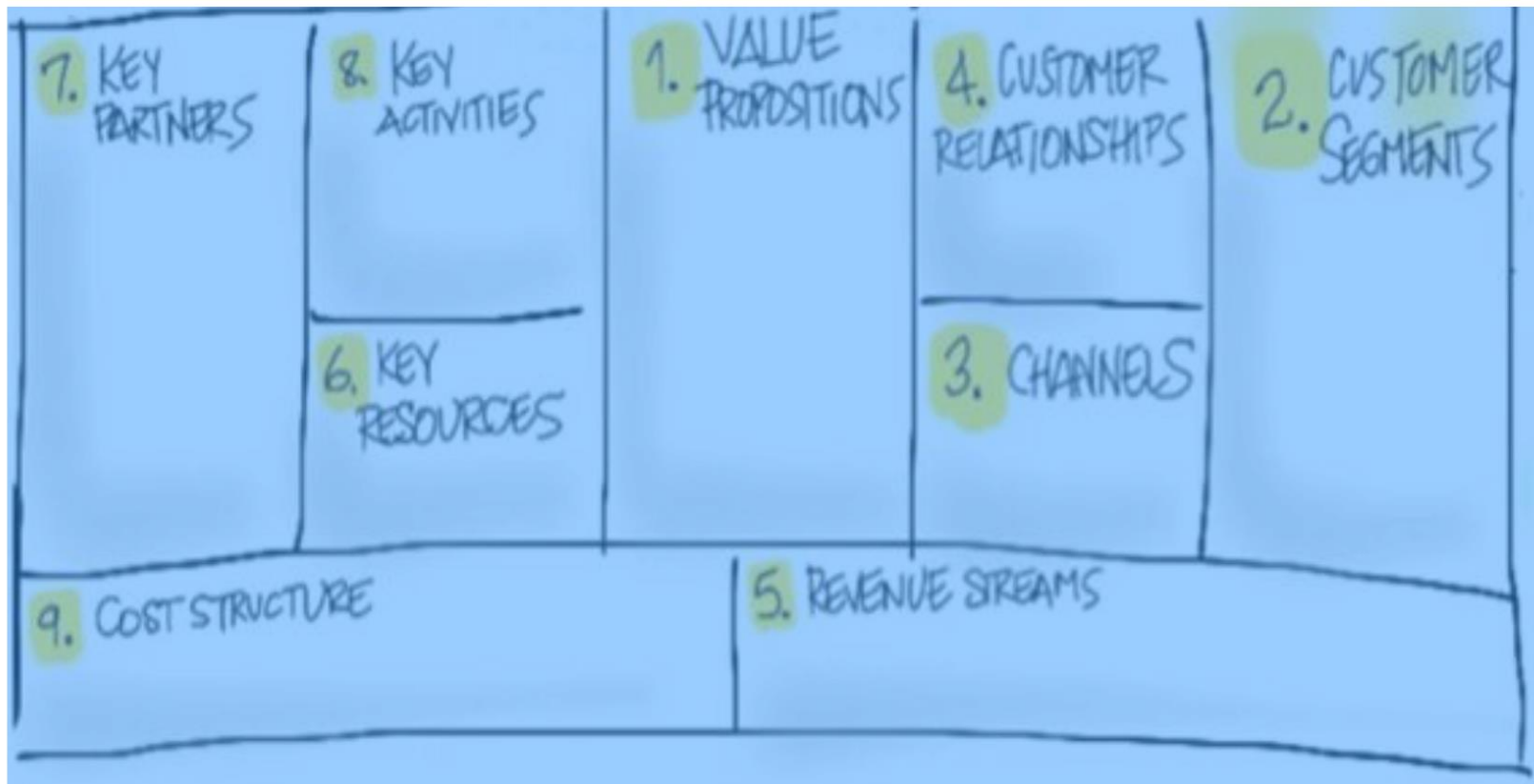


# Business

- An Organization that creates, delivers, and captures value
- Four main areas of a business are: customers, offer, infrastructure and financial viability
- Business model show the logic of how a company intends to make money
  - a blueprint for a strategy to be implemented through organizational structures, processes, and systems

# Business Model Canvas

poster at: [www.businessmodelgeneration.com](http://www.businessmodelgeneration.com)



Business Model Canvas (Figure 3.1)



More than 15 million  
on

GLOBAL

.net domain names  
are hosted in more  
than 200 countries

Net Innovation Challenge 2014

Date 09 04 2014  
D D M M Y Y Y Y

Pay

Chaat

Rupees

Seventy Five  
Thousand

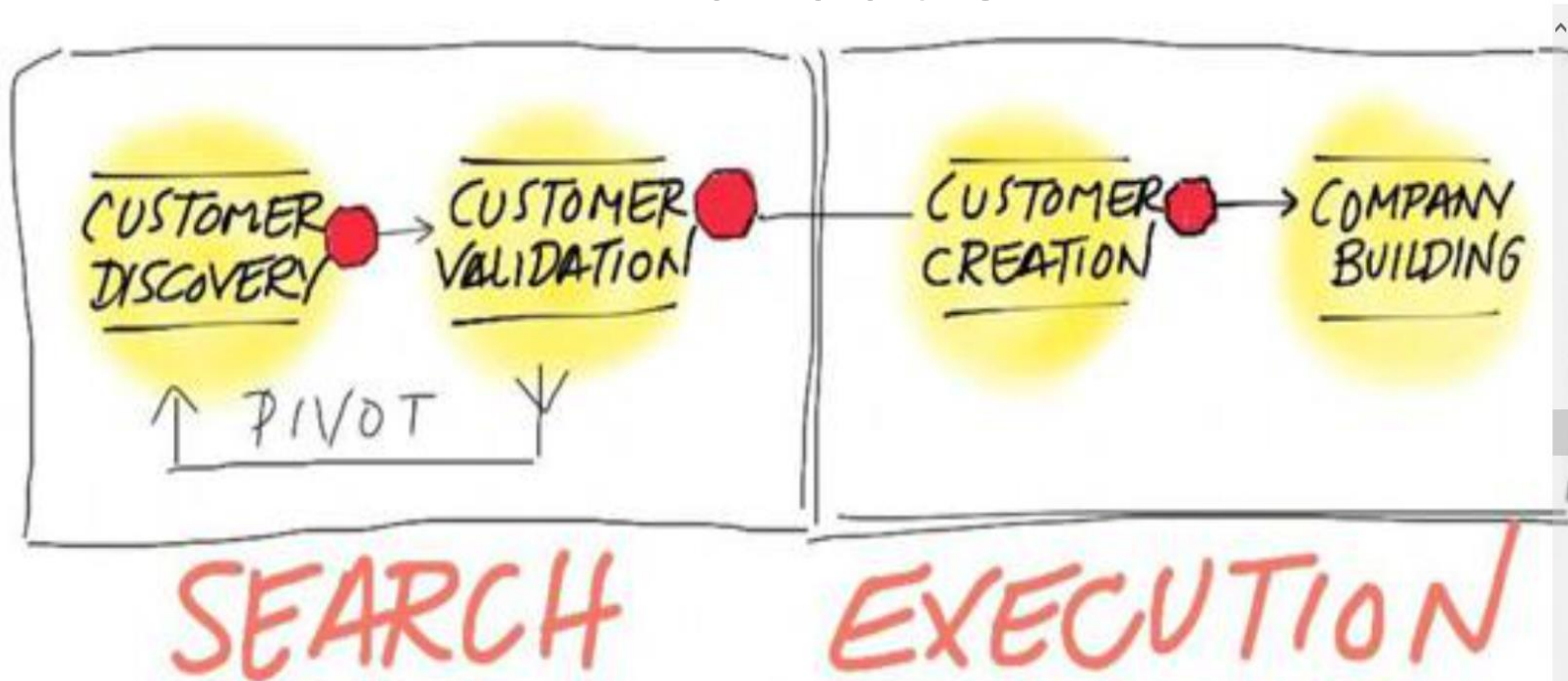
₹ 75,000

# Sample BMC: Locate (CHAAT)

<b>KP</b> <b>Key Partners</b> <ul style="list-style-type: none"><li>• End Users</li></ul>	<b>KA</b> <b>Key Activities</b> <ul style="list-style-type: none"><li>• Customer Development</li><li>• Software and Database Development</li></ul>	<b>VP</b> <b>Value Propositions</b> <ul style="list-style-type: none"><li>• Empower the search services with crowd wisdom.</li><li>• Central Platform for one to locate places based on custom searches using the experience of the crowd.</li><li>• Efficiency increases in terms of time and money spent and quality of decision.</li></ul>	<b>CR</b> <b>Customer Relationships</b> <ul style="list-style-type: none"><li>• Customer is the source and target of information</li><li>• Social Media Marketing</li><li>• Word of Mouth</li><li>• Learning customer preferences to give better search results</li></ul>	<b>CS</b> <b>Customer Segments</b> <ul style="list-style-type: none"><li>• People aged between 15-45 years of age residing in Urban areas of Tier I &amp; II cities</li><li>• Smartphone user base in India (~ 63m )</li><li>• Population with access to Internet services (~ 24 m)</li><li>• Most important customers would be youth and working population.</li></ul>
	<b>KR</b> <b>Key Resources</b> <ul style="list-style-type: none"><li>• Software Platform</li><li>• Cloud Storage</li></ul>		<b>CH</b> <b>Channels</b> <ul style="list-style-type: none"><li>• App stores: Service will be provided on Apple/Android platforms.</li><li>• A Website will cater to internet users.</li><li>• Facebook/ Pinterest can be used to share relevant information within the social circle of the user.</li></ul>	
<b>C\$</b> <b>Cost Structure</b> <ul style="list-style-type: none"><li>• Server</li><li>• Domain name</li><li>• One time fixed setup costs</li></ul>			<b>R\$</b> <b>Revenue Streams</b> <ul style="list-style-type: none"><li>• Advertising Revenue- Targeted Advertising</li></ul>	

# Customer Development

- Discovery
- Validation



Customer Development Process (Figure 2.1)

**“The Search for a Business Model:” Steps, Iteration and Pivots**

# Customer Development Manifesto

- **Rule No. 1: There Are No Facts Inside Your Building, So Get Outside.**
- **Rule No. 2: Pair Customer Development with Agile Development**
- **Rule No. 3: Failure is an Integral Part of the Search**
- **Rule No. 4: Make Continuous Iterations and Pivots**
- **Rule No. 5: No Business Plan Survives First Contact with Customers So Use a Business Model Canvas**
- **Rule No. 6: Design Experiments and Test to Validate Your Hypotheses**
- **Rule No. 7: Agree on Market Type. It Changes Everything**
- **Rule No. 8: Startup Metrics Differ from Those in Existing Companies**
- **Rule No. 9: Fast Decision-Making, Cycle Time, Speed and Tempo**
- **Rule No. 10: It's All About Passion**
- **Rule No. 11: Startup Job Titles Are Very Different from a Large Company's**
- **Rule No. 12: Preserve All Cash Until Needed. Then Spend**
- **Rule No. 13: Communicate and Share Learning**
- **Rule No. 14: Customer Development Success Begins With Buy-In**

# Webvan Case Study

- Founded Dec 1997, raised \$10M
- Targetted \$450B Grocery market with online shopping and delivery model
- Strong Founding Team, including CTO, Peter Relan, IITD IT Guru
- Raised additional \$400M in VC funds in 2 years
- Launched Product in Q3, 1999
- Raised \$400M in IPO in Q4, 1999
- Went Bankrupt in 2000



# Lessons from Webvan

- ASSUMING "I KNOW WHAT THE CUSTOMER WANTS"
- ASSUMING "I KNOW WHAT FEATURES TO BUILD"
- FOCUS ON LAUNCH DATE
- EMPHASIS ON EXECUTION INSTEAD OF HYPOTHESES, TESTING, LEARNING AND ITERATION - TRADITIONAL BUSINESS PLANS PRESUME NO TRIAL AND NO ERRORS
- EMPHASIS ON JOB TITLES VERSUS GETTING THE JOB DONE
- SALES AND MARKETING EXECUTE TO A PLAN
- PRESUMPTION OF SUCCESS LEADS TO PREMATURE SCALING
- MANAGEMENT BY CRISIS LEADS TO DEATH SPIRAL
- Relan insight: EGO of CEO – REFUSAL TO ACKNOWLEDGE ERROR AND PIVOT, ULTIMATELY LED TO BANKRUPTCY



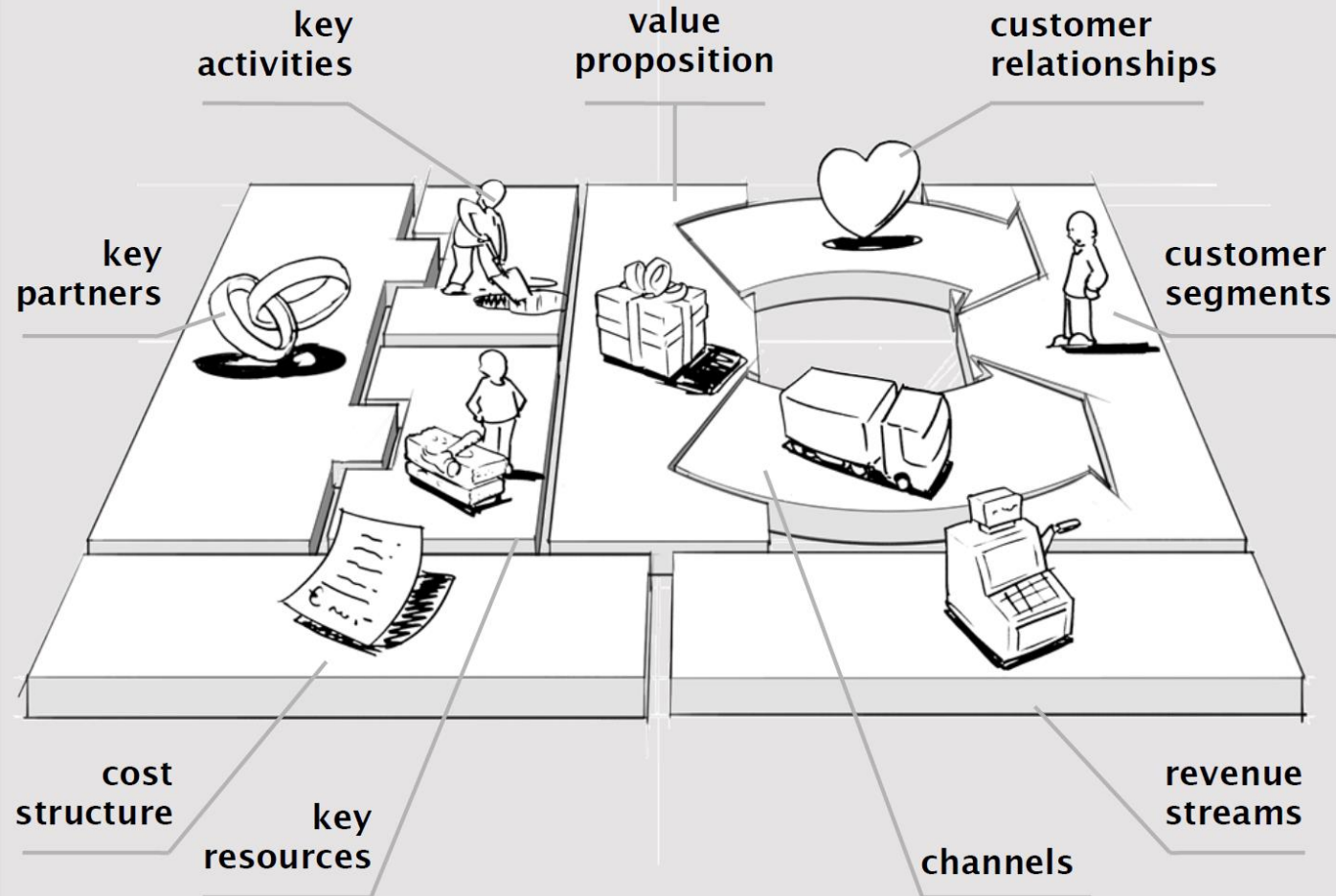
# Customer Development Manifesto

- **Rule No. 1: There Are No Facts Inside Your Building, So Get Outside.**
- **Rule No. 2: Pair Customer Development with Agile Development**
- **Rule No. 3: Failure is an Integral Part of the Search**
- **Rule No. 4: Make Continuous Iterations and Pivots**
- **Rule No. 5: No Business Plan Survives First Contact with Customers So Use a Business Model Canvas**
- **Rule No. 6: Design Experiments and Test to Validate Your Hypotheses**
- **Rule No. 7: Agree on Market Type. It Changes Everything**
- **Rule No. 8: Startup Metrics Differ from Those in Existing Companies**
- **Rule No. 9: Fast Decision-Making, Cycle Time, Speed and Tempo**
- **Rule No. 10: It's All About Passion**
- **Rule No. 11: Startup Job Titles Are Very Different from a Large Company's**
- **Rule No. 12: Preserve All Cash Until Needed. Then Spend**
- **Rule No. 13: Communicate and Share Learning**
- **Rule No. 14: Customer Development Success Begins With Buy-In**

# Key Difference: Search vs Execution

	Search		Execution
<b>Strategy</b>	Business Model Hypotheses	→	Operating Plan + Financial Forecasts
<b>Process</b>	Customer Development, Agile Development	→	Product Management Agile or Waterfall Development
<b>Organization</b>	Customer Development Team, Founder-driven	→	Functional Organization by Department
<hr/>			
<b>Education</b>	Business Model Design, Customer Development, Startup team building, Entrepreneurial Finance, Agile Development, Marketing	→	Organizational Behavior, HR Mgmt, Accounting, Modeling, Strategy, Operations, Leadership, Marketing, Manufacturing
<i>Instructional Strategies</i>	Experiential, constructivist, learner-centered, inquiry-based	→	Case, Lecture, Small Group, Mentorship

## The Business Model Canvas



# The Business Model Canvas

Designed for:

Designed by:

On:  Day:  Month:  Year:

Iteration:

## Key Partners



Who are our Key Partners?  
Who are our key suppliers?  
Which Key Resources are we acquiring from partners?  
Which Key Activities do partners perform?

**Key Partners:**  
Partners that help us reduce risk or increase efficiency  
Partners that help us acquire key resources  
Partners that help us perform key activities

## Key Activities



What Key Activities do our Value Propositions require?  
Our Distribution Channels?  
Customer Relationship?  
Revenue Streams?

**Key Activities:**  
Activities that our Value Propositions require  
Activities that our Distribution Channels require  
Activities that our Customer Relationships require  
Activities that our Revenue Streams require

## Value Propositions



What value do we deliver to the customer?  
Which one of our customer's problems are we helping to solve?  
Which bundles of products and services are we offering to each Customer Segment?  
Which customer needs are we satisfying?

**Value Propositions:**  
The bundle of products and services that we offer to each Customer Segment  
The bundle of products and services that we offer to each Customer Segment  
The bundle of products and services that we offer to each Customer Segment  
The bundle of products and services that we offer to each Customer Segment

## Customer Relationships



What type of relationship does each of our Customer Segments expect us to establish and maintain with them?  
Which ones have we established?  
How are they integrated with the rest of our business model?  
How costly are they?

**Customer Relationships:**  
The type of relationship that we establish and maintain with each Customer Segment  
The type of relationship that we establish and maintain with each Customer Segment  
The type of relationship that we establish and maintain with each Customer Segment  
The type of relationship that we establish and maintain with each Customer Segment

## Customer Segments



For whom are we creating value?  
Who are our most important customers?

**Customer Segments:**  
The groups of people or organizations that we are creating value for  
The groups of people or organizations that we are creating value for  
The groups of people or organizations that we are creating value for  
The groups of people or organizations that we are creating value for

## Key Resources



What Key Resources do our Value Propositions require?  
Our Distribution Channels?  
Customer Relationship?  
Revenue Streams?

**Key Resources:**  
Resources that our Value Propositions require  
Resources that our Distribution Channels require  
Resources that our Customer Relationships require  
Resources that our Revenue Streams require

## Channels



Through which Channels do our Customer Segments want to be reached?  
How are we reaching them now?  
How are our Channels integrated?  
Which channels are best?

**Channels:**  
The channels that we use to reach our Customer Segments  
The channels that we use to reach our Customer Segments  
The channels that we use to reach our Customer Segments  
The channels that we use to reach our Customer Segments

## Cost Structure



What are the most important costs inherent in our business model?  
Which Key Resources are most expensive?  
Which Key Activities are most expensive?

**Cost Structure:**  
The total costs that we incur to create, distribute, and maintain our Value Propositions  
The total costs that we incur to create, distribute, and maintain our Value Propositions  
The total costs that we incur to create, distribute, and maintain our Value Propositions  
The total costs that we incur to create, distribute, and maintain our Value Propositions

## Revenue Streams



For what value are our customers really willing to pay?  
How much do they currently pay?  
How and how often are they paying?  
How would they prefer to pay?  
How much does each Revenue Stream contribute to overall revenues?

**Revenue Streams:**  
The revenue that we generate from each Customer Segment  
The revenue that we generate from each Customer Segment  
The revenue that we generate from each Customer Segment  
The revenue that we generate from each Customer Segment

sketch out your  
business model

**On:**  Day  Month  Year

**Iteration:**  No.



# Exercise

- Work in your teams
- Identify 1 – 2 assumptions (AKA hypotheses, AKA guesses) you are making about each of the 9 parts of the Business Model canvas.
- Identify which assumptions are most critical to the success of your business model.
- “Get out of the building” ASAP to test assumptions with customers & channel partners.
- Share what you have learned in your OAP I.

# Amazon Secret Sauce





# Amazon Flywheel

The next Monday, Jeff got his team together and they cut the price of all their products by 20 to 30 percent to be the very lowest in the market. Jeff went out and announced:

*“There are two kinds of retailers: There are those folks who work to figure out how to charge more, and there are companies that work to figure how to charge less, and we are going to be the second, full-stop.”*

Jeff then ran a two-day off-site management meeting with the bestselling author of “Good to Great”, Jim Collins. That’s where the team came up with the “Amazon Flywheel” -

1. Lower prices led to more customer visits,
2. More customers increased volume of sales,
3. Volume of sales attracted more 3rd party sellers,
4. More 3rd party sellers led to better economies of scale
5. Better economies of scale led to lower prices...

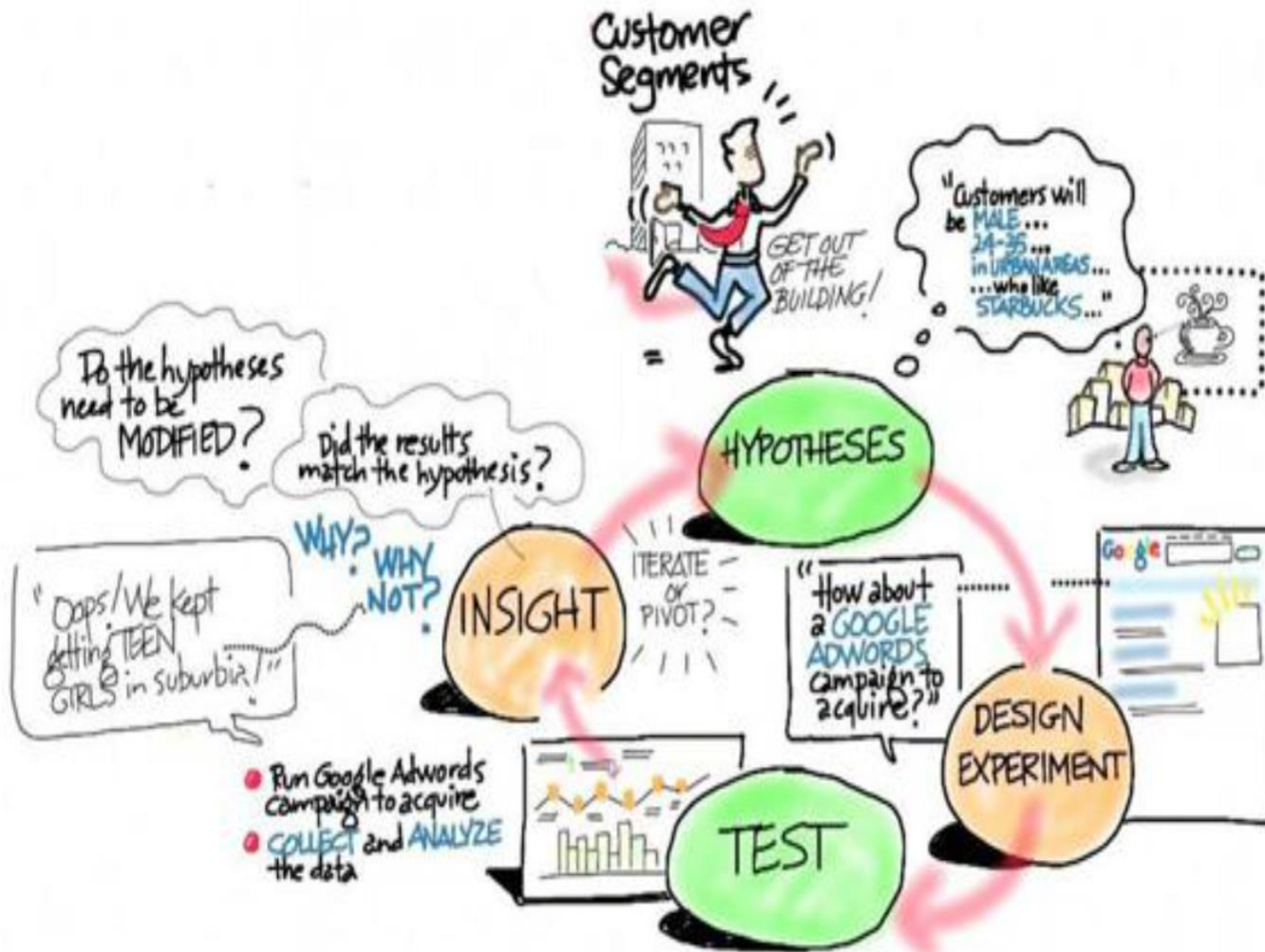
While others were waiting to get to economies of scale to lower prices, Amazon decided to lower prices to get to economies of scale.

For many at the meeting, it was the first time they finally had a clearly defined strategy that explained their business. Every division within Amazon had a focus on a different part of the flywheel, and each small improvement in any part made the wheel spin faster.

# Amazon Success

Now, fifteen years after that meeting (and through many years of being misunderstood), Amazon has grown from a start-up struggling through the dotcom crash to an expected \$100 billion+ in sales this year, and is now worth over \$300 billion.

# Developing Insight



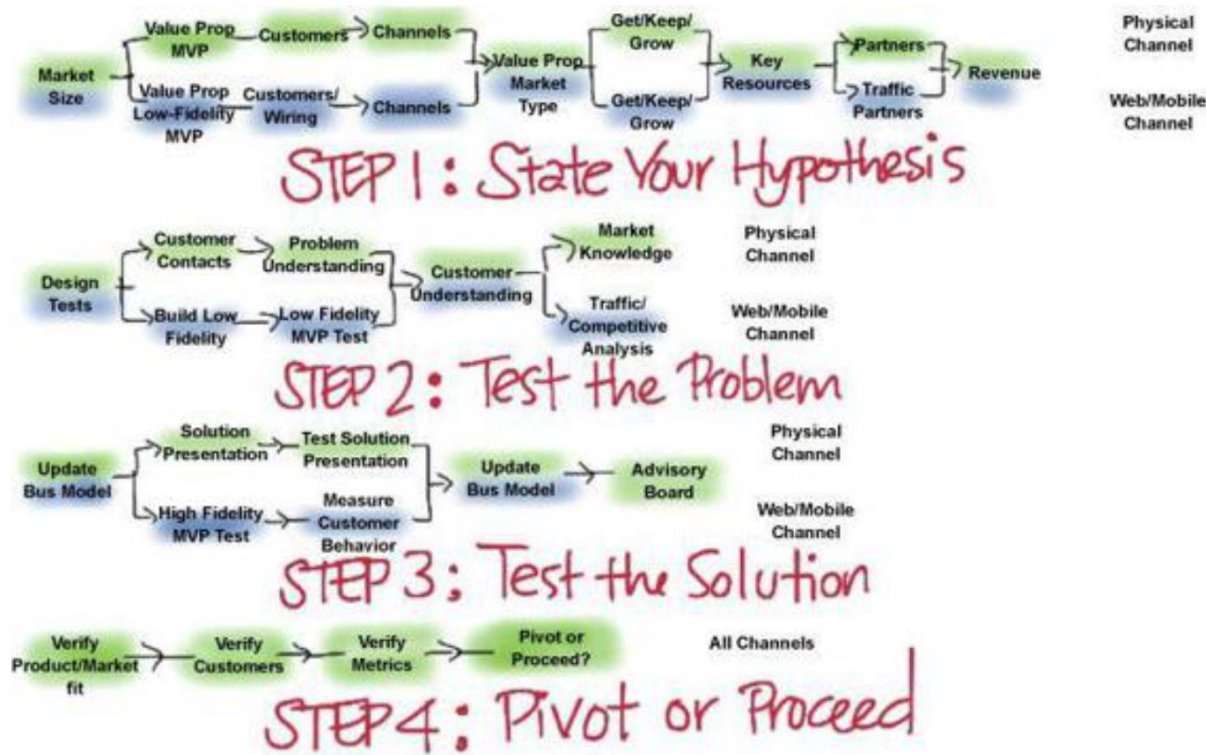
The Customer Development Insight Cycle (Figure 3.2)

# Examples of Customer Discovery in Real Startups

- Product Requirements: Selectica Earlyvangelist
  - Klaus Strassman, Siemens CIO
- System Requirements: Sun RFQ (Request For Quote)
- Market Discovery: Dyyno BOMTV MD from Cochin
- Competition Discovery: Strategic Customer Partnership; Hiring VP of Sales from Competition

# Customer Discovery Process

## Overview of the Customer Discovery Process



# CS: Customers Segments

- CS defines the different groups of people or organizations an enterprise aims to reach and serve
  - An organization serves one or several Customer Segments
- Many Types
  - Mass Market
  - Niche Market
  - Segmented
  - Diversified
  - Multi-sided Markets

# VP: Value Propositions

- VP describes the bundle of products and services that create value for a specific Customer Segment
  - It seeks to solve customer problems and satisfy customer needs with value propositions
- Values are quantitative (price, speed of service...) or qualitative (design, customer experience)
- Some element of VP
  - Newness, Performance, Customization, Getting the job done
    - Syntel logo: Consider IT done
  - Design, Brand/Status, Price, Cost Reduction, Risk Reduction, Accessibility, Convenience/Usability



# CH: Channels

- CH describes how a company communicates with and reaches its Customer segments to deliver a Value Proposition
  - Value propositions are delivered to customers through communication, distribution and sales Channels
- Channel types
  - Own or Partner
  - Direct or Indirect
- Examples are: Sales force, Web sales, Own stores, Partner stores, Wholesaler, Distributor...
- The 5 Channel Phases
  - Awareness, Evaluation, Purchase, Delivery, After sales

# CR: Customer Relationships

- CR describes the types of relationships a company establishes with specific Customer Segments
  - Customer relationships are established and maintained with each Customer Segment
- Motivations for CR:
  - Customer Acquisition
  - Customer Retention
  - Boosting sales by Upselling
- Types of CR:
  - Personal assistance
  - Dedicated Personal assistance
  - Self service
  - Automated services
  - Communities
  - Co-creation

# RS: Revenue Streams

- RS represents the cash a company generates from each Customer Segment (costs must be subtracted from revenues to create earnings)
  - Revenue streams result from value propositions successfully offered to customers
- Two types:
  - Transaction Revenues – one-time customer payment
  - Recurring Revenues – on-going payments
- Ways to generate RS:
  - Asset sale, Usage fee, Subscription fees, Lending/Renting/Leasing
  - Licensing, Brokerage fees
  - Advertising
- Pricing Mechanisms
- Fixed Menu: List price, Product Feature or CS or Volume dependent
- Dynamic Pricing: Negotiations (bargaining), Yield management, Real-time-market, Auctions

# KR: Key Resources

- KR describes the most important assets required to make the business model work
- KR can be owned or leased by the company or acquired from key partners
- KR categories:
  - Physical
  - Financial
  - Intellectual
  - Human

# KA: Key Activities

- KA describes the most important things a company must do to make its business model work
- KA categories:
  - Production: for mfg companies
  - Problem solving: for service companies
  - Platform/Network: for networks, matchmaking platforms, software and brands

# KP: Key Partnerships

- KP describes the network of suppliers and partners that make the business model work
  - Some activities are outsourced and some resources are acquired the enterprise.
- Three motivations
  - Optimization and Economy of scale
  - Reduction of risk and uncertainty
  - Acquisition of particular resources and activities

# CS: Cost Structure

- CS describes all costs incurred to operate a business model
- Two types of business models
  - Cost-driven
  - Value-driven
- CS characteristics
  - Fixed costs
  - Variable costs
  - Economies of scale
  - Economies of scope



# First: A Validated Business Model

A business model describes the flow between key components of the company:

- value proposition, which the company offers (product/service, benefits)
- customer segments, such as users, and payers, or moms or teens
- distribution channels to reach customers and offer them the value proposition
- customer relationships to create demand
- revenue streams generated by the value proposition(s)
- resources needed to make the business model possible
- activities necessary to implement the business model
- partners who participate in the business and their motivations for doing so

# Business Plan vs Business Model Canvas

# The GOAL: The Business Plan

(<http://www.slideshare.net/goldfinger80/investor-presentation-template-1227413>)



## **12 slides is all you need**

---

1. **Cover Page/Introduction**
2. **Overview**
3. **Problem**
4. **Market**
5. **Team**
6. **Technology/Solution**
7. **Customers/Revenue Model**
8. **Go to Market**
9. **Competition**
10. **Financials**
11. **Milestones**
12. **Summary**

# Types of Business Models

- Unbundling Business Models for the 3 core types of businesses
  - Customer Relationship Businesses
  - Product Innovation Businesses
  - Infrastructure Businesses
- The Long Tail
- Multi-Sided Platforms
- FREE as a Business Model
- Open Business Model

# Validation Process



# Four Phases of Customer Validation Process

- Phase 1 consists of six “get ready to sell” activities; product positioning, sales/ marketing materials for “test selling” efforts, the hiring of a sales closer, the creation of a distribution channel plan, refining a sales roadmap, and creating an advisory board. These activities make your team the best prepared early stage venture ever to hit the streets.
- Phase 2 gets founders out of the building to put the product to the ultimate test: will customers validate your business model by buying your product? Dozens if not hundreds of meetings help refine the product presentation and channel plans, validate the sales roadmap, prove the predictability of the sales funnel, and validate that the business model is repeatable, scalable and profitable in a real-world test.
- Phase 3 happens once you have a couple of orders under your belt and enough customer information to develop and refine your product and company positioning. The positioning is tested in meetings with industry pundits and analysts and face-to-face with the expanded customer audience.
- Phase 4 stops all activity for long enough to conduct a detailed pivot-or-proceed analysis and verify that, regardless of channel, customer validation is complete and the company knows how to scale.

# Key Steps to successful Customer Validation

- From Business Model Canvas to the Sales Roadmap
- Building a Sales Roadmap Versus Building a Sales Force
- Founders Must Lead the Customer Validation Team
- Validation Proceeds at Different Speeds in Different Channels
- Make Early Sales to [Earlyvangelists](#)
- Constrain Spending in Customer Validation
- Prioritize What Needs to be Validated
- [Why Accountants Don't Run Startups](#)
- And Finally: Don't Be Afraid to Let Go When Lightning Strikes



# Early Adopters...Geoffrey Moore

- In *Crossing the Chasm*, Moore argues there is a chasm between the early adopters of the [product](#) (the [technology](#) enthusiasts and visionaries) and the early majority (the pragmatists). Moore believes visionaries and pragmatists have very different expectations, and he attempts to explore those differences and suggest techniques to successfully cross the "chasm," including choosing a [target market](#), understanding the [whole product](#) concept, [positioning](#) the product, building a [marketing strategy](#), choosing the most appropriate [distribution channel](#) and [pricing](#).
- *Crossing the Chasm* is closely related to the [technology adoption lifecycle](#) where five main segments are recognized: innovators, early adopters, early majority, late majority and laggards. According to Moore, the marketer should focus on one group of customers at a time, using each group as a base for marketing to the next group. The most difficult step is making the transition between visionaries (early adopters) and pragmatists (early majority). This is the chasm that he refers to. If a successful firm can create a bandwagon effect in which enough momentum builds, then the product becomes a de facto standard. However, Moore's theories are only applicable for disruptive or discontinuous innovations. ...Wikipedia

# From BMC to Sales Roadmap

## Customer Discovery

- Value proposition: You affirmed it with a few dozen to a few hundred people
- Customer segments: You have a hypothesis about customer archetypes
- Customer relationships: You tested several “get, keep and grow” activities
- Channel: You understand your key channel partners, and some have expressed interest
- Revenue model: The company has an idea of how to price its offering

**Sales Roadmap** uses all you’ve learned from customer discovery to guide the creation of a sales funnel specifically for your company

- Who influences a sale? Who recommends a sale?
- Who is the decision-maker? Who is the economic buyer? The saboteur?
- Where is the budget for purchasing the type of product you’re selling?
- How many sales calls are needed to make one sale?
- How long does an average sale take from beginning to end?
- What is the selling strategy? Is this a solution sale?
- If so, what are “key customer problems?”
- What’s the profile of optimal visionary buyers, the earlyvangelists every startup needs?
- Where will the traffic come from? Will it stick?
- Will the product be strong enough to grow virally?

# Checklist for Customer Validation

Business Model Checklist
<p>✓ <b>Value Proposition:</b></p> <ul style="list-style-type: none"><li>• Are customers passionate about long-term product vision? Cannot be translated to be quantified revenue projections?</li><li>• Do the product features and benefits still make sense? Can they be built within the development budget and timetable?</li><li>• Did Customer Validation interviews validate the Value Proposition components?</li></ul>
<p>✓ <b>Customer Segments:</b></p> <ul style="list-style-type: none"><li>• Are the Customer Segments tested and proven can they map?</li><li>• Are customer needs active or urgent? Can they drive forecasted revenues?</li><li>• Does the product improve a "day in the life"?</li><li>• Does the company understand the customer purchase influences and associated costs?</li></ul>
<p>✓ <b>Value Proposition 2: Market Type</b></p> <ul style="list-style-type: none"><li>• Did customer feedback confirm the Market Type hypothesis?</li><li>• Are the cost impacts of the Market Type selection factored in where appropriate?</li><li>• Is the team confident its Market Type selection will deliver the forecasted customers?</li></ul>
<p>✓ <b>Channels:</b></p> <ul style="list-style-type: none"><li>• Does the company fully understand the food chain, its responsibilities and costs?</li><li>• Does the team have confidence in its channel revenue forecasts road map?</li><li>• Are there any important indirect channel costs such as sales reps or promotional fees?</li><li>• Are the channel partners willing to buy?</li></ul>
<p>✓ <b>Customer Relationships:</b></p> <ul style="list-style-type: none"><li>• Are "get" plan elements aligned with schedules?</li><li>• Are the test plans for Get/Keep/Grow complete with schedules and budgets?</li><li>• Are "get" customers costs affordable?</li><li>• If a multi-sided markets, have the "get" costs been computed for both sets of customers?</li></ul>
<p>✓ <b>Cost Structure:</b></p> <ul style="list-style-type: none"><li>• Are all the core company operating and overhead costs (payroll, benefits, rent, legal, overhead) clearly identified?</li><li>• Are all the product development and manufacturing costs calculated?</li><li>• What "corporate" costs (legal, accounting, pr, taxes) are forecast?</li></ul>
<p>✓ <b>Revenue Stream:</b></p> <ul style="list-style-type: none"><li>• Has the company sized its market opportunity?</li><li>• Has the pricing model volume, demand, purchase frequency and other revenue variables been confirmed?</li><li>• Does the forecast indicate an increasingly scalable, increasingly profitable business?</li><li>• Has the team considered the revenue impact of competitive response to the product?</li></ul>

# Customer Validation: Pivot or Proceed

- **The 3 Key Steps:**
  - Assemble and review all key discovery and validation findings
  - Review the business model hypotheses and their interactions with one another
  - Focus on the “metrics that matter” in the financial model
- **Assemble Data Findings**
  - The best way to “translate” piles of data, is to make it as visual as possible.
- 
- **Build a War Room**
  - lock the founding team in a room for a day or two to walk step by step through each hypothesis.
  - Cover one wall with a blown up “final” business model canvas.
  - Cover the other wall with the hypotheses themselves, sorted to keep the pieces of each hypothesis together (remember, many hypotheses have multiple parts). Use another wall for supporting diagrams, and allow space for the most recent canvas and perhaps one or two earlier iterations. Leave a large whiteboard available for keeping score of questions and changes and for the key “metrics that matter” numbers that emerge (discussed in detail in Step 3).
- **Review the Data**
  - customer feedback, particularly from sales report cards evaluating customer enthusiasm for the product and its potential sales revenue over time
  - market size and market share estimates
  - channel feedback and revenue potential summaries
  - pricing, customer acquisition costs, and any major product cost changes
  - detailed information about the industry, the customers, and their behavior
  - competitive product and pricing information
- **Validate Your Business Model**
  - The team should assemble data collected in the last phase in its “war room” use the checklist to walk through the business model hypotheses, box by box, and ascertain that there are factual, definitive answers to at least every question on the checklist.
- **The Business Model Canvas as a Scorecard**
  - the closer a company is to this “fact-based plan,” the greater its chances for business and fund-raising success.
- **Validate the Financial Model**
  - figure out whether you have a potentially thriving business, a hobby, or a tax loss.
  - the two metrics that matter most: how many months’ worth of cash remain in the bank? And how fast are we burning through what’s left?
- **Metrics that Matter**
  - In a physical channel, less than a dozen numbers usually tell the entire story:

# Validation Metrics

- **Metrics that Matter**
- In a physical channel, less than a dozen numbers usually tell the entire story:
- Value proposition: What are product cost, market size, attainable market share, and customer impact of network effects?
- Customer Relationships: What are customer acquisition costs, prospect conversion rates, customer lifetime value, and customer switching costs that the company may have to pay?
- Market Type: As discussed in [Chapter 3](#), different market types drive different revenue curves to consider in longer-term revenue predictions
- Cost Structure: What are the basic operating costs of the business?
- Channel: What are the costs of selling through the channel? Channel margin, promotion, shelf-space charges?
- Revenue Streams: What are the average selling price, total achievable revenue, and number of customers a year?
- Burn Rate (derived from the above): How much cash is the company “burning” (spending) a month? When will the company run out of cash? There’s no precise formula for what a burn rate should be, but since it’s the issue over which boards most often fire their founders, the founders and investors must agree on what the burn rate should be and how many more pivots the startup can afford in its search for the scalable, profitable business model
- In the web/mobile channel, less than a dozen numbers tell the entire story:
- Value proposition: What is the estimated per-user cost of a user, and are there any incremental costs when one’s added. Estimate the market size, attainable market share, and the customer impact of referrals or network effects
- Customer Relationships: What are customer acquisition costs, prospect conversion and retention rates, and how many new customers or users will your current customers get you virally, for free?
- **Metrics that Matter Scenarios**
- Metrics matters are a radically new approach to startup math. They’re best illustrated with a series of examples. The three spreadsheet scenarios on the next pages illustrate how you can use “Metrics that Matter” to evaluate your business. The three examples are:
- a physical product sold in a physical channel
- a web/mobile product sold in the web/mobile channel
- and a multisided web/mobile market
- **If These Were Your Numbers, What’s a founder to do?**
- **Some Final Thoughts About the Financial Model**
  - Market Type Affects Revenue Streams. Each of the four market types has a distinctive sales-growth curve shaped by the degree of difficulty involved in transitioning from sales to the earlyvangelists to sales to mainstream customers. Obviously in new markets, it typically takes considerable time for the product to catch on beyond earlyvangelists, who aren’t typically high-volume mainstream buyers. So success with early sales doesn’t guarantee fast revenue scaling.
- **When to Bring in the Accountants**
  - Eventually, prospective investors, banks, and others will want to see the traditional P&L, forecast, and more, and that’s fine. Once the metrics that matter are firmly understood to make sound business sense and are validated, almost any finance type (or high school math student) can convert them into a VC-ready multiyear P&L spreadsheet, balance sheet, and cash-flow statement (the “usual stuff” everyone is accustomed to seeing) with ease.
- **Adding it all up**
- This phase is a vital make-or-break analysis of how well the business model should work. But remember that the numbers are still only educated guesses, validated—we hope—through extensive customer discovery and validation effort with scores if not hundreds of customers.

# Last Look: Customer Validation

- **Pivot or Proceed: Re-Validate the Business Model**
  - Customer creation is a radically different stage during which the company suddenly shifts from “searching for a business model” to “executing one.” It’s no longer celebrating mistakes and wrong turns. It shifts full-throttle into “execute” mode, with revenue targets and timetables to hit, product and plans to deliver, and more granular and precise accountability to investors and board members.
  - The company is about to spend a great deal of money far faster, and irrevocably, as it works ambitiously to deliver its chosen business model. With that comes the typical “career risk” for founders, which always prompts investors to ask if the seemingly manic “founder type” should be replaced by a “seasoned” leader with proven execution skills. Massive amounts of money are about to be spent on a single, focused bet that the business model, as developed, has a high likelihood of scaling to profit and success. Boards and investors are suddenly less forgiving and typically far less welcoming of reports like “That idea was wrong” and “That didn’t work as we hoped” than they were during the earlier “search” phases.
- **Best Bets**
  - You’ve run the numbers in the last section and are still feeling like your business is a winner. But have you picked the best value proposition? Is your product delivery schedule right? Are you confident you’ve gotten the optimum revenue model and costs? And have you missed any best moves on the overall business model? Here are a few last things to check.
- **Make Sure the Value Proposition is Right**
  - If you don’t feel that it’s going to win the marketplace now, it doesn’t get better over time. It may be time to reconfigure, repackage or unbundle the product. This requires a loop all the way back to customer discovery. Once there, use the core technology to develop another product, configuration, distribution method or price and then modify product presentations and return to Phase 3 (product presentation) and do it again. Yes, it hurts, but it hurts far less than failure.
- **Make Sure the Product Delivery is Right**
  - Even with selling success, check the product delivery timing with the product-development team. Schedules inevitably change, seldom for the better. Can the company still deliver what was just sold and do so as promised, or was the sale actually vaporware? If vaporware, at best the company secured a few pilot projects. Continuing to sell as if nothing has changed is a bad idea. As schedules slip, hard-won earlyvangelists weaken, and references evaporate quickly. The good news is, if this happens (it happens often), the situation is still recoverable. There aren’t many people to fire, and the burn rate is low. (As discussed earlier, it’s always important to have enough cash to get this phase wrong at least once.) The solution is to shut down any additional selling for a while, admit mistakes, and turn pilot projects into something useful—first for the customer and then as a marketable product.
- **Make Sure the Revenue is High and Costs are Low**
  - There’s nothing worse than leaving money on the table or spending more than you needed to. The best way to answer these questions and more is to “walk” slowly through the business model one more time.
  - Start with the value proposition. Are there too many features or not enough variety? Would a lower price sell far more units or sell the same number at a lower acquisition cost? What if the product were free, or free to those bringing three or five or 10 other customers along?
- **Make Sure Your Business Model is Right**
  - Changing direction at this juncture is a bold move indeed. It’s not what the investors expected, especially after a long, grueling process of customer discovery and validation. Then again, bold moves are the work of great entrepreneurs. And even though a pivot at this point leads to more customer validation and more time, it’s far better to pivot now than to forge ahead at full speed and full spend if it’s possible that there’s a better idea out there somewhere.
- **The Toughest Startup Question: Pivot or Proceed?**
  - This is the moment of truth when the team and the investors will vote on whether to begin spending massive amounts of money to execute the business model. To vote honestly, the team needs to take a hard, honest look at the pivot-or-proceed analyses developed in this phase.
- **What’s Next?**
- The first two steps of Customer Development are where entrepreneurs live or die in the search for a repeatable and scalable business model. When a company has successfully exited Customer Validation, there’s a library full of business-building texts available to help execute the business model. So, at least for now, if you’re eager to execute the next two steps—Customer Creation and Company Building—return to the original Four Steps to the Epiphany, or turn to a more targeted text for fine-tuned support.
- Whatever you do next, the successful completion of Customer Validation is a momentous step in the life of your startup. You have completed an arduous, challenging journey. Our warmest, most sincere congratulations. We look forward to learning about your success!