

# Sowing the Seeds of a Successful Startup

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A little intuition, a touch of luck, and a great deal of realistic planning go into establishing solid groundwork for a new technology venture.

The brilliant, unique idea: whether it serendipitously strikes in the middle of the night or emerges out of frustration over a problem you have experienced, it is a precious seedling with the potential to blossom into a thriving new business. When you are an entrepreneur, this singular idea will become the center of your universe as you begin to cultivate a living business from thin air.

With this idea in hand, along with passion and technological savvy, you may feel your company is ready to go out and seek funding. Although passion and technological savvy are critical ingredients to propagating any new company, they are simply not enough by themselves to drive a technology startup to success.

Entrepreneurs are often misled by tales of companies that are born from the minds of smart, scrappy inventors whose companies legendarily explode into multi-million dollar successes overnight. The harsher reality is that many startups do not succeed, and those that do rarely see success overnight. A number of different studies generally estimate that around 80 percent of all new ventures will fail within the first three to five years.

So, how you approach your project in the beginning matters a great deal. There are countless variables as to why companies fail, but one body of research draws a clear distinction between a startup's failure to engage in good, old-fashioned business planning — gathering information

about the market, understanding competing technologies, developing a financial roadmap — and the disbanding of the ventures in the first two years of their lives.<sup>1</sup>

Entrepreneurs who spend the time to research their ideas and establish realistic goals and projections for their companies not only are more prepared when they begin to explore opportunities for funding, but also gain a more developed perspective on the overall market opportunity, the true customer needs, the competitive landscape, and the operational challenges — which may in the end change or refine the original idea, technology, or approach into a venture that ultimately flourishes.

This article is the first in a series focused on the concerns and activities of an early-stage technology startup. The following pages serve as a checklist designed to aid entrepreneurs in establishing a viable roadmap that will help them bridge the gap between idea and reality.

## VALIDATING YOUR CONCEPT

One of the biggest mistakes new entrepreneurs make is failing to thoroughly research their business concepts to ensure that their ideas actually have a chance of taking off in the marketplace. Driven by enthusiasm, founders often set off on a course designed by general assumptions rather than reality.

## ARE YOU SOLVING A REAL PROBLEM?

Your goal at the outset should be to define the problem your company and technology are trying to solve. Most startups lack the resources to conduct broad market research to validate their concept. However, taking the time to sit down one-on-one with individuals who represent your target customer — the decision-makers or decision-

## CAN YOU ANSWER THESE QUESTIONS?

- What is the problem you are solving?
- What pain points are you addressing?
- Why does the problem exist?
- Why has no one solved this before?
- What barriers exist?
- Why are you the right company to solve the problem?

influencers of the kinds of companies or consumers you imagine might desire the disruptive new technology you are developing — can be just as effective.

Reach out to one to two dozen prospective customers and ask questions about the problems they face, how they currently work around those problems, how those problems affect their lives or businesses and what it costs them. Explain your solution and elicit their feedback. Ask them: *Would you buy this product or service if it were available?*

These interviews provide you with a real-world perspective on the challenges your prospective customers face every day, including complexities and pain points you may not have identified before. They also help you determine how companies are currently solving the problem (i.e., your competition). The insights you will gain will also provide you with the market intelligence you need to refine your approach, focus your product, and develop a more robust technology prototype that will resonate with the market needs.

<sup>1</sup>Delmar, Frédéric and Scott Shane. “Does Business Planning Facilitate the Development of New Ventures?” *Strat. Mgmt. J.*, 24: 1165–1185 (2003).

In addition, if you receive positive feedback from prospects, you are armed with real-world testimonials you can use as you speak to investors about your company and product. Having ten to twenty real prospects who help validate that the solution you are developing fills an unmet need goes an awfully long way with potential investors who will be looking to mitigate risk in any early-stage investment.

## WHO ARE YOUR CUSTOMERS — AND ARE THERE ENOUGH OF THEM?

The “interviews” you conduct will further help you define the universe of potential customers who are the right target for your solution.

You may find in the course of your conversations, for example, that while you assumed your technology would appeal to companies across all industries and verticals, your idea really only solves a particular problem that only one vertical experiences.

### CAN YOU ANSWER THESE QUESTIONS?

- Who are your customers?
- What are the verticals of your prospective customers?
- Do you have any existing clients?
- What is the long-term vision of your customers?
- How big is the problem you are solving?
- What is the lifetime value of your customer?
- Can you quantify the problem you are solving?
- Is this really a problem worth solving?
- How much is your client willing to pay for your solution?

To illustrate, let’s say an entrepreneur has an innovative idea for helping the delivery of multimedia ads online. It is tempting for the entrepreneur to believe that *all companies purchasing online advertising* are prospective customers for this technology. To test this assumption, the entrepreneur speaks to a range of customer types — from the heads of marketing at Fortune 100 companies to small businesses and agencies.

He or she may find that while marketing departments are relatively indifferent to the technology, ad agencies show particular enthusiasm for the idea because it solves a problem they are experiencing with their clients and would enable them to achieve a better ROI in the online ad space. The entrepreneur may choose to explore this niche market further, potentially fine-tuning the technology to best serve the general agencies’ needs.

Similarly, many times startup founders tend to look at the market potential for their new idea from the “top down” instead of the “bottom up.” In other words, they fail to narrow down their potential customers, seeing the entire ocean as their playing field instead of the one coral reef where their true prospective customers hide out.

In the case of our illustration, the entrepreneur might be tempted to present the case that online advertising is a \$16 billion business each year, and that at a 10 percent penetration rate, they have a \$1.6 billion dollar business. This can be misleading, as the startup is not necessarily tapping into the entirety of that business.

A more realistic approach to validating the market opportunity would be to look at how many ad agencies are facing this issue, what this issue is costing them, and how much they would be willing to spend to solve this problem, and then to forecast out how many agencies the entrepreneur believes he or she could sign up during a period of three to five years.

Being able to define your niche customer segment and understand the true market size and reach of your solution enables your company to more realistically forecast your potential earnings as well as plan how to market and price your product or service.

## WHO IS YOUR COMPETITION?

Commonly, entrepreneurs believe they have hit upon a truly unique idea — a way of doing something that no one else has ever done before. This is often true, especially with disruptive technologies; but it is important to understand that no matter how innovative the idea, there is always competition.

The key to identifying your competitors is to take the opposite tack from the one you use when defining market size. Instead of looking at the narrow space in which your company operates, you need to think more broadly. At its core, what problem does your technology solve — and how are customers currently solving that problem? What other solutions are they using that draw from different categories?

### CAN YOU ANSWER THESE QUESTIONS?

- Who are your main competitors?
- How are they currently addressing the problem you are solving?
- In which key ways is your product superior?
- Where are your competitors in the development stage?
- What direction are they moving with their technology?
- What IP protection or barriers to entry do you have over them?

All of those products may be considered competitors to your solution.

Consider Twitter, a truly groundbreaking online “microblogging” platform that has revolutionized the way people communicate with each other. Before Twitter, microblogging didn’t exist as a category, so it would be difficult to point to a direct competitor or someone that was doing what Twitter was doing.

Notwithstanding, in defining its competition, a company such as Twitter would have to compare itself with the dozens of other communication platforms — online and offline — available to people who want to reach and network with others. In addition, the company would have to establish why it would be a preferred solution for anyone wanting to connect with other people. In every category competition exists. Twitter has been successful in gaining traction because they have created a truly innovative way for people to stay easily connected and informed.

Defining your competition realistically enables you to better differentiate yourself in your product design, and prepares you for the risks involved in taking your product to market so you can build a solid defense. It also helps you to recognize market conventions so you are better able to deliver your product or service in a way that your customers will expect and adopt.

## FROM IDEA TO REALITY: PLANNING AHEAD

Once you have established through solid research that your idea will be widely accepted in the marketplace and can stand up against your competition, it is time to begin thinking ahead to the time you plan to go live. Entrepreneurs need to think through all of the many possible scenarios to anticipate challenges, predict costs, and ensure that their beliefs about how they will bring their product to market are realistic.

## IS YOUR TECHNOLOGY BULLETPROOF?

Now that you have established that your idea is a valid one, the next step is to see if the solution you plan to build can actually do what you think it should.

Based on what you have learned from your initial research, ask yourself if your technology as it is currently designed addresses a large percentage of your customers' concerns. Does it require iteration to more accurately meet your prospective customers' needs? You may significantly increase your level of risk if you overpromise what your product can do, or conversely, if you fail to take into account the feedback you were given about the problems your technology solution is aiming to solve.

Although it may require a delay in your timeline, it is important to consider and address possible technology flaws and shortfalls early on, before the product hits the market. In today's information age, word travels fast, especially when a product does not live up to expectations — and negative feedback can plague you well into the future, particularly when your competitors catch wind of it.

### CAN YOU ANSWER THESE QUESTIONS?

- What does your technology do?
- How does your technology improve a customer's business or processes?
- Does your technology require major changes to your customers existing technology platform?
- Is your technology defensible?
- Does your technology work the way it needs to?
- Are there adoption risks?

## WHAT IS YOUR GO-TO-MARKET STRATEGY?

Caught up in prototyping the technology, entrepreneurs may fail early in the game to work through the logistics of how they will take the product or service to market once it is ready. This is where the proverbial rubber meets the road, yet oftentimes founders neglect to address key operational, distribution, and marketing challenges among their first courses of action.

Unfortunately, failure to understand pragmatically the complexities, challenges, and costs facing a new business down the road can lead to that business's downfall. "Entrepreneurs who hope to secure a niche ... often fail because the costs of serving a specialized segment exceed the benefits to the customers," writes entrepreneurial expert Amar Bhidé, visiting scholar at Harvard University's Kennedy School of Government. "Entrepreneurs should therefore analyze carefully the incremental costs of serving a niche and take into account their lack of scale and the difficulty of marketing to a small, diffused segment. And especially if the cost disadvantage is significant, entrepreneurs should determine whether their offering provides a significant performance benefit."<sup>2</sup>

### CAN YOU ANSWER THESE QUESTIONS?

- How will you reach your customers in an economical way?
- What is your distribution strategy?
- What channels will you use?
- Are there key partnerships you have locked up?
- How are you planning to build momentum?
- On a volume of 1, am I able to make a profit?

<sup>2</sup>Bhidé, Amar. "How Entrepreneurs Craft Strategies That Work." Harvard Business Review, March-April 1994.

In other words: if the costs of bringing your product or service to market far exceed how much customers are willing to pay, you need to rethink things before proceeding further with your idea. It is critical to address this realistically — and it is simply not enough to believe that you can count on a “viral” effect to help distribute your technology.

## BUILDING THE RIGHT TEAM

Creating the right culture in any company is truly an art. Many companies, including SVB Financial Group, are fortunate that their founders devoted time establishing the right culture that is now part of their companies’ DNA. Early in the life of your business, you often work alone or with a core team of people who collaborate to develop the technology and begin to put flesh and bones to the original idea. The trick is recognizing when it is time to add to the original team, and to shift responsibilities as the company begins to grow and demand a different level of leadership.

## THE ORGANIZATIONAL BALANCING ACT

It should be recognized that the founders’ strength does not necessarily lie in the ability to determine when and how to grow and change the organizational structure, especially early in the life of a company. Loyalty to the founding team, a focus on the immediate task at hand, and a tendency to prefer working independently to solve a challenge — the latter a common trait among engineers turned entrepreneurs — are all obstacles that entrepreneurs face as they work to scale as necessary in their new ventures. [1]

On the other hand, growing and scaling too quickly and bringing on heavy-hitter C-suite executives too early in the game can not only be a waste of resources, it may turn off potential investors. Investors want to know that

## CAN YOU ANSWER THESE QUESTIONS?

- Who are your team members?
- How have team members worked together in the past?
- Do your team members have prior startup or domain expertise?
- What relationships or successes have team members had that can be leveraged for the new company?
- Are there any gaps in your current team?

entrepreneurs are disciplined in the art of adding value at every step of the way of the company’s development. “Creating fixed expenses before the right time is one of the most common mistakes” says Allan May, Managing Director of Emergent Medical Partners and Chairman and co-founder of the Life Science Angels. “Nothing screams “High Burn” more than seeing an early stage company equipped with the full set of C level execs (CMO, COO, CFO etc.) before they are needed. Adding the right people is really the art of execution in any early stage effort, and spending money in the right place at the right time is key.” With every expense the entrepreneur takes on, an entrepreneur needs to ask themselves: Is this expense critical to achieving our current round milestones or otherwise adding value that can be realized at the next round? “If not, or if it can be delayed to a later date, don’t write the check!” says May.

Company founders also face the important but entirely unscientific challenge of ensuring their team has the right chemistry. Much of the success at this may be based on finding people with whom you have worked in the past or

## THE ADVISORY BOARD: AN ENTOURAGE OF EXPERTISE

Ryan Howard led the launch of an impressive number of new products in his career. But when it came to launching his own company, he instinctively knew he required more than just his own expertise to be successful.

“We’re a startup in a crowded space,” says Howard, CEO of [Practice Fusion](#) in San Francisco, which provides free, Web-based electronic health record software for doctors. “The way we do what we do is innovative, but the industry is very David and Goliath.”

As a first-time entrepreneur, Howard also knew he lacked the track record to attract top-notch talent, partners and customers. His solution: soak up the wisdom and guidance of experienced advisors.

“I created a relationship right away with anyone who would talk to me,” Howard says. He put together a strong, revolving advisory board of healthcare business leaders and physicians — people who knew the industry deeply and understood how to pragmatically put the technology to work.

Exchanging equity for expertise, Howard frequently bent the ear of his advisory board in the early days. “I used them to validate the business,” he says. “They assisted me with not burning a lot of time and money.” His advisors additionally offered their own networks and made valuable introductions to investors.

The time spent at the outset building an advisory board helped Howard build credibility and, ultimately, a winning product. Recently backed by Salesforce.com, the company has won more than 18,000 customers in less than two years on the market.

who share similar philosophies, an unyielding passion for what you are doing and specific domain expertise. Some of it is pure luck. Nevertheless, the chemistry a team exhibits and the specific experience they have along with the culture of the organization are factors investors will observe and consider heavily — because they are proven contributors to a startup’s ability to attract talent, execute on its plan, and ultimately succeed.

## AN ADVISORY BOARD THAT ADVISES

For many early-stage startups, trying to score the biggest names in the Valley for the advisory board becomes a strategy for helping to establish credibility in the eyes of investors.

But having technology superstars on your advisory board is usually not enough. Investors will want to know how you are *leveraging* those people and how involved they are in your business. Too many times founders bring advisors on board solely for their names, but fail to actually reach out to them and stay in touch.

Be sure you establish a structure for interacting with and leveraging your advisory board in ways that will help you to achieve early milestones. This can range from introductions to potential customers, to help with technical due diligence or even feedback on operational challenges.

## BUILDING THE ALL-STAR SUPPORT TEAM

Early in the game, entrepreneurs will need to build a support infrastructure of professional services providers. This is the time to begin accessing your network — your advisory board, other entrepreneurs, former colleagues — for referrals to companies with extensive experience and strong connections within the investor and technology communities.

Your banking partner, your law firm and your accounting firm should not only understand your specific needs as an early-stage technology company, but they should also be positioned to help introduce you to people along the way that will help make your company a success.

## CREATING A FINANCIAL ROADMAP

Once again, orchestrating financials for a technology startup is both a science and an art. You generally need to have the financial resources to begin building your product prototype and begin establishing an operational infrastructure for your company, but you also need to focus on these activities rather than halting everything to go on the fundraising trail when you run out of money.

Realistically forecasting the true cost of bringing your product to market, as well as the revenues you anticipate in the coming years, will be key. Many entrepreneurs make the mistake of *overestimating* their income potential and *underestimating* their costs in their pitches to potential investors. If you have done your homework, taking a hard look at your market size, customer, operational costs and other logical considerations, your financial projections should be more in line with actual scenarios and should

mirror the roadmap you plan to follow in order to make your venture a success. There are many variables that can throw a wrench into even the best-laid plans, but having a realistic view of the key financial drivers of your business will aid in establishing your credibility with investors and result in fewer surprises in the future.

Timing plays a crucial role as well. Entrepreneurs should focus on funding their ventures appropriately, so that they are building incremental value with each dollar they take in and each share of equity they give out. It can be very challenging for founders to raise an adequate amount of money to achieve critical milestones. However, entrepreneurs need to understand the financing risk associated with each round of capital and the amount of runway needed to achieve key milestones so they can attract additional capital or achieve profitability.

Watch for future articles on the topic of artfully capitalizing your startup. Also understand that much of the research we have discussed earlier in this article plays an important role in helping you put the pieces together for a sound financial roadmap.

## SEEKING THE RIGHT INVESTORS

Everything you focus on in the first months after your compelling idea incites you to start a new venture leads up to this: the moment when you are ready to go on the fundraising trail. If you have conducted your research thoroughly and have gotten to the point where you feel you can reasonably, soundly, realistically answer many of the questions listed above, you may be ready to put together your investor pitch.

This is a topic we will be exploring in greater detail in future articles, but the most important concept to remember is that not all investors are cut from the same cloth — and

### CAN YOU ANSWER THESE QUESTIONS?

- What are your 5-year forward-looking projections?
- What are your current revenues, costs, and margins?
- What is your pricing model?
- How much money have you raised so far?
- How much do you need going forward?

investor relationships, whether with angels or VCs, will differ with each entrepreneur and each new company.

You have a vision for the future of your company. Ideally, you will want to partner with investors who share in that vision and who can help you move that vision to a reality. In addition, you would be best suited to work with investors who bring value to your company beyond just the financial support you need. Some questions to consider when speaking to investors:

- Does the investor specialize in or have specific experience in the segment of the industry in which I operate?
- Does the investor bring special expertise to the table that I can leverage?
- Can the investor share a strong network of connections that will help my company thrive?
- Does the investor share in the same vision I have for the company?
- Can the investor support me if additional rounds of capital are needed?

Taking the time to explore the right investor partnership can help you avoid conflicts and disappointments down the road, and can give your company a leg up as it grows. It is a lot like dating, so finding the right investors whose interests are aligned, who share in the same vision you have for the company, and who can add value at each stage of your development is a key factor to any startup's success.

## ONLY THE BEGINNING

You are off and running, buoyed by a brilliant idea that promises to take on a life of its own. Time is precious, and there are a thousand things to accomplish to bring your idea to fruition.

However, pausing to validate your idea and plan ahead can help you give your vision a real chance, establishing solid ground on which you can grow your auspicious new venture. With proper planning, you will have a better chance of ensuring that your seedling of an idea grows and can blossom into a venture that will change your customers' lives and garner great financial success for you and your team.

*This article is the first in a series of writings about startup success. Watch for more detailed articles about each of these topics in future issues.*

## ABOUT THE AUTHOR

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