

The Customer Development Methodology



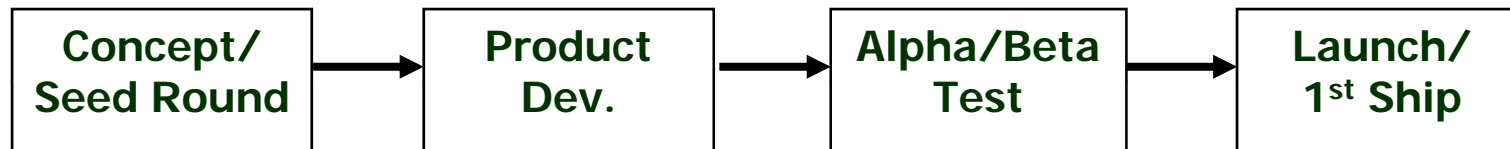
Stanford Technology Ventures Program's
ROUNDTABLE on ENTREPRENEURSHIP EDUCATION

Steve Blank
Sblank@kandsranch.com

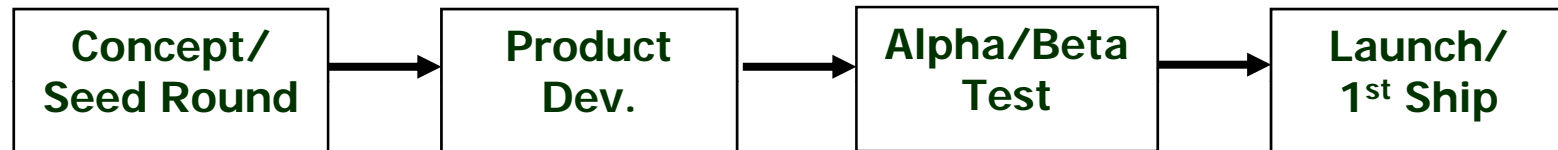
Goals of This Presentation

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

Product Development Model



What's Wrong With This?



Marketing

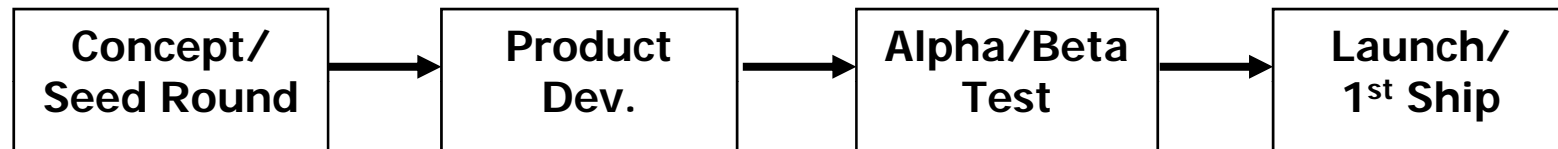
- Create Marcom Materials
- Create Positioning

- Hire PR Agency
- Early Buzz

- Create Demand
- Launch Event
- "Branding"

What's Wrong With This?

Product Development



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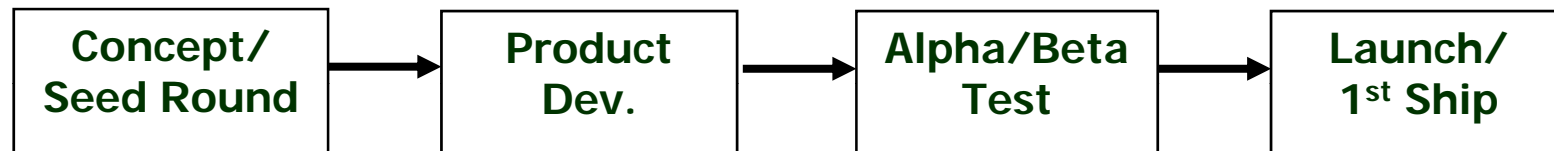
Sales

- Hire Sales VP
- Hire 1st Sales Staff

- Build Sales Organization

What's Wrong With This?

Product Development



Marketing

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Sales

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Business Development

- Hire First Bus Dev

- Do deals for FCS

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

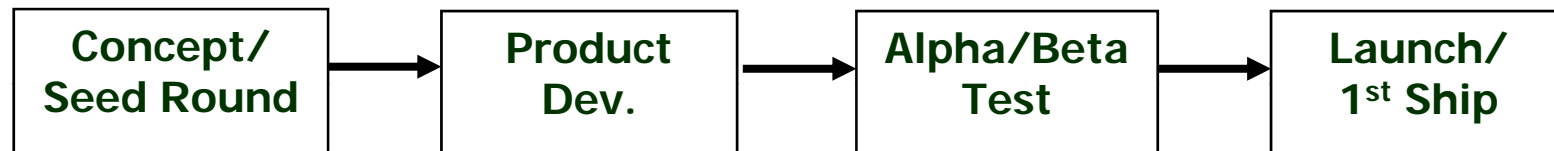
An Inexpensive Fix

Focus on Customers and Markets
from Day One

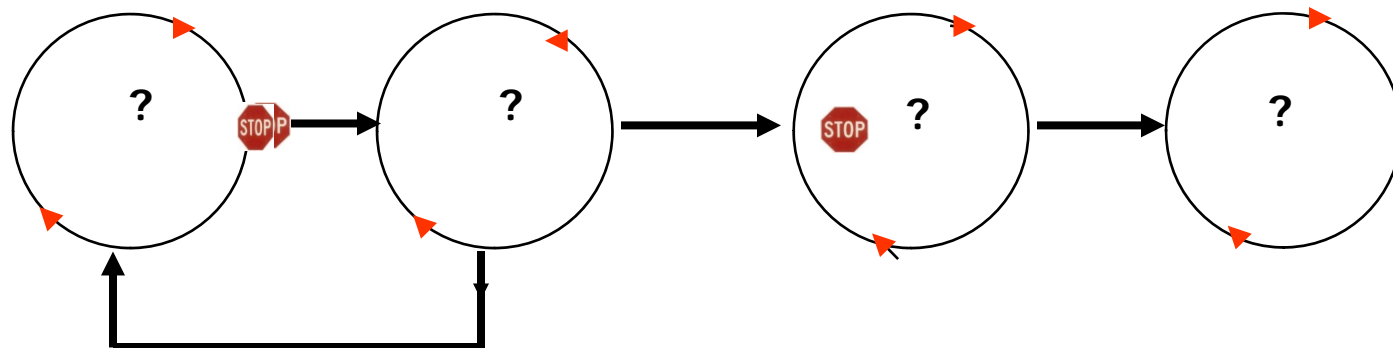
How?

Build a **Customer** Development Process

Product Development

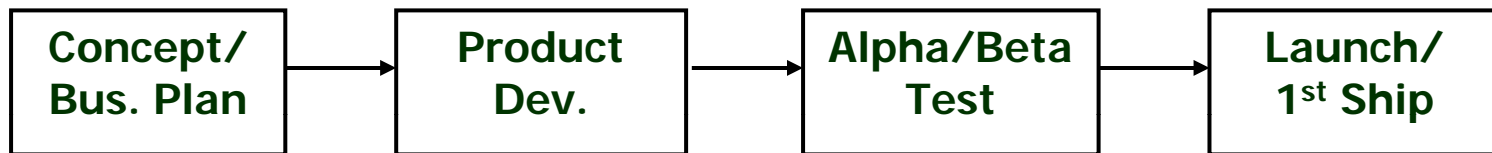


Customer Development

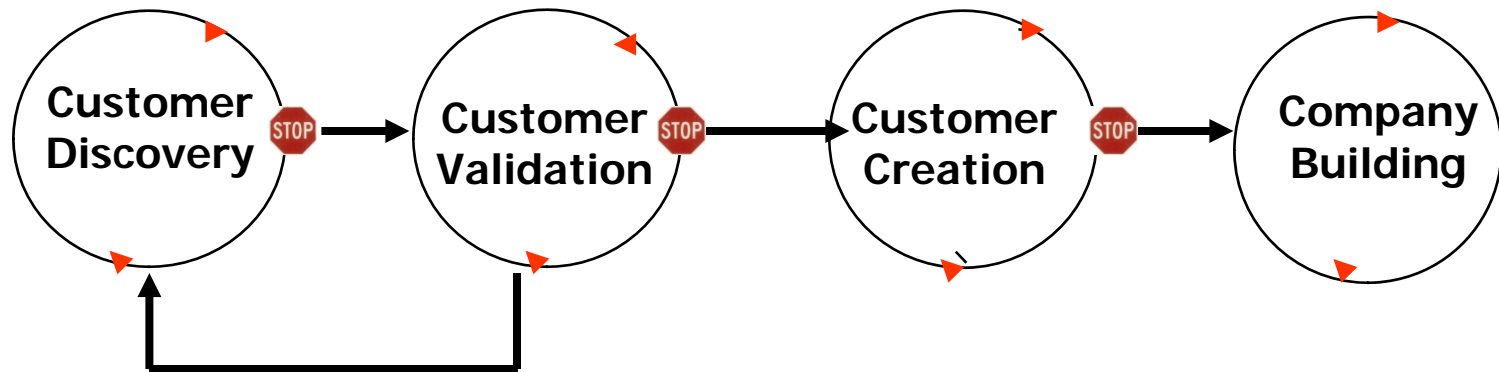


Customer Development is as important as Product Development

Product Development



Customer Development



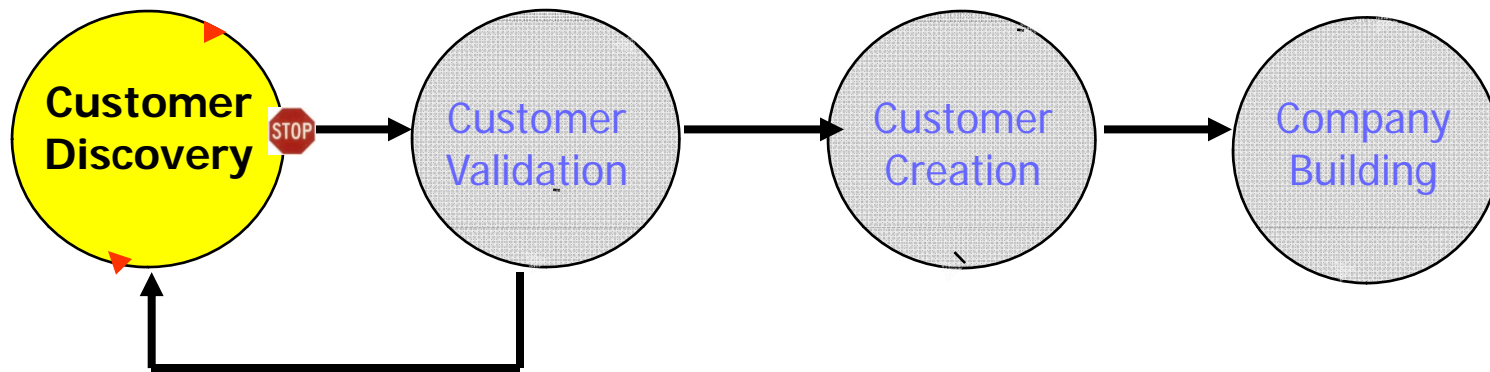
Customer Development: Big Ideas

- 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 (\geq \$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?

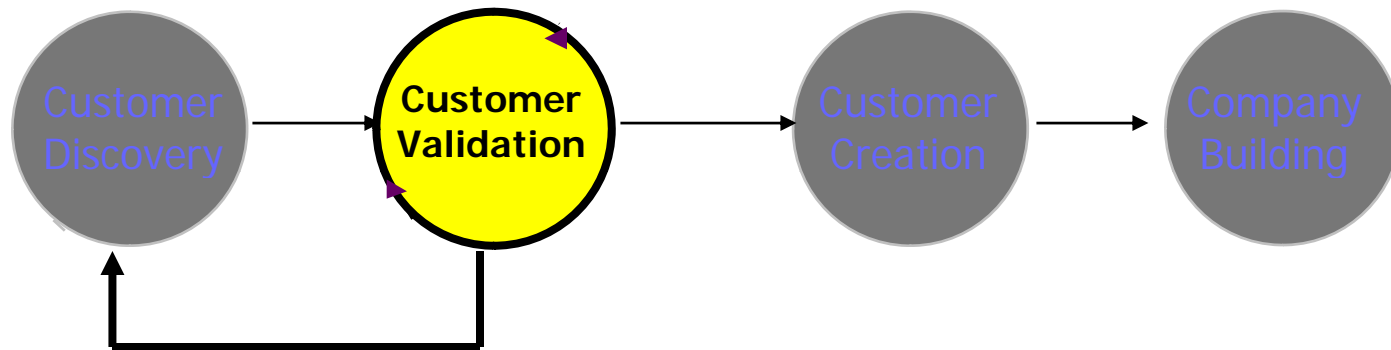
Facts Vs. Hypothesis

- Opportunity Assessment
 - ◆ How big is the problem/need/desire?
 - ◆ How much of it can I take?
- Sales
- Distribution Channel
- Marketing
- Engineering

Fact or Hypothesis?

End of Sidebar

Customer Validation: Step 2



- **Develop a repeatable sales process**
- **Only earlyvangelists 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?

Sidebar

Customer Development Engineering

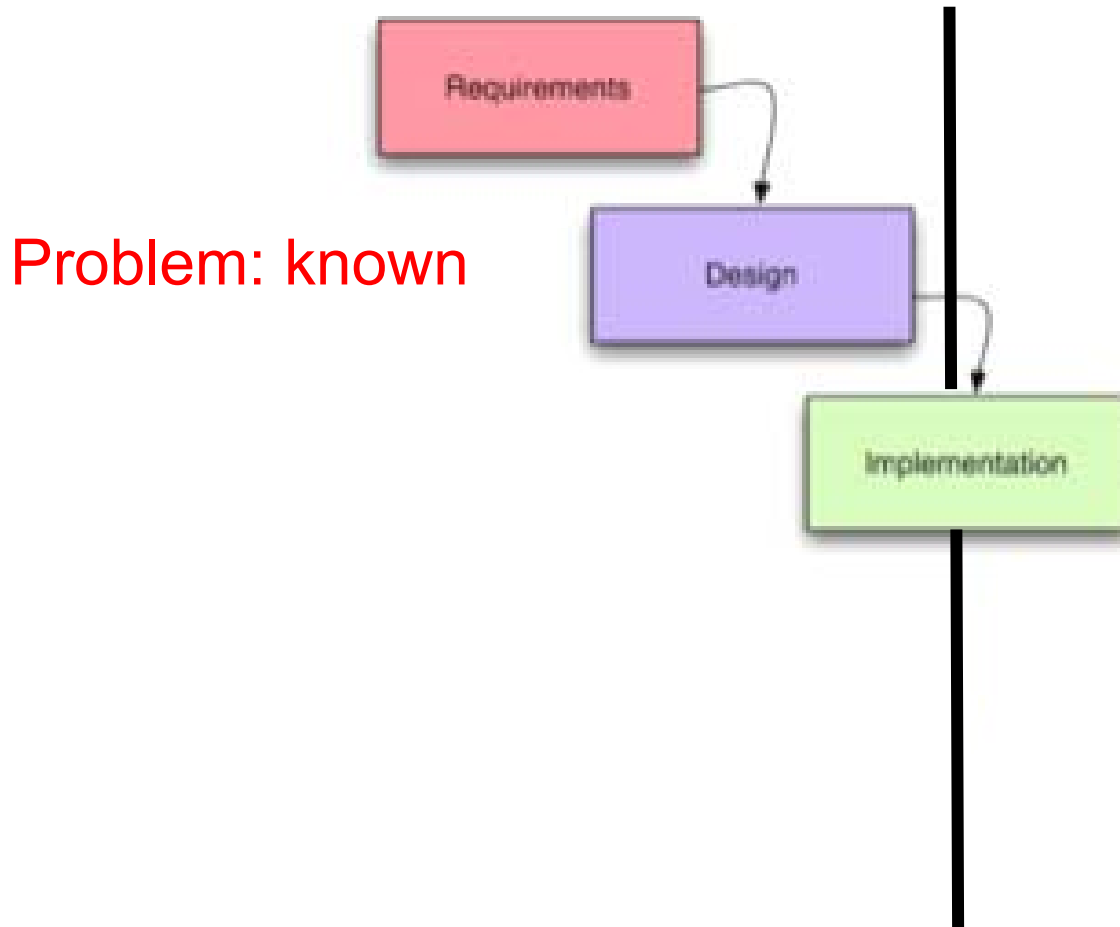
And Agile Development Methodologies

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

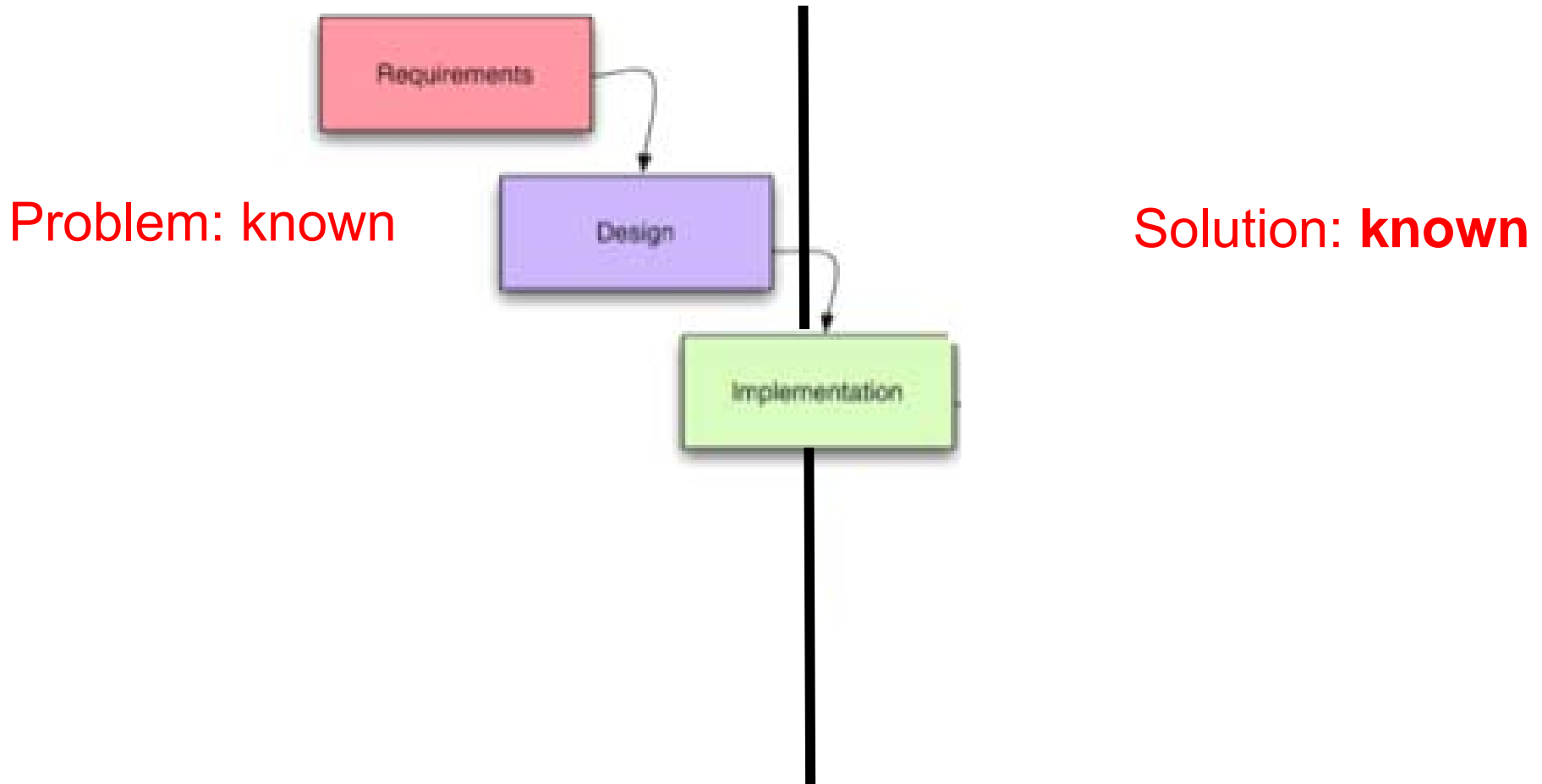
Unit of progress: Advance to Next Stage

Waterfall



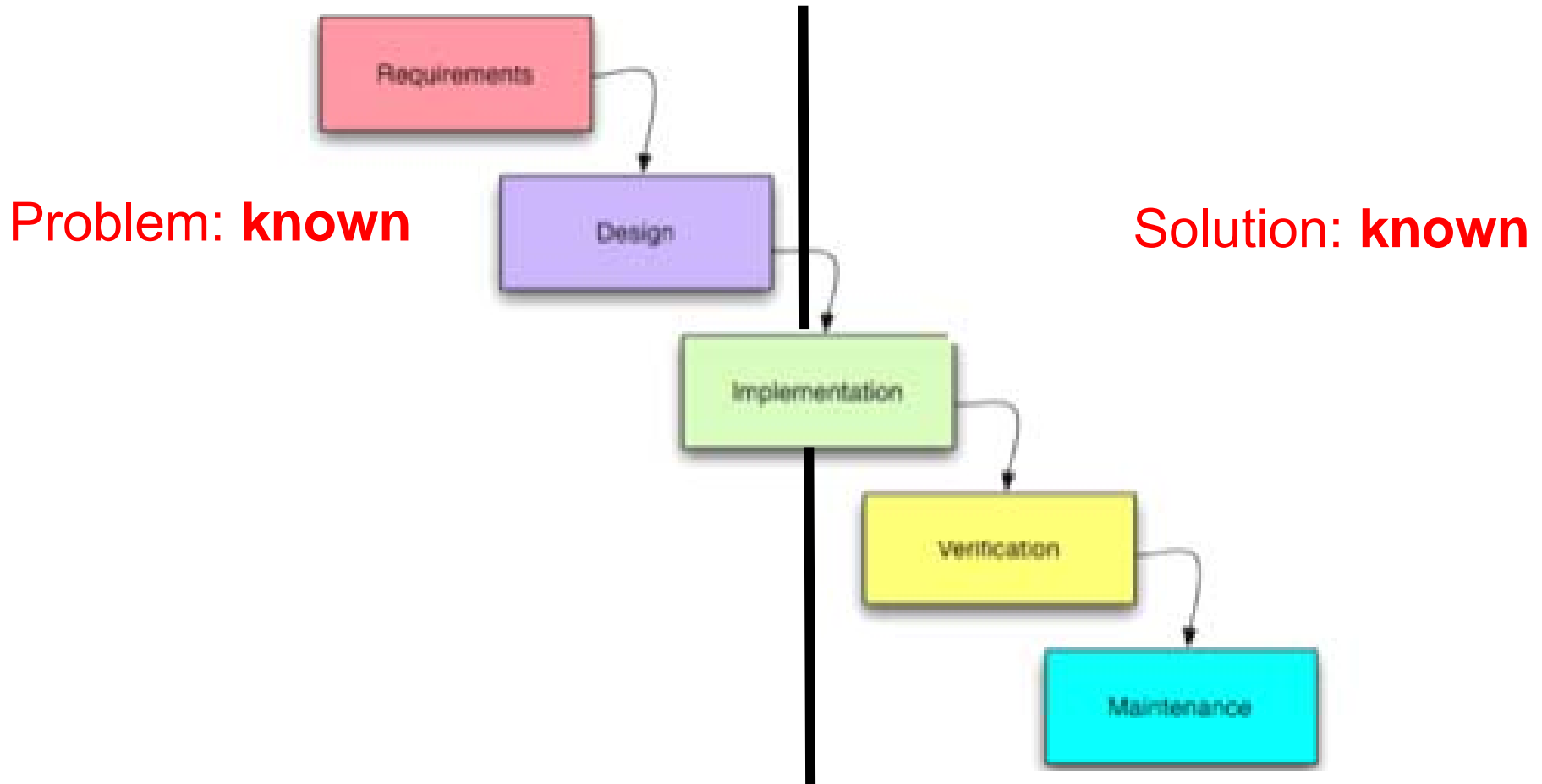
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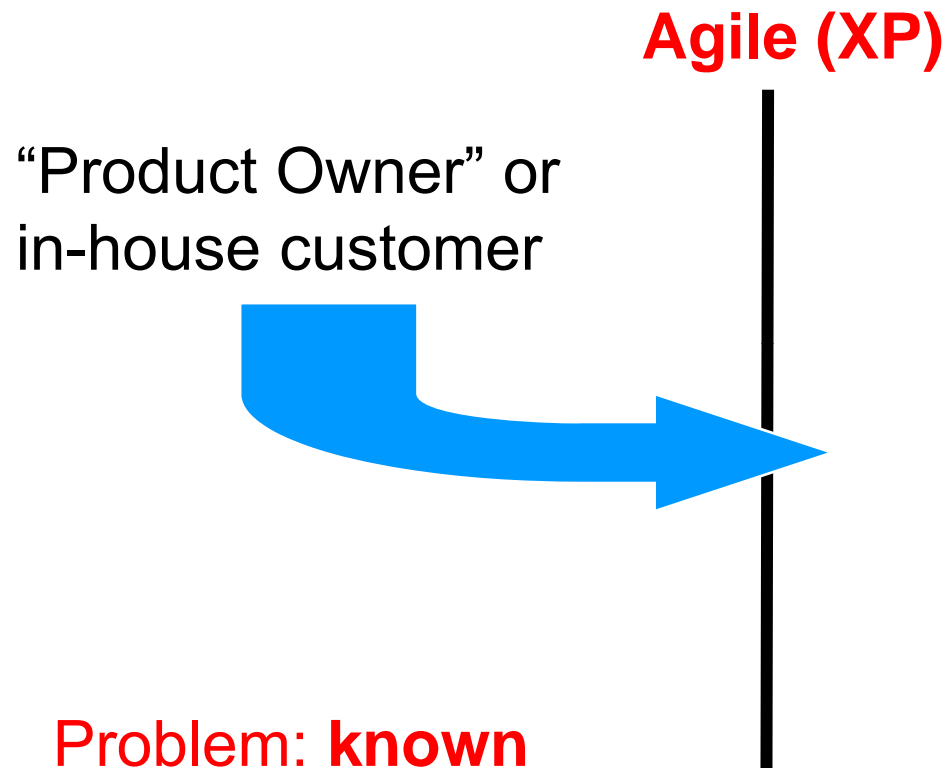
Waterfall



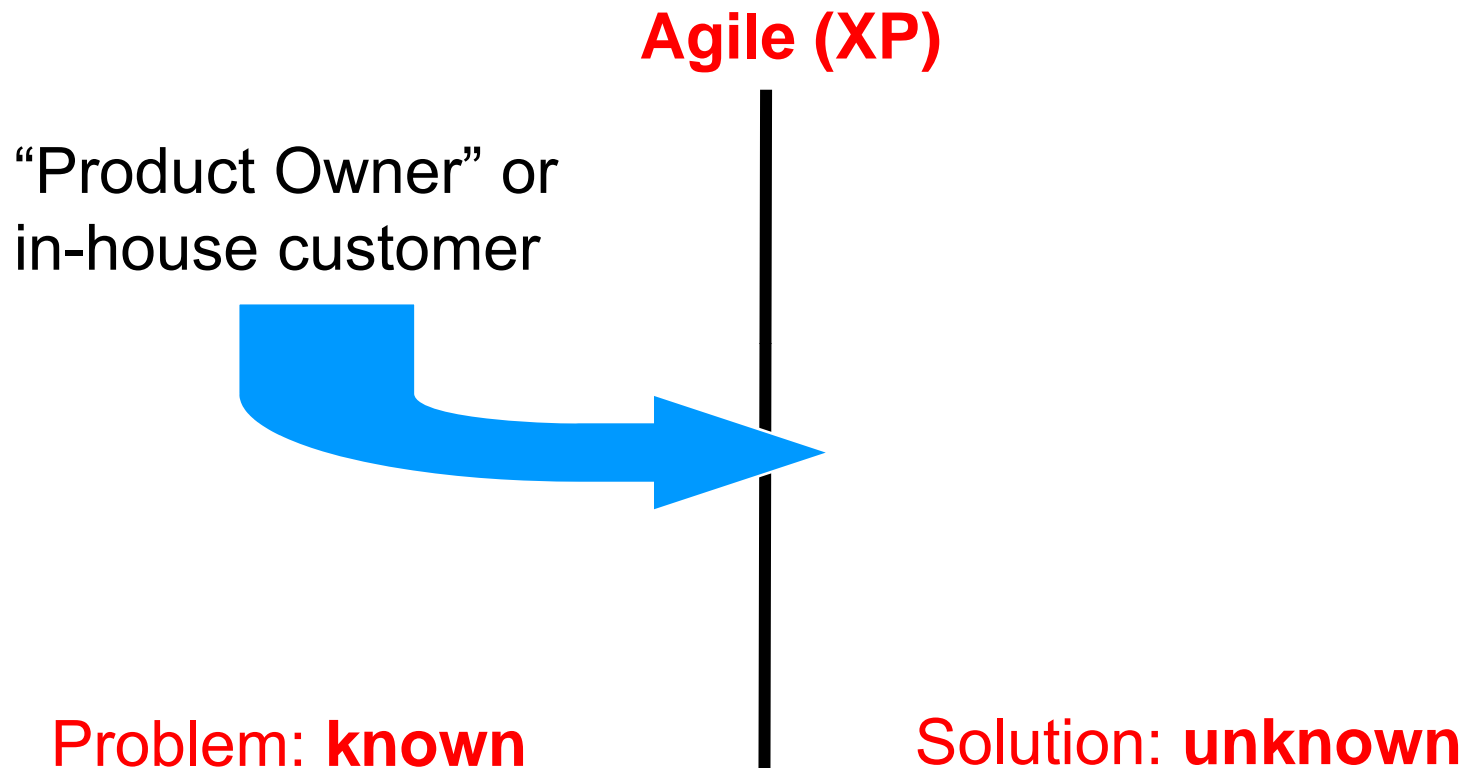
Agile Development

- “Our highest priority is to satisfy the customer through early and continuous delivery of valuable software.” <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

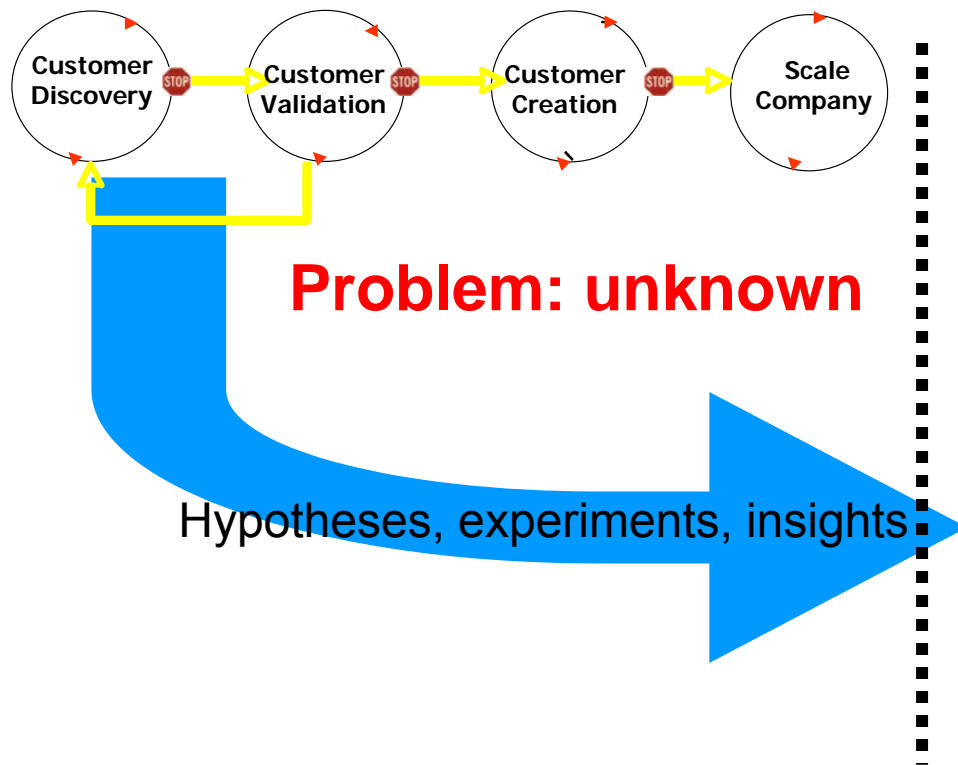


Unit of progress: Working Software, Features



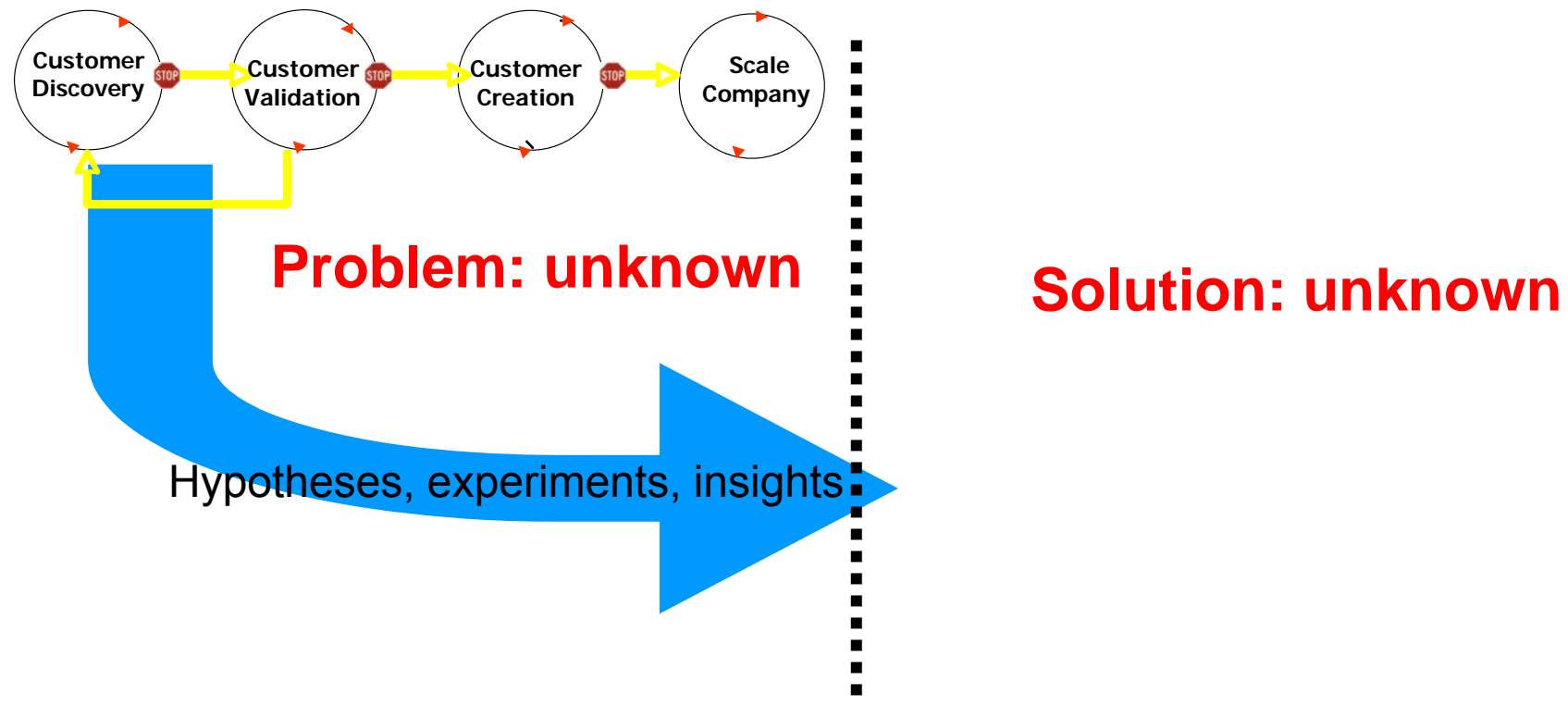
Unit of progress: Learning about Customers

Customer Development Engineering



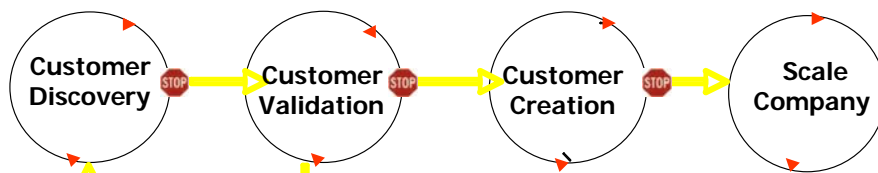
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Customer Development Engineering



Unit of progress: Learning about Customers

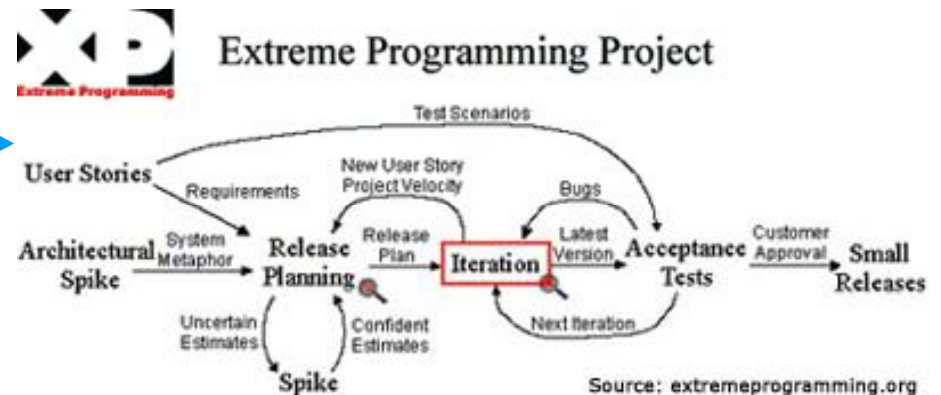
Customer Development Engineering



Problem: unknown

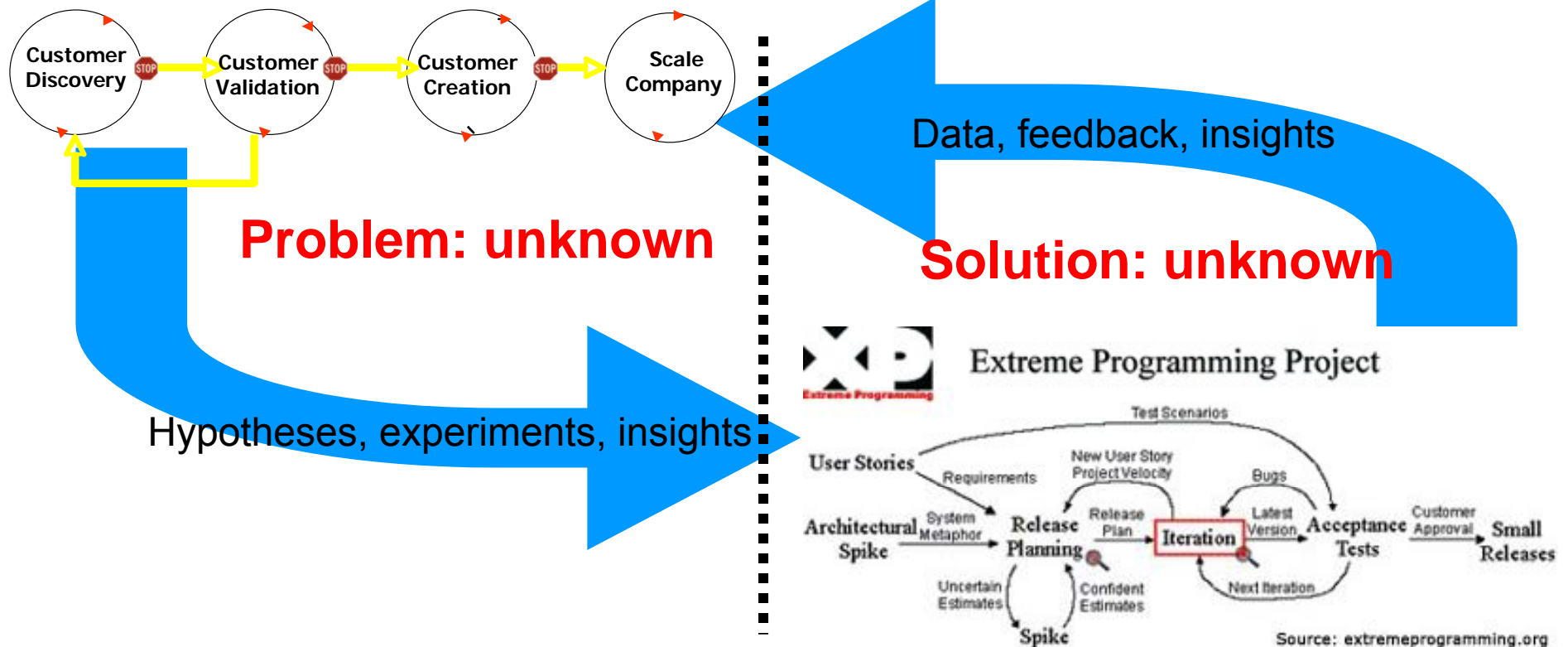
Hypotheses, experiments, insights

Solution: unknown



Unit of progress: Learning about Customers

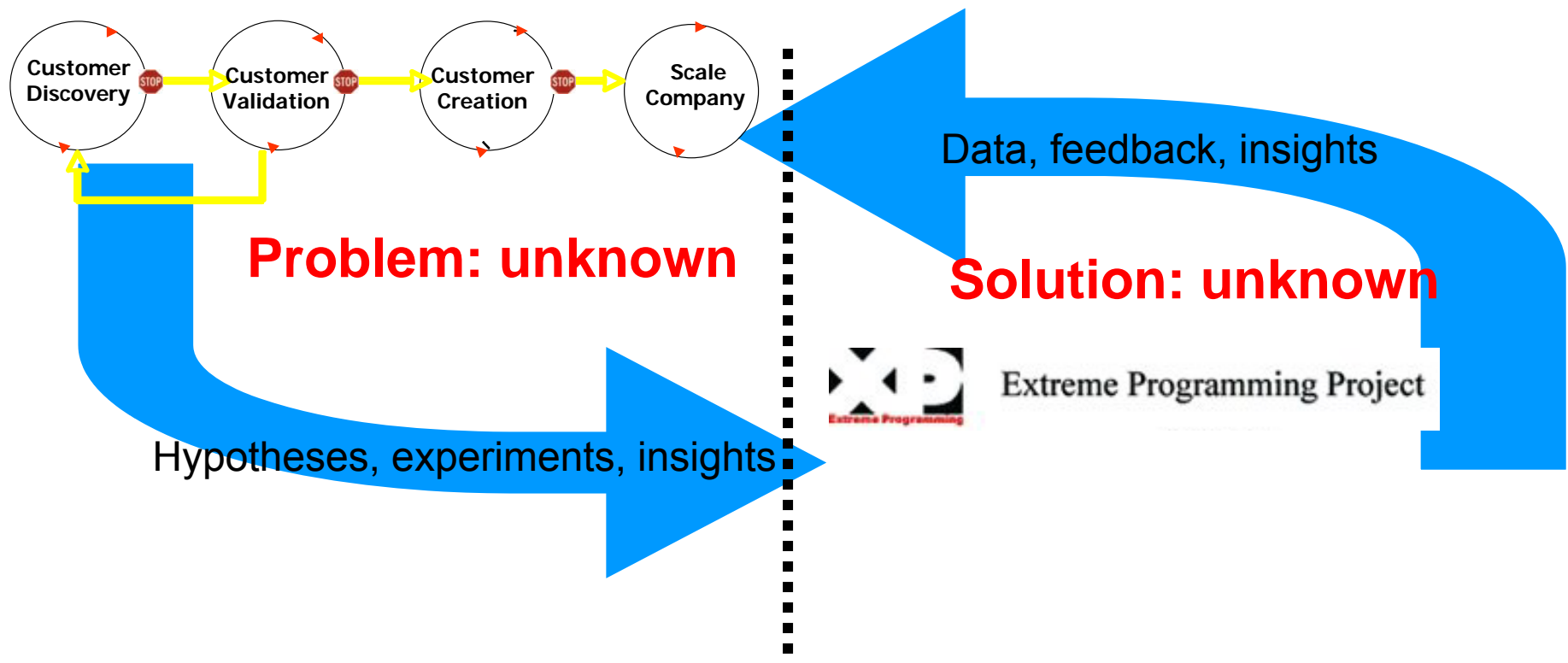
Customer Development Engineering



Unit of progress: Learning about Customers

Customer Development Engineering

Incremental, quick, minimum features, revenue/customer validation



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

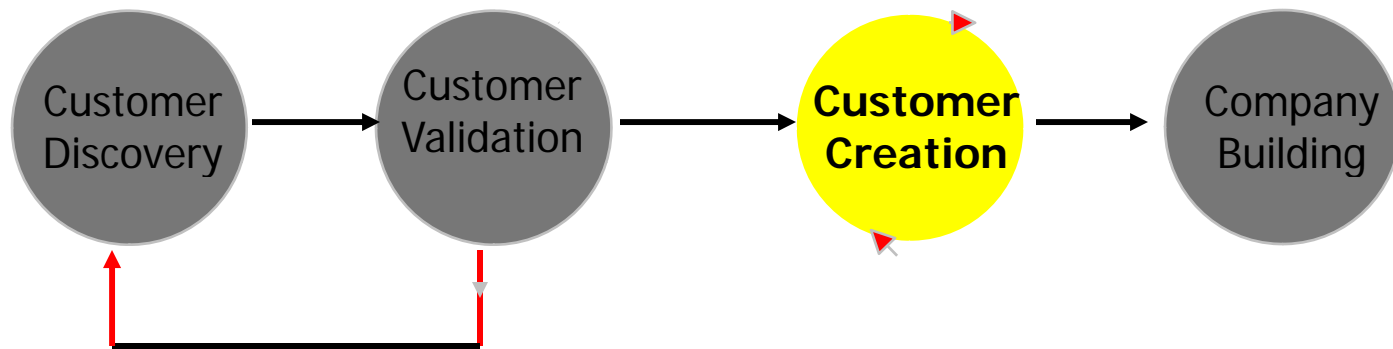
Customer Development Engineering

- 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

Existing Market

Resegmented
Market

New Market

- Existing Market
 - ◆ Faster/Better = High end
- 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?

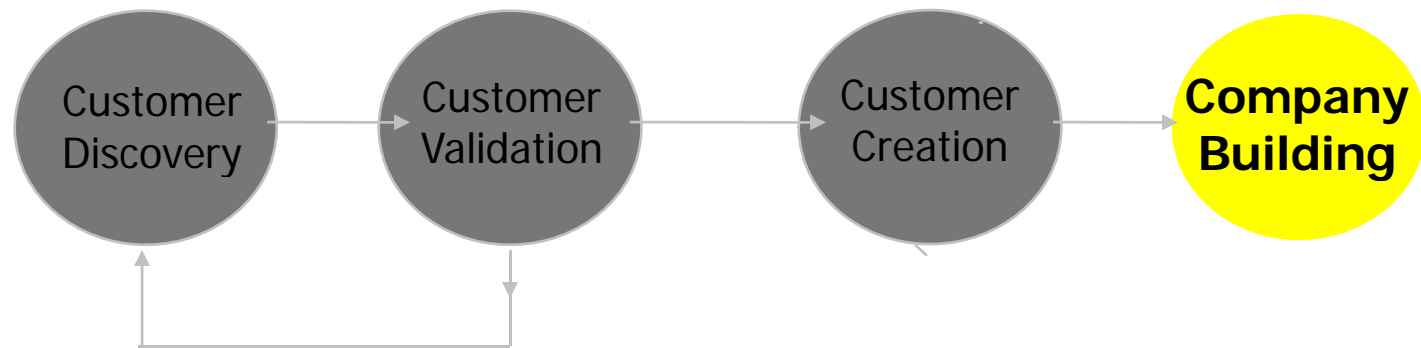
New Market Definition

- 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 ⇒
 - ◆ Mission-centric ⇒
 - ◆ 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

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A Plethora of Opportunities

Web 2.0	Enterprise Software	Enterprise Hardware	Comm Hardware	Comm Software	Consumer Electronics	Game Software	Semicon	Electronic Design Automation	Cleantech	Med Dev / Health Care	Life Science/ Biotech	Personalized Medicine
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Startup Checklist – 1

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
- Cleantech
- Med Dev / Health Care
- Life Science / Biotech
- Personalized Medicine

Market Risk vs. Invention Risk



Web 2.0	Enterprise Software	Enterprise Hardware	Comm Hardware	Comm Software	Consumer Electronics	Game Software	Semicon	Electronic Design Automation	Cleantech	Med Dev / Health Care	Life Science/ Biotech	Personalized Medicine
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Startup Checklist - 2

- Market Risk?
- Technical Risk?
- Both?

Execution: Lots to Worry About

	Web 2.0	Enterprise Software	Enterprise Hardware	Comm Hardware	Comm Software	Consumer Electronics	Game Software	Semicon	Electronic Design Automation	Cleantech	Med Dev / Health Care	Life Science/ Biotech	Personalized Medicine
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? Brand?													
What does Biz Dev do?													
Customer Development Steps Do end users matter?													
Possible Business/ Revenue Model(s) How do we organize to make money?													
IP/Patents													
Regulatory Issues?													
Time to Market													
Product Development Model How to you engineer it?													
Manufacturing What does it take to build it?													
Seed Financing													
Follow-on Financing													
Liquidity													

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/PatentsRegulatory 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

	Web 2.0	Enterprise Software	Enterprise Hardware	Comm Hardware	Comm Software	Consumer Electronics	Game Software	Semicon	Electronic Design Automation	Cleantech	Med Dev / Health Care	Life Science/ Biotech	Personalized Medicine
Opportunity Where does the idea come from?	Idea/Insight Cust need	Cust need Technology	Cust need Technology			Idea/Insight Cust need Technology	Entertainment	Moores Law Technology Cust need	Moores Law Technology Cust need	Technology Regulatory Cust need	Science Need	Excellent Science Need	
Innovation Where is the innovation?	Business- Model	Technical- Innovation Business- Model?	Technical- Innovation Business- Model?	Technical- Innovation	Technical- Innovation	Business- Model & Technical- Innovation	Story line Technology	Technical- Innovation	Technical- Innovation	Technical- Innovation Business- Model?	Technical- Innovation	Science- Innovation	Science Technical- Innovation
Customer: Who is the User/Payer?	U: End User P: End User Payment Methods: Credit Card, EFT, Paypal	U: IT or operating div P: IT or operating division	U: IT or operating div P: IT or operating division	U: End User P: Enterprise/ Telecom	U: End User P: Enterprise/ Telecom	U: any age P: Adult	U: any age P: Adult Payment Methods: Credit Card, EFT, Paypal, SMS billing, Prepaid cards (network or your own), Cash in the mail	U: End User P: OEM	U: Designer P: Project	U: Utility P: Gov't / Utility	P:Insurance/ Gov't,Doctors/ Hospitals U: Doctors		U: Consumer P:?
Competition: Who is the competitor/ complementor?	No first mover for customers			First Mover?	First Mover?		Finite time Other genres Seasonality	Design wins				First Mover	
Sales: What is the Channel to reach the customer?	Web	Direct >\$150K \$1.5M/head Telesales Web	Direct >\$150K \$1.5M/head Channel VAR's SysIntegrators	Direct OEM VAR's	Direct OEM VAR's	Retail Distributor Web	License Distributor Web Direct to retail	OEM Disti IP License	Direct VAR's Telsales	Direct System- Integrators Partners	VAR's License Direct		
Marketing: How do you create end user demand? Brand?	SEO SEM Banner Ads PR Blogs Reviews Viral	Trade shows PR Tech Press Bus Press Presales Seminars Webinars	Trade shows PR - blogs Tech Press Bus Press Presales Seminars Webinars	Tradeshows PR Presales Seminars Webinars	Tradeshows PR Presales Seminars Webinars	Reviews Ads PR- blogs	Game reviews Blogs End user buzz Game mag ads Promotions Tie-ins	Ads Presales Seminars Webinars	Tradeshows PR Presales Seminars Webinars			None until past NDA	
What does Biz Dev do?	Affiliates Developers		Whole- Product	Whole- Product	Whole- Product	Channel alliances	Distribution Deals	Whole- Product	Distribution Deals		Channel- Partners	Licensing	
Customer Development Steps Do end users matter?	All	All	All			All Desire	All Hits-based	All			Some	None	
Possible Business/ Revenue Model(s) How do we organize to make money?	<ul style="list-style-type: none"> o Advertising o Infomediary o Brokerage o Merchant o Direct o Affiliate o Community o Subscription 	Direct SAAS Cloud SOA Open Source	Direct OEM	Direct OEM	Direct OEM	OEM Direct	Per-copy royalty Per-copy sale Virtual goods Subscription Bundle	IP-License	OEM Direct		License Direct sale Indirect Reps	<ul style="list-style-type: none"> o FIPCO o RIPCO o DIDCO o LIPCO o NRDO o Contract research. o Discovery technology o Platform technology 	
IP/Patents	N/A	Optional	Optional			Optional		Important			Very Important	Patents are Critical- no	

Market Risk Reduction Strategy

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Customer Development and the Business Plan

The Traditional Plan & Pitch

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

Better



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

Business Plan Becomes the Funding Slides



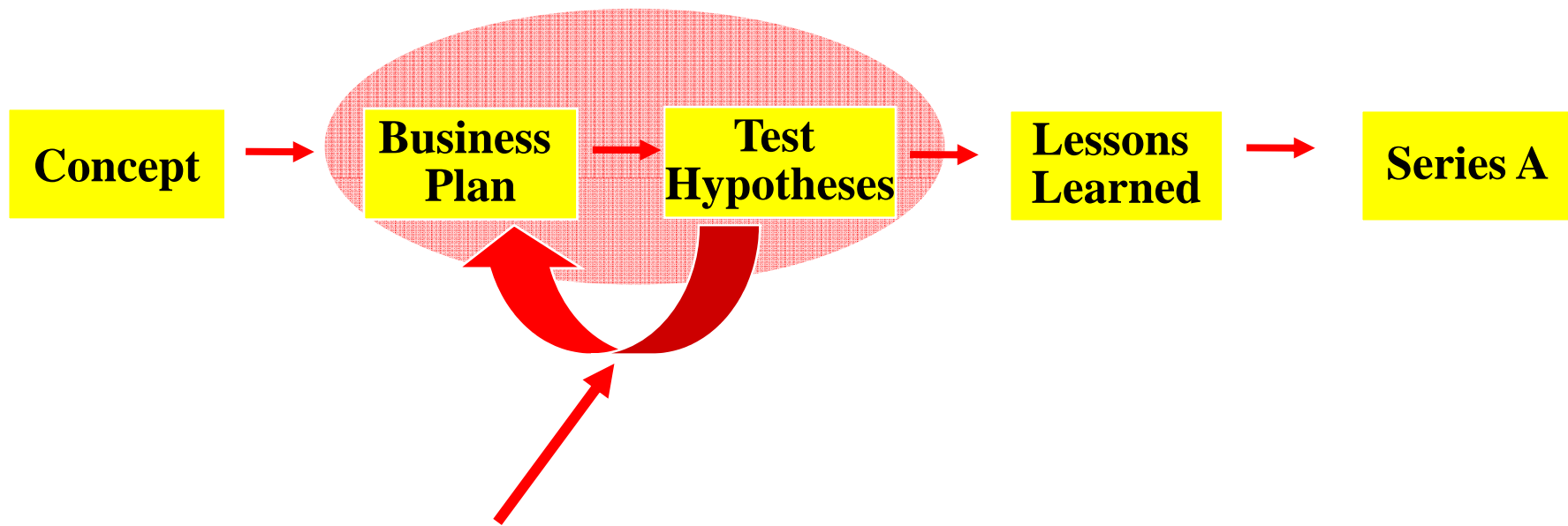
Why Don't VC's Believe a Word You Say?

- 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

The Four Steps to the Epiphany

*Successful Strategies for
Products that Win*



Steven Gary Blank