4.3. **Lean StartUp (Explained)**

Lean Startup Explained in 5 minutes

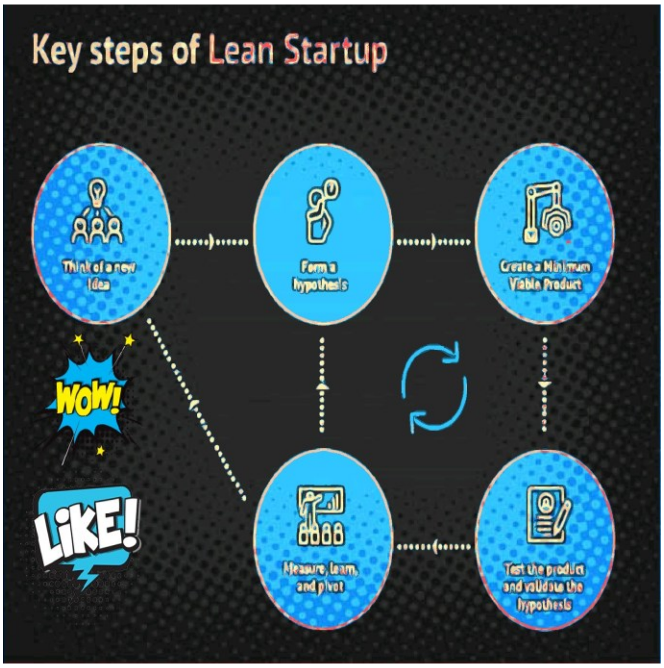


Figure 4.2 Key Steps of Lean StartUp – YME Project

Introduction

Lean Startup is a business development method designed to reduce the product development cycle and to minimize the risk of failure. The Lean Startup method is based on experimentation, repeated small-scale product launches in different stages of completion, continuous consultation of the targeted market segment and validated findings. The method (The Lean Startup) of Eric Ries (allows the avoidance of measuring the success at the end (through sales). The method also prevents going in a wrong direction and prevents the premature expenditure of large amounts of money.

A central problem of the startup that needs to be treated with the utmost attention is the understanding of its client. Most of the times, startups that have relied on assumptions, invalidated by objective marketing methods, have failed. The most frequent mistake in these cases is the self-centeredness of the entrepreneur who believes that his/her needs and expectations are also those of the customer segment. An entrepreneur needs to find out what consumers really want, not what they say they want, nor what the entrepreneur believes they should want.

If the consumer's views are neglected and the entrepreneur goes in the wrong direction, then all the efforts are obviously in vain, and the associated costs are wasted. In addition, the needs of the consumer (i.e. the ones that really matter to him/her) have to be prioritized so that most efforts are focused on the important customer needs. At the heart of the notion of Lean Startup is the question: Which of the efforts made are value creators and which simply represent losses?

Value creation refers directly to that functions and characteristics constitutes benefits for the consumer.

With regard to the importance of constant experimentation, the Lean Startup experts recommend that the startup or its product should be treated as a scientific experiment, with hypotheses to be verified by experiments. Among the first actions of the entrepreneur is the breakdown of his/her vision of business into its component elements. If a component is an assumption, then it should be tested.

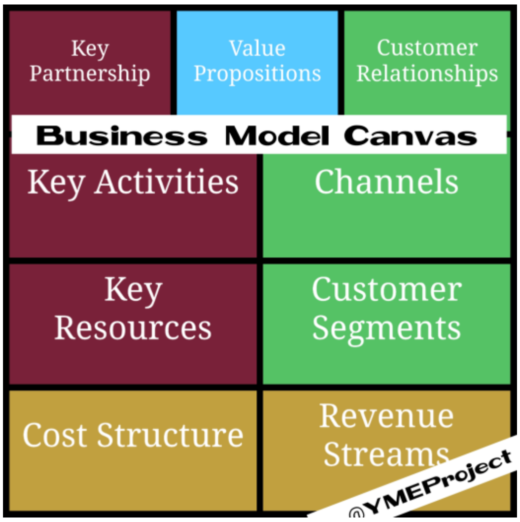
The Lean Startup method has the following steps:

4.3.1. Designing the business model;
4.3.2 Development of the consumer segment;
4.3.3 Monitoring the startup progress.

4.3.1 Designing the Business Model (in Lean Startup)

A business model is an abstract representation of a business (in textual and/or graphic format) of all the organizational, operational and financial structures essential for the functioning of the business designed and developed by a company (at present, but also in the future), as well as the basic products/services manufactured/distributed/marketed by the company, in order to achieve the strategic objectives. In other words, the business model indicates: the capabilities and resources needed to run the business; how the value produced is created and marketed; financial flows.

The business model must be clear and allow the future development of the company to be observed. The particular importance of the business model is given by its use in the actions to obtain the financing. Based on the business model, the company's strategy and especially how the company produces value for customers and how it generates revenue for itself is established. An illustration of the business model structure is shown in below Figure 1.



Again Figure 4.1 Business Model Canvas by YME Project

It has been found that those companies that innovate at the business model level have a higher growth rate than those that only innovate or those that only copy a known business model. The levels at which the business model is innovated can be:

- Financially (it changes the way the company revenues are generated through new value propositions or new models are proposed for establishing the product price);
- As a Company (rethinks the way the value is generated within the company, resulting in the revision of internal procedures and collaboration protocols);
- As an Industry (the business model represents an innovation at the level of the economic branch or, rarely, a new economic branch is born).

It is recommended to follow these steps (represented by significant questions) in completing the business model format in order to better understand how the business is carried out:

- How do you reach customers? (methods, time consumed, people involved)
- Once the customer contact has been established, how will the contact be maintained and how will the customer relationships be managed?
- How the income will be generated?
- What is the price/fee of the product/service offered?
- Can the company revenue be calculated with an approximate accuracy for the next month, semester or year?
- What assets (financial, materials, logistics, etc.) are accessible?
- Who are the key partners?
- What key activities are needed to achieve the value proposition?
- What are the fixed costs?
- What are variable costs? Can these be calculated for the next month, semester or year?
- Can the projected revenues indicate an increased profitability towards the end of the period considered?

All the categories addressed in the format of the business model are important and must be dealt carefully and in detail, but the value proposition is crucial for the success of the new business. Therefore, it should be considered as a central element of the company's strategy.

The value proposition is a concise statement expressed by a company that clearly indicates the benefits obtained by the consumer after purchasing the product or service of that company. The value proposition convinces the consumer that the company's product or service will bring more value (expressed in different formats) or will satisfy their needs much better than other products or services available on the market.

The value propositions vary significantly depending on the economic branch and the market segment concerned. It is important that the value proposition is understood and it is meaningful to the consumer. Thus, the concept of the value of the consumer was introduced, namely the difference between the benefits obtained by the consumer and the associated costs (including the price). Therefore, when formulating the value proposition, the company must look at the benefits of the product or service through the eyes of the consumer. Moreover, reporting to the consumer's perspective must be carried out permanently, because the economic, social, demographic, technological context etc. is changing at an ever-increasing pace and over time. At a certain moment, the company may find that the benefits offered no longer matter to the consumer or that the targeted market segment has changed. Therefore, the value proposition should:

*be superior to the competition;

allows a clear differentiation from the competition and the company will occupy a distinct position in the market;

*indicates an in-depth understanding of the consumer's needs and desires.

More specifically, the value proposition is a statement that must include at least one of the following types of benefits: functional, emotional and self-representation. The questions that help to crystallize the value proposition are the following:

*What is offered to consumers?

*How does the offer reach consumers?

*What kind of benefits are offered?

*What is different about the offer from others on the market?

It should not be forgotten that the product or service for which the value proposition is formulated benefits from the contribution of the brand of the producing company.

Here are some examples of advertising slogans inspired by value propositions:

Activia [yoghurt with digestive ferments]: "The well-being comes from interior";

Stejar [strong beer]: "Essentially strong";

MailChimp: "Send Better Email";

Apple MacBook: "Light. Years Ahead ”;

Vimeo: "Make Life Worth Watching";

Weebly: "The Easiest Way to Make a Website";

Uber: "Tap the App, Get a Ride";

Budweiser: "The Great American Beer".

For the elaboration of a complete and efficient value proposal, the Format of the Value Proposal has been proposed, presented in figure 2.

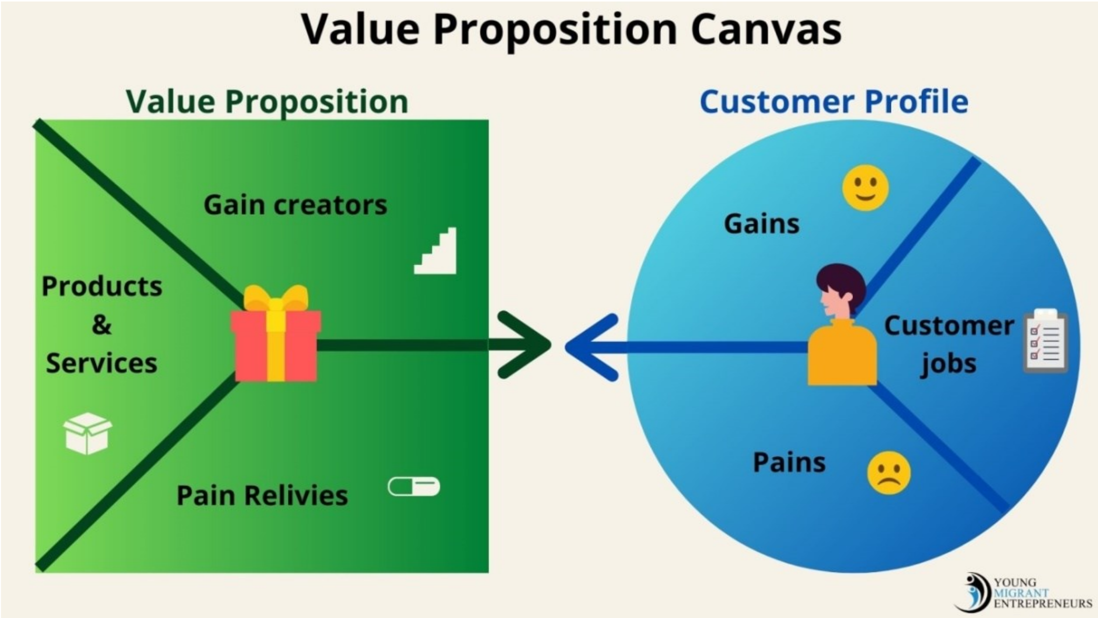


Figure 4.3 Based on format of Value Proposition [strategyzer.com] by YME Project

Once the business model was complete, the entrepreneur goes to check the model's viability. The hypotheses underlying the model are identified. The hypotheses are practically a series of assumptions about the evolution of the market, the behaviour of consumers, etc. Examples of hypotheses are:

Consumers want to use the new product and are willing to pay for the product's purchase.

Supermarkets are interested in distributing the new product.

The company's marketing campaign draws consumers' attention to the new product.

There are two general assumptions for startups:

- value hypothesis;

- growth hypothesis

Value Hypothesis

By the value hypothesis, it is tested whether a product or service really offers value to consumers who use it. Testing is not done by asking consumers if they like the product or if it helps them. True testing means organizing an experiment that measures objective parameters and, preferably, quantifiable. For example, an objective parameter is the product's lifespan or the period until the consumer buy a similar product.

Growth Hypothesis

By the growth hypothesis, it is tested how the new customers will discover the offered product. Again, this is the case of an experiment that identifies how early adopters discover the product. It can be measured: how many times do they use the product a second time; how many times they tell others how good the product is; etc.

Regardless the hypothesis, it is tested through an experiment organized in detail and on objective basis. A hypothesis is not tested by another assumption based on the logic of the entrepreneur. If the consumer behaviour is verified, then an experiment is organized in which the hypothesis is used to test a significant survey lot for the targeted market segment. The results of the hypothesis testing are evaluated from the perspective of their contribution to the success of the business. In addition, the hypotheses perceived to have the lowest probability must be verified!

Taking into account all the assumptions checks, a decision is made regarding the continuation of the business development process. In case all the hypotheses have been confirmed by the experimental data, the process is continued. If some of the assumptions have not been confirmed, then the problem of revising the business model or even abandoning it is raised. If most of the hypotheses have been confirmed, then the model is improved, and if too few hypotheses have been confirmed, then the business idea is abandoned, because the uncertainty level is too high.

4.3.2 Development of the consumer segment

Customer segment development is a step in the development process of a startup which is recommended to be run in parallel with the development of the new product. The customer segment development model is, in essence, a set of objectives and benchmarks that are of particular significance for startups. As with the business model, the customer segment development model includes a number of assumptions that need to be verified directly with the targeted market segment.

The main objective of the customer segment development is a deep understanding of the market segment, the needs and expectations of the potential customers. Thus, the entrepreneur and the product development team can focus on the real needs and expectations of the targeted market segment. It is noteworthy that the developers of the new product, like those in marketing and sales, know what are the most important features (in the eyes of the buyer) in the product class they are targeting. The measure of the importance of a characteristic is not given by a consumer response of the type "Yes, characteristic X is important", but by a categorical answer that "The product must necessarily have characteristic X!". Also, it must be determined how much the consumer is willing to pay for the desired feature.

Those who have proposed the customer segment development model claim, which has been confirmed by many real situations, that the model allows the focus of activities on the really important issues, the shortening of the product development cycle and the rapid maturation of the startup.

The development of the customer segment is focused, at the beginning, on identifying the customer profile who is interested in the new product and on his problem that the new product will solve completely and at a higher level. It is noteworthy that this action does not involve making long lists of product features offered by potential buyers.

The client of a startup is not an average customer from the mainstream, as is the customer targeted by the large companies, who manufacture, distribute and market more or less traditional products. To satisfy such different customer, the new product would require an extremely long time, considering the possibilities of a startup. But the customer of a startup is a person who adheres to the vision of the startup and for whom the new product satisfies an important and especially acknowledged need. The clients of a startup are not a large group, but they are sufficient to provide the feedback needed to improve the product and make the sales strategy more efficient.

And now, the entrepreneur makes a series of assumptions regarding the customer profile and his/her motivations in the new product's purchase. These hypotheses must be tested and corrections will be iteratively made to the client's profile and motivations until the hypotheses are confirmed.

The key questions during this step are the following:

- Do you know who the customer is?
- Was identified the problem that the customer wants to solve?
- Is the customer fully aware of the acute importance of the problem?
- What solutions have the top users found so far?
- Does the new product completely solve the customer's problem?
- Is there enough information to develop a successful product on the market?

If until this moment the startup structure was more or less fluid, the company development brings a much better structure, with the differentiation of the production, financial, marketing, sales, administrative, and human resources departments. This step is based on the validated findings from the previous steps, as well as the guarantee of success confirmed by the first sales.

In the end, it can be considered that the startup has become a well-structured and mature company targeting a large market. The entrepreneur and the managers of the different departments give up the trial-and-error approach in favour of a move based on the declared mission of the company.

4.3.3 Monitoring the startup progress

A entrepreneurs' common mistake is ignoring the signs of stagnation and the inability to recognize that persevering in the current direction is a mistake. There are very few cases where the new product has zero consumers and it is obviously a failure. In most cases of failure, the new product has a few buyers, whose number does not increase, but the entrepreneur continues to hope for a miracle.

In order to avoid persevering in the wrong direction, the monitoring of progress is used.

The monitoring phases are:

- Determining the current level of the company (number of customers, revenues, etc.).
- Adjusting the growth engine of the company to move from the current level to the ideal level.
- The decision: continue with the chosen strategy or pivot to a new direction with a new strategy.

Every improvement of the product, marketing action or any other activity of the company must be oriented towards maximizing a parameter of the company growth model. That parameter must be measurable. For example: The company modifies the product for easier use. The target parameter of the growth model is the rate of new customers. If the change does not increase the rate of new customers, then the conclusion is that the change was a failure.

Usually, improving the product in a large organization with a history on the market leads to positive financial results, because consumers are known, the market is known and the technology is known. This is not the case for a startup, which has to deal with many unknowns. In addition, managers who come from the area of large organizations find it difficult to understand that the improvement of radically new products does not automatically attract positive financial results.

A common mistake is that when evaluating a company's performance, vanity parameters are used, which do not accurately reflect the evolution of the company. Actionable evaluation parameters should be used to highlight a cause-effect link. The vanity evaluation parameters do not really reveal anything and are usually increasing, creating the illusion that the last actions of the company, whatever those were, caused them.

For example, a company that sells packaged foods measures its performance in the number of final customers. At one point, the company finds that the number of customers is increasing, but revenues are falling. The obvious answer is given by the decrease of the quantity of products sold, given that each customer purchases less on average. So, the number of customers is a vanity parameter, and the quantity sold is the actionable parameter.

Sustainable growth has only one rule: New customers come from the actions of old customers. Old customers bring business growth through the following channels:

- human-to-human advertising;
- use of the product in public;
- the advertising paid from the revenues brought by the product;
- repeated purchase of the product.

The growth of the company is achieved with the help of the growth engine. The growth engine of a company can be:

• sticky engine;

• viral - growth appears as a side effect of using the product/service;

• paid - the company spends an amount of money for each new client.

Sticky Engine

In the case of the sticky engine, the actionable parameters are the number of customers who give up the product or service per unit of time (the "unsubscribe rate") and the number of new customers per unit of time (the rate of new customers). Companies that use this engine really grow when the rate of new customers exceeds the rate of unsubscription. This growth engine is specific to mobile companies, internet providers, cable television providers, etc.

Viral Growth

Viral growth engine does not necessarily mean human-to-human advertising, but much more. The use of the product by a consumer attracts the attention of a future consumer. Examples of such services are: social networks, free e-mail, etc. Examples are also in the field of products: Tupperware through the promotion system through presentations at home in front of friends, neighbors, etc.

Many companies that rely on the viral growth engine do not charge users directly to stimulate long-term use of the product/service and to face the competition that offers the product/service for free. The company's revenues come from the extra advertising included in their services.

Paid Growth

The paid growth engine assumes that the organization invests money in advertising, consumer-oriented marketing, etc. The organization is growing if the revenues obtained significantly exceed the direct, indirect costs and advertising costs, all related to the unit (product).

ATTENTION! The growth engine (whatever its type) of the company inevitably ends up stopping as the base of new customers runs out.

The third phase of monitoring is the decision related to maintaining the current strategy or performing a pivot. In fact, it is not just a singular decision made only at one moment, but the usual approach to this problem periodically (a few weeks). In the event that it is necessary for company to pivot, the startup must take into account the funds that are available. If these are insufficient, then the costs must be reduced or new funds raised. Cost reduction should be done carefully, as there is a danger that even activities that are essential to the development of the startup may be affected.

Pivoting is not a simple operation and is loaded with emotions. Many entrepreneurs are unable to carry it out and end up in failure. Other entrepreneurs manage to do it, but do it too late and either fail or recover, but with great losses.

Pivoting is more common in the early stages of development of a startup, but also large companies well anchored in the market are able to pivot. Pivoting is not a change for the sake of change, but a structural change, well thought out and carried out according to a clear strategy. Essentially, pivoting is an experiment that tests a new hypothesis about a product, market or company.

Here are some types of pivoting:

- pivoting towards simplification (the non-essential characteristics of the product/service are eliminated);
- pivoting towards amplification (the product/service should be given new functions and features in order to become viable);
- pivot to a new market segment (the product/service is viable, but not for the initially targeted segment);
- pivot to a new need of the segment (the need for the product is not essential, instead a new need has been discovered, unsatisfied with any other product or service);
- pivoting from a single product to a product platform;
- pivoting the profit-making model (sales in large quantities with a small profit margin or sales in small quantities with a large profit margin);
- pivoting the value proposition;
- pivoting the growth engine;
- pivoting the distribution channel;
- pivoting the type of technology.

4.3.4 Examples of Application of Lean Start-up Method

A prime example is Dropbox.

Founder Drew Houston's idea came from the fact that he used multiple computing units and had to transfer files between these different units to keep them synchronised, and sometimes he lost the memory stick he was transferring with. This situation is a typical case for generating a successful business idea, namely finding a very annoying personal problem, which motivates the entrepreneur to solve it (considering it a personal challenge). Thus, the basic concept was outlined: a cloud-based service that automatically synchronizes files on different devices. Improvement of the concept and detailed design was achieved through the continuous consultation of future users with the descriptions posted on different blogs and websites. As it would have been difficult to get regular funding, a "seed accelerator" was used. It should be emphasized that not every idea is financed through a "seed accelerator" and even the acceptance rate is 1 - 3%. The additional functions were gradually integrated, but at a rapid pace and the company has grown from 100,000 to 4 million users in just 15 months.

Webvan is a negative example

Webvan: A "don't do that", probably one of the biggest failures of the dotcom era. The company was established in the mid-1990s to offer consumers the opportunity to buy food online with delivery within a maximum of 30 minutes. The concept has been refined and a business plan has been created to impress investors. And it really impressed because in 3 years they made investments of hundreds of millions of dollars. The investors were investment funds, a bank and the general public following the listing on the stock exchange. The presence of investment funds was not a mistake in itself, but it created an unhealthy climate through the urgent demand for large and immediate profits. Without working too much on the business model, the company started growing too fast: it spread over too large territory, without self-testing in a small area, and created a gigantic infrastructure from the start (huge automated system and an impressive fleet of trucks and commercial vehicles). Moreover, it acquired HomeGrocer, a similar company, which constituted an additional financial effort. The market was also not analysed very well, because they targeted the main segment of the market (consumers interested in low prices) and not the wealthiest. In the end, Webvan went bankrupt, losing $ 800 million. The fact that the idea of online commerce with food is really valuable was proven later by Instacart's and Picnic's successes.

Prepare for Trial and Error

Whether you're starting your first or your third business, expect to make mistakes. This is natural and so long as you learn from them, also beneficial. If you do not make mistakes, you do not learn what to do less of and what to emphasize. Be open-minded and creative, adapt, look for opportunities, and above all, have fun!

The great thing about owning your own business is that you get to decide what you want to do and where you'll grow.