## Execution: Lots to Worry About

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### Startup Checklist - 3

- **Opportunity**: Where does the idea come from?
- **Innovation**: Where is the innovation?
- **Customer**: Who is the User/Payer?
- **Competition**: Who is the competitor/complementor?
- **Sales**: What is the Channel to reach the customer?
- **Marketing**: How do you create end user demand?
- **What does Biz Dev do?**: Deals? Partnerships? Sales?
- **Business/Revenue Model(s)**: How do we organize to make money?
- **IP/Patents/Regulatory Issues?**: How and how long?
- **Time to Market**: How long does it take to get to market?
- **Product Development Model**: How to you engineer it?
- **Manufacturing**: What does it take to build it?
- **Seed Financing**: How much? When?
- **Follow-on Financing**: How much? When?
- **Liquidity**: How much? When?
## Execution: Very Different by Vertical

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<td>Possible Business/Revenue Model(s): How do we organize to make money?</td>
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Note: The table provides a comparison of various aspects across different verticals, including opportunity, innovation, customer, competition, sales, marketing, what does Biz Dev do, customer development steps, possible business/revenue models, and IP/patents.
# Market Risk Reduction Strategy

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| Competition: Who is the competitor/complementor? | No first mover for customers | First Mover? | First Mover? | First Mover? | First Mover? | First Mover? | First Mover? | First Mover? | First Mover? | First Mover? | First Mover? |

| Sales: What is the Channel to reach the customer? | Web | Direct $150K | SLM head | Tiesales Web | Direct $150K | SLM head | Channel VAR’s Sydintegrators | Direct OEM VAR’s | Retail Distributor Web | License Distributor Web | Direct to retail | OEM Dist Jeh License | Direct VAR’s Tiesales | Direct System Integrators Partners | VAR’s License Direct |


| What does Biz Do? | Affiliates Developers | Whole-Product | Whole-Product | Whole-Product | Channel alliances | Distribution Deals | Whole-Product | Distribution Deals | Channel-Partners | Licensing |

| Customer: Do end users matter? | All | All | All | All | All | All | All | All | All | All |

| Possible Business Model(s) | Advertising | Infomediary | Brokering | Merchant | Direct | Saas Cloud | SOA | Open Source | Direct | Direct | Direct | Direct | OEM | OEM | OEM | OEM | OEM | License | Direct sale | Indirect Raps |

| Possible Business Model(s) | FIPCO | RichCo | $CDIC | LPC | NRDO | Commute | Research | Discovery | Technology | Platform | Technology | Therapeutic | 2: Diagnostics |

| IP/Patents | N/A | Optional | Optional | Optional | Important | Important | Important |

| Note: Patents are Critical | No |

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**September 2008**
Customer Development and the Business Plan
The Traditional Plan & Pitch

Since You Can’t Answer my real questions here’s the checklist

- Technology
- Team
- Product
- Opportunity
- Customer Problem
- Business Model
- Customers

Better
Business Plan Becomes the Funding Slides

Concept → Business Plan → Seed or Series A → Execute → Fire Founders
Why Don’t VC’s Believe a Word You Say?

- What’s wrong with a business plan?
  - Hypothesis are untested
  - Execution Oriented
    - Assumes hypothesis are facts
  - Static
    - No change upon contact with customer and market
What Are Early Stage Investors Really Asking?

- Are you going to:
  - Blow my initial investment?
  - Or are you going to make me a ton of money?

- Are there customers?
  - How many? Now? Later?

- Is there a profitable business model?
  - Can it scale?
“Lessons Learned” Drives Funding

Do this first instead of fund raising
Credibility Increases Valuation

Customer Development and the Business Plan

- Extract the hypotheses from the plan
- Leave the building to test the hypothesis
- Present the results as: “Lessons Learned from our customers”
- Iterate Plan
The Customer Development Presentation

- Answer the implicit questions about the viability of the business
- Tell the Discovery & Validation story
  - Lessons Learned & “Our Customers Told Us”
  - Graph some important upward trend
Customer Development:

- Parallel process to Product Development
- Hypothesis Testing
- Measurable Checkpoints
- Not tied to FCS, but to customer milestones
- Notion of Market Types to represent reality
- Emphasis is on learning & discovery before execution
Further Reading

Course Text at:

www.cafepress.com/kandsranch
or
www.amazon.com