

BLOG

TO BOOK



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Marketing

Agile Product Development, Business Model Design,
Web Analytics, and Other Keys to Rapid Growth



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I.

Introduction to Startup Marketing

Picking the Right Startups

Each new startup I help take to market offers many potential rewards, but there are risks too.

The most obvious reward is the financial upside of equity in a successful company. But there are less tangible benefits like the thrill of being part of a team realizing the potential of their vision. Probably the most important long-term reward is that each startup success enhances my reputation and opens doors to additional startups with strong potential – while improving the skills I need to maximize these opportunities. This allows me to continue doing the most enjoyable “job” of my life.

But the risks are very real. A startup in a bad space with a bad product won't be much fun to market – and I'll probably fail. And when the company flops, it will damage my reputation. Enough damage to my reputation and I'll have to figure out a new pursuit. Of course most people recognize that it's impossible to have a perfect startup record, but the opportunity cost of committing to the wrong startup means I won't have the bandwidth to take on a potentially hot company.

Given these rewards and risks, I increasingly find myself evaluating opportunities with a VC-like diligence. I've created an opportunity assessment worksheet that identifies key risks in the business. The standard format makes it easier to compare opportunities. One of the biggest risks of any business is the inability to raise capital,

so early on, I set the requirement that I'll only work with companies that have recently raised a series A or large seed round. A very good VC can also help improve the odds, as they've achieved a better track record with their historical picks (and many would argue their "added value").

Beyond general business risks, I obviously need to be confident that it is a marketable business and one on which I can make a meaningful impact. The ideal category is what I refer to as a "disruptor" startup. These are businesses that enter an existing category with a breakthrough feature or very disruptive pricing model. My iterative, metrics driven marketing approach is perfect for helping these types of businesses discover their ideal market, differentiate appropriately and identify viable customer acquisition drivers. Generally these businesses can get substantial traction just by harvesting the existing demand for the category.

Another startup category I often consider is what I call "innovator" startups. These are much more challenging to take to market, but under certain conditions they are very marketable. If they solve a specific important problem for a large addressable market and the potential customer lifetime value is high enough, it is generally possible to fund the full demand generation process. Still, it takes a lot of time to discover the right target users. Not only do they need to suffer from the problem, your product needs to effectively solve the problem. Your next big problem is finding a profitable way to reach these target users and messaging they'll respond to. These are difficult go to market assignments, but they definitely improve my skills.

For now I find myself alternating between these types of startups and avoiding those that don't fall into these categories.

What Makes A Great Startup?

That's the zillion dollar question. And no one knows the answer definitively. Even the most successful VCs have major duds in their portfolios. But every startup that becomes a large profitable company has the following two elements in common.

1) Product/service people really want or need.

A “product/service people want” is the starting point for any successful startup and part of the reason that [I love working with Y Combinator startups](#). They drill the mantra “make something people want” into hackers’ heads who are actually capable of executing the vision.

MBA's often spend way too much time obsessing over the business model before they've figured out how to create a useful product. A great business model can never make up for a product that doesn't meet a want or need.

I don't really consider myself an expert on creating useful products. In fact, I'm not sure anyone is an expert. Steve Jobs may be considered the world's best product visionary, but [NeXT Computer](#) was hardly a smash hit. And the [executive](#) behind Microsoft's lucrative Xbox business has added much less value with the Zune.

I was lucky in my first two startups to work with great products – the original founder’s vision really resonated with users. I helped both companies reach their [potential](#), but I didn’t create that potential. Luck of stumbling into great products can’t last forever, so I now obsess over finding better ways to figure out if a product has potential before committing to take it to market. Every launch program starts with a discovery phase where we dig into how well the product is resonating with users, who really needs it, and why it’s resonating. Then we decide a timeline for going to market.

The only way to know if a product will resonate is to get actual users on it – and the sooner the better. If the product isn’t striking a nerve, it’s better to delay an aggressive go to market push. Many startups succeed with a refined vision rather than their original product. See [this list](#) for examples.

[Sean O’Malley’s blog](#) and [Eric Ries’ blog](#) are both great resources for helping you hone your product. But remember, the only way to know if you’ve succeeded is to trickle some users onto it. Sean O’Malley’s slideshare presentation below is also very helpful.



[WATCH](#): *Sean O'Malley's Slideshare Presentation*

2) Business model that works

Ultimately startups get VC funding based on their potential to create a thriving business. This requires combining a needed product with a business model that pays the costs of building a lucrative business. There is as much art in creating a strong business model as there is in creating the perfect product. It is a thing of beauty when all the pieces fit together in a perfectly tuned economic engine. Each ingredient is relatively simple, but making them work together at scale is extremely difficult.

These are the key variables to consider when developing a business model that supports profitable, scalable user acquisition channels:

- Lifetime value of a user
- Cost of acquiring a user
- Marginal costs (besides acquisition cost)

The lifetime value of a user must exceed the cost of acquiring the user and any marginal material/service costs (costs that increase incrementally with each customer). This is generally pretty easy to achieve if you have low marginal costs. Most traditional software has zero marginal cost, which is why freeware is possible (it may not be profitable, but it is sustainable). If you're lucky, the lifetime value of each user is significantly higher than the marginal cost. In this case you have a lot leftover to spend on profitable customer acquisition. On the other hand, if you have marginal costs that exceed the lifetime value, then this is a non-starter, no matter how useful the product is.

If your product is useful and the basic business economics work, then the next part of the business model puzzle is figuring out "customer acquisition channels." VC funded businesses must have very scalable customer acquisition opportunities. No VC is interested in funding a business that maxes out at \$1 million/year in revenue - even if it has 90 percent profit margins.

Once you have a basic engine that works, keep tuning all pieces to make it work better (improve conversion rates, bring marginal costs down, find ways to increase LTV...). This will open additional profitable customer acquisition channels. And obsessively tuning all these areas has been a

major factor in my ability to attract tens of millions of users for startups that ultimately filed for NASDAQ IPOs.

The Ultimate Startup

The ultimate startup would be one where the product meets a critical need for a huge addressable market, users have a very high average lifetime value, there are no marginal costs and there are very scalable user acquisition channels that are completely free (i.e. viral). Unfortunately I don't know any businesses like this. Facebook comes close, which helps explain their valuation of \$15 billion (who knows what it is now?)... The only piece they are missing is a high lifetime value per user.

[The science behind viral marketing](#) has rapidly evolved in recent years, so I'm anxiously waiting for this ultimate startup to launch. Hope I can get some of the early equity in it.

Key Elements of a Massively Scalable Startup

VC backed startups generally aspire to valuations in the hundreds of millions or even billions of dollars, but very few really consider all of the elements they'll need to make it happen. After analyzing several startups I've worked with that have reached or are approaching these valuations I've boiled it down to four interdependent commonalities that always seem to exist. While they are easy to describe, they are of course very difficult to achieve. Still your best chance of achieving them is to know what they are.

Element 1: Gratification engine

Your gratification engine is the repeatable process of turning cold prospects into highly gratified customers. Whether you are aiming big or small, an effective gratification engine is probably the hardest of the four elements for a startup to get right. Tenacious execution works for a lot of things, but you can't force customers to want, need or like what you have created. Building an effective gratification engine is an iterative process driven by a lot of prospective customer feedback. Once you get the basics right, your process of gratifying users can be optimized with tools like Performable

for landing pages and KISSmetrics for full funnel tracking/improvement (I'm an advisor to both).

Element 2: Economic engine

Once you have figured out how to gratify prospects, your next challenge is creating a viable economic engine. For your business to be sustainable in the long run your average revenue per user will need to exceed your average cost per user. Beyond business sustainability, the right monetization approach will also be based on the value users get from your solution, the competitive environment and your ultimate growth strategy.

Element 3: Growth engine

Your growth engine is very dependent on your economic engine. If you have relatively limited revenue per user, you'll need to pursue tactics with a very low marginal cost such as PR, SEO or viral marketing. With a higher revenue per user, you'll also be able to effectively arbitrage growth through paid tactics like display advertising and SEM. The most valuable companies generally choose an approach that allows them to capture the biggest share of the market in a sustainable way. This often means a strategy with lower revenue per user. They don't invest too much time in one off gimmicks, instead they focus on growth drivers that can be repeatable and scalable.

Element 4: Huge addressable market

The best opportunities generally have the hardest markets to accurately size. That's because these are fast growing or whole new markets that are based on potential rather than

existing customers. Perfect accuracy on market sizing isn't important here. Instead creative scenarios that show how it will likely be big should generally suffice. You also want to breakdown potential segments and people that are new to the market or coming from an existing related market. Again, you just want to have approximations that are believable and big.

Start with a Hypothesis for Each Element

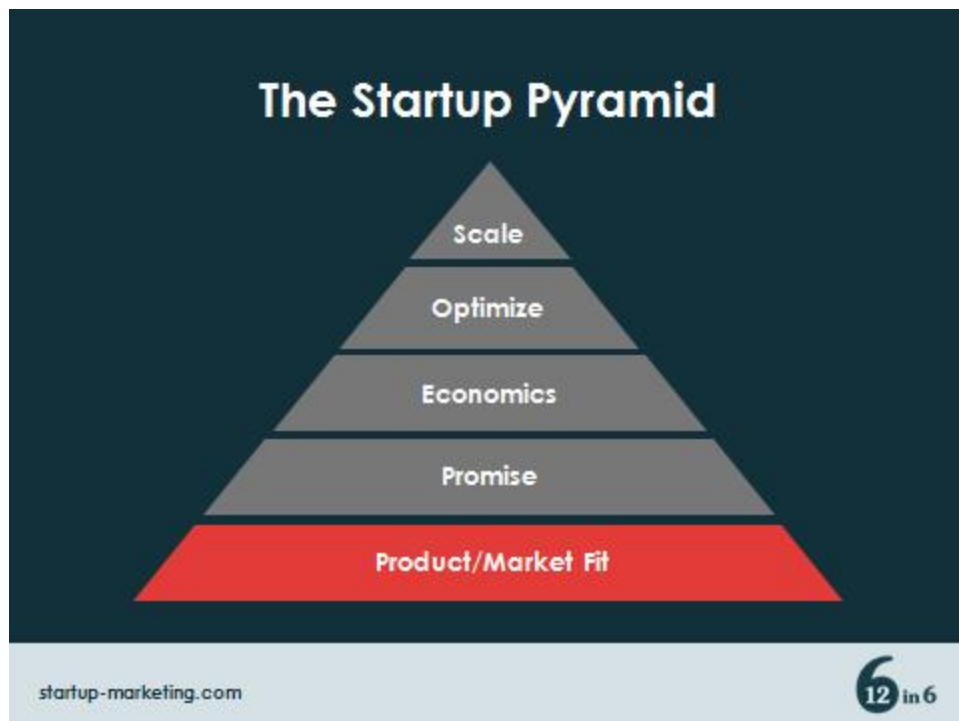
It is important to have a realistic hypothesis for each of these elements before you even get started with the business. If you are having a hard time creating a realistic hypothesis for one or more of these elements, your vision probably isn't viable.

I can often look at a business for less than an hour and decide if I believe it is massively scalable opportunity based on my hypothesis for each of these. If I'm not confident on a specific element, I spend a lot of time vetting this with the CEO before committing to a project

Of course it won't happen exactly the way you plan. The best opportunities have multiple contingency plans in case your initial theory doesn't work. But if you can't even creatively come up with a viable theory for each, you'll likely have a very hard time raising VC funds. Once you have a theory for each, start with the practical bottoms up execution described in the following **Startup Pyramid** article.

The Startup Pyramid

Every six months I rethink the optimal startup go to market approach based on new insights gained at recent startups. Lately I've been using a pyramid to represent the process I'm using. Startups require a solid foundation of product/market fit before progressing up the pyramid and scaling the business.



Achieving Product/Market Fit

Product/market fit has always been a fairly abstract concept making it difficult to know when you have actually achieved it. Yet many entrepreneurs have highlighted the importance of creating a product that resonates with the target market:

- **Paul Graham:** The mantra at Paul's successful startup incubator YCombinator is: "make things people want."
- **Steve Blank:** In Steve's book Four Steps to the Epiphany he writes: "Customer Validation proves that you have found a set of customers and a market who react positively to the product: By relieving those customers of some of their money."
- **Marc Andreessen:** A couple years ago Marc wrote the following on [his blog](#): "... the life of any startup can be divided into two parts - before product/market fit and after product/market fit." He goes on to write: "When you are BPMF, focus obsessively on getting to product/market fit. Do whatever is required to get to product/market fit. Including changing out people, rewriting your product, moving into a different market, telling customers no when you don't want to, telling customers yes when you don't want to, raising that fourth round of highly dilutive venture capital - whatever is required."

I've tried to make the concept less abstract by offering a specific metric for determining product/market fit. I ask existing users of a product how they would feel if they could no longer use the product. In my experience, achieving product/market fit requires at least 40 percent of users