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THREE ENGINES OF GROWTH IN START-UPS – ERIC REIS

The three engines of growth in lean is a really important topic. Most visionaries are afraid of data and they are afraid because most of them have been trained in some variation of a stage gate development process and in stage gate at each gate you get trained to make a go kill decision. They call it by either to proceed to the next stage or you kill the whole project and so visionaries generally have learned that if they expose that idea to data too early it can cause the team to make a premature kill decision. So, the solution to that impasse is to have a built in ahead of time commitment to iteration.

No matter how bad the news is you are going to keep trying to find some path to get you to your vision. And once you kind of really buy into that idea, then it makes it much lighter to say “Now given our current strategy, let us think about what are some of the big questions” and Ries said that when he analyses a start-up he almost always thinks about two basic hypotheses. One which we call the value hypothesis which is simply what is an indication that a customer finds this product valuable. And again, it is not about if a million customers find it valuable, it is not about gross numbers, it is not about revenue targets. It is about on a per customer basis, “Do we have an indication” that for example if a customer uses a product and then voluntarily uses it again that is a pretty good indication that they found it valuable the first time. If they pay you money and that money is in excess of how much it costs you to make the product, of a part of a positive margin then that is a pretty good indication that they find it valuable. But that can leave you just in a small business and there is something wrong with that.

A lot of start-ups are trying to grow to something bigger and in that case we have a second thing which is what we call the growth hypothesis which is: Given a population of customers to find your product valuable, how are we going to get more of them and we try to think about how do we engineer that growth so that the actions that customers do help get the next customer and the next customer and the next customer. When you actually think about it, this was particularly interesting. The way that you look at growth and think. Sometimes the question we have to ask ourselves is, “yes we want growth but we may be focusing on only one way”. We might get growth as opposed to really comparing.

Here the three standard levers for growth, the law of sustainable growth is very simple. It just means new customers come from the actions of past customers and as long as that is true, we can continue our growth almost indefinitely. Everything else, every other form of growth, publicity stunts, PR campaigns, Super Bowl ads, they are like a short-term drug that is, it is like trying to cheat the law of sustainable growth and ultimately you pay for it in the end. So, start-ups should be measuring from the beginning and really focusing on that sustainable growth.

And if you think about how can your past customers help you get new customers, there are really only three ways. One through paid acquisition meaning you take the revenue you have got from the past customers and reinvest it in, say advertising or new storefronts or sales staff as long as that money you make from a new customer is greater than the amount it cost you to get that customer. That so-called marginal profit will determine how fast that engine of growth turns and the more margin the faster the growth.

A second way that customers can help you get new customers is by viral growth. Now in a viral product a natural side effect of say an influencer using the product is that other people start to use it too. So, if you think about Facebook or PayPal every time you send money from one person to another that second person automatically learns about the product.

And then comes the third engine of growth which we call sticky. The old customers are the new customers because they are coming back through some kind of repeat engagement. So for products that are on a subscription or where they have very strong network effects, customers either cannot or do not quit. There is a different kind of compounding interest effect you can get from that kind of business.

Suppose you are a start-up. You have done some unusual but effective things to give initial traction to your new business. But now your growth has plateaued. How do you continue to grow your start-up in a most sustainable manner? You need to focus on the right metrics: GROWTH. Growth comes from having more customers, new customers come from the actions of past customers. Which metric should you focus on to drive new customers? That depends on your growth engine.

Eric Ries described an engine of growth as a combustion engine, turning over and over. The faster the loop churns, the faster the company will grow. He identified three distinct engines of growth: sticky, viral and paid. Each engine has a determined set of metrics that we determine how fast a company can grow when using it. They are designed to give start-ups a relatively small set of metrics on which to focus their energy.

Which engine is yours? If you need customers for a long-term, you are probably using the sticky engine of growth. Your growth comes from gaining and keeping customers so you need to look at your retention rate as a metric. If the rate of new customer acquisition is greater than your churn rate, you will see growth. The speed of this engine is determined by the rate of compounding. Rate of compounding is equal to natural growth rate subtracted by churn rate. If new customer is balancing out by old customer, you are losing. You need to focus on keeping existing customers to increase growth.

If you have a product that will naturally expose itself to new users through existing users then you need to work out the viral coefficient. How many more people will each new customer bring with them to grow? You need to focus on getting the viral coefficient as high as possible. Even small changes can have a big effect. So, elevating the viral coefficient, maybe with the help of influencers is what you should be doing.

The paid engine of growth is quite simply paying for advertising but it is only an engine if you can find that from revenue rather than from investment. Revenue per customer subtracted by acquisition cost per customer is the metric to be followed. You need to know the difference between how much revenue each client brings you and how much you paid to get them. To improve growth of your product or business you need to either reducing your acquisition cost or increasing your revenue.

So, if you think about those three engines of growth, we call them paid engine, viral engine and sticky engine. These really are the three paths to sustainable growth and start-ups really have to pick one to specialize in.

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