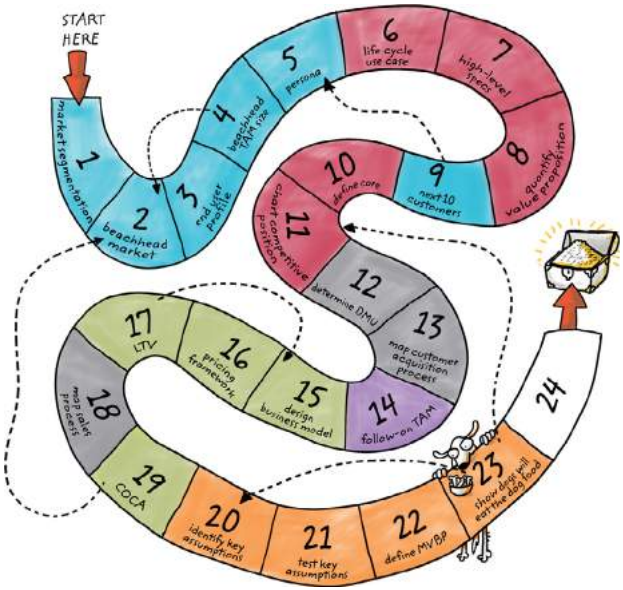
STEP 23

Show That "The Dogs Will Eat the Dog Food"



IN THIS STEP, YOU WILL:

- Demonstrate quantitatively that customers will pay for your Minimum Viable Business Product (MVBP).
- Develop metrics that indicate the level of word of mouth your MVBP is creating among customers.

Now that we have launched our product, show measurable proof that the customers are adopting the product; no rose-colored glasses—data is required.

In this step, you will take your Minimum Viable Business Product, put it in front of your target customer, and test whether this integrated system of assumptions will be accepted and paid for by your target customer, thus showing that your individual assumptions when assembled together actually work in the real world.

The following story is fictional, but has many parallels to very real companies:

> Once upon a time in a land called Ivory Tower, not so far away from here, there was a chemist who wanted to make better dog food. He studied to see what kind of food would improve the health, happiness, and financial and spiritual well-being of the dog.
>
> He came up with a breakthrough formula that was better for everyone and cost one-tenth the price of the cheapest dog food on the market. Dogs would sleep better at night, have a better demeanor, shed less hair, have whiter teeth, be friendlier to strangers, obey their owners more, and so on. They had tested in the lab from a chemical standpoint and were told that it would even taste better. Everything made logical sense. It was a business opportunity that was almost too good to be true.
>
> He sprang into action, raising a large sum of money and spending $3 million to build a plant to produce the dog food. He signed up distributors and kicked off a huge marketing campaign. To quote Jackie Gleason from *The Honeymooners*, "This thing is going to the moon, Alice!"
>
> The product shipped. Owners put the food in front of their dogs. And the dogs refused to eat the dog food. The company crashed and burned in a spectacular fashion.

"That's crazy! That wouldn't happen in real life," you may say. But it happens all the time.

When I worked at IBM during the 1980s and early 1990s, I saw that "electronic medical records" made all the logical sense in the world, so lots of smart people spent lots of time and money working on making it a reality. But guess what? For decades, even though the technology was sufficient and the logic compelling, the doctors simply wouldn't use electronic medical records—they wouldn't eat the dog food. It has finally changed, but for hundreds of startups for over two decades, they went out of business because the timing was not right.

Based on every detail you've uncovered about your product and your customer, it might make sense that your product would be viable; but ultimately a person is going to have to accept your new innovative product and humans are not always rational. Some behavioral economists have made a name for themselves in focusing their research on irrational human behavior—Professor Dan Ariely, the behavioral economist from Duke, probably being the most well-known. So after you have made your logical plans with individual experiments along the way, as in our great fable above, and before you invest large amounts of time and money, make sure the dogs will eat the dog food! And, oh yes, make sure the dog's owners (or friends, as the primary/secondary customer discussion from Step 22 explains) will *pay* for the dog food too.

With regard to testing to see if someone will pay for the dog food, the initial price of the product is not as important as showing that target customers will pay for the adoption of your product. It is good to "beta-test their wallet," as HubSpot co-founder Dharmesh Shah calls it.

Even if the dogs do not eat nearly as much dog food as you thought, you can now learn a tremendous amount because you have real data on the MVBP. You are now in an iterative learning feedback loop with your customer, which is where you will start to mine the gold that will make you rich—customer preferences. With today's tools, there are so many ways to measure if the dogs are eating the dog food, so entrepreneurs should take full advantage of these tools.

It is critical to first see if the target customer will buy and accept the product; but it is also important now to start to measure how much they will advocate to others in the TAM about the benefits of your product. What is the magnitude of the positive word of mouth your product is generating? This is often referred to as the virality coefficient. So in this step, measure if at all possible whether your customers tell others about your product, because this creates valuable word of mouth that will decrease your Cost of Customer Acquisition.

EXAMPLES

StyleUp

Once Kendall and Ryan released their MVBP, it was time to first measure the engagement and adoption of their target customer. They needed to see if women would respond to the service and encourage their friends to sign up. Consistent engagement and growth were the key metrics to value the progress and validate a business opportunity. Engagement included both whether women opened the e-mails and whether women clicked through to webpages where they could purchase the merchandise they saw in the e-mails, which was a potential way to monetize the product.

StyleUp's analytics showed that women were opening the e-mails every day, and some women were opening each e-mail an average of five times—which either means the recipient re-opened the message, or the recipient forwarded the message to her friends. The company's e-mail open rate is 70 percent, compared to an industry average of 14 percent. (See Figure 23.1.) The metrics showed that women were engaged and were looking forward to receiving the e-mails.

They also received key anecdotal support. Google's shopping editor Adelle McElveen wrote, "StyleUp inspires me to think about what I'm going to wear the next day, and how to not just dress for the weather, but to dress stylishly for the weather."

Beyond daily engagement, Kendall and Ryan could see that women were also telling their friends to sign up for StyleUp. It was easy to track this quantitatively via the referral link through which

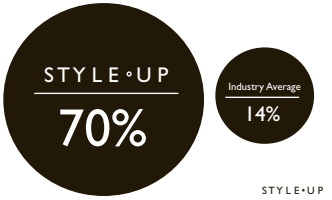


Figure 23.1 NEW StyleUp e-mail open rates.

members signed up. Despite not spending money on marketing in the first few months, word spread to 1,500 people based on pure word-of-mouth traction and minimal press coverage. Even when they reached nearly 8,000 members, StyleUp had committed minimal capital and time to marketing and yet continued to see 20 percent month-over-month growth. The goal to create a product women love so much that they naturally share it was working and they had data to back it up.

Of course additional customer satisfaction metrics, like Net Promoter Score®, would be a valuable additional piece of data to gauge the long-term viability. This indicates the strength of the word of mouth for your product as well as their likelihood to be a repeat customer.

The second dimension that we mention above was to prove that the dogs, or someone associated or wanted to be associated with the dogs, would pay for the dog food. That is, clearly the women were taking to the product, but now the questions were "Can StyleUp can get paid for this customer engagement? Can StyleUp monetize the situation it has created?"

TechCrunch reported that StyleUp was using an affiliate model for monetization.[1] So to show that secondary customers—affiliates—would find value from StyleUp and be willing to pay to reach StyleUp's primary customers, three important metrics to measure would be click-through rates on the e-mails that were opened, the amount of money in sales that affiliates realized from the click-throughs, and the payments made to StyleUp for these sales. One might think that only the last of these three factors matters; but it is very valuable to know all three in order to provide a robust data set if the business model needs tweaking. In such a manner, they will be able to better understand the sustainable nature of the economics of the new venture.

[1] Leena Rao, "YC-Backed StyleUp Recommends Daily Personalized Outfits Tailored To Your Style And Location," *TechCrunch*, March 18, 2013, http://techcrunch.com/2013/03/18/yc-backed-styleup-recommends-daily-personalized-outfits-tailored-to-your-style-and-location.

With this combination of metrics, StyleUp will have developed a case that should be extremely compelling to themselves first, and then to any potential strategic partners (like investors). While it would not guarantee success, it would indicate that the odds of success are quite high.

ThriveHive

As introduced in Step 22, ThriveHive is a marketing platform for small but ambitious businesses. To test their MVBP, they signed up a small group of beta testers and offered the platform for free for a limited time in exchange for providing feedback sessions.

After a few months of private beta, they had gathered enough feedback to figure out which features people were using and which new features people were asking for. While great, the private beta had not yet proven if the dogs would eat and pay for the dog food; this was yet to come. All they had done was eat for free so far but the moment of truth was coming. As they ended the private beta, and gave each beta tester one full month to decide whether to start a paid subscription, they simultaneously began offering the product to the public with a 30-day free trial. The proof of whether the dogs would really eat the dog food and pay for it (because it created real value that exceeded the price) would be evident in their conversion rate to start with. This was the moment of truth.

Fortunately for Max and Adam, of the beta testers, 74 percent converted to a paid subscription, showing the team they had a successful MVBP—that customers got value from the product and would be willing to pay to continue using it. Another metric that would help the case would be signups from the public.

With the momentum of this success, Max and Adam continued to develop their product, and while the above testing is sufficient for the basic requirements of this step, their more-robust testing of whether the dogs would keep eating the dog food is valuable as well as you think beyond the 24 Steps into execution and scaling.

Specifically to make the business economically sustainable and scalable, Max and Adam focused on three key areas for further testing:

- Market Access: Can they generate leads in our target market using repeatable techniques?
- Sales Process: Can they sell to customers with unit economics that make sense?
- Deliver Value: Can they deliver more value than they capture?

Market Access ThriveHive decided to target very small businesses (<20 employees), so the question became: What are the most scalable and effective ways to reach that target? While some businesses

like SCVNGR were using a direct sales approach to reach this market, ThriveHive decided instead to use only online methods in the beginning, due to the ability to start small and scale.

ThriveHive launched an organic content play to start building a presence in online search and social media, but that would take time to get off the ground. To start getting data fast, the team ramped up a Google AdWords campaign that could drive targeted traffic quickly.

All the work was done with the idea to generate enough leads to feed a single salesperson so the unit economics could be proven.

After about six months of work, the team had built a lead pipeline generating hundreds of qualified leads per month at a cost per lead that was in line with the unit economics model that was coming together on the sales side. More importantly, ThriveHive had shown the ability to scale the lead generation quickly as the company growth would demand.

Sales Process The sales process was a challenging model to prove out. Focusing again on the unit economics, ThriveHive brought on board a single inside sales rep to begin selling to the leads being generated. There were literally hundreds of variables at play, from the salesperson himself, to the process used to bring a customer on board, to pricing. The challenge was to figure out what was working and what wasn't, with almost no data. The sales process was slow and the numbers were so small that it was hard to know when the process needed to be tweaked when things were on track, or whether only more time was needed.

Similar to the market access, after about six months the unit economics started to work. Three major tweaks that helped everything come together were: to balance the give and the take during the sales and on-boarding process (there was a 30-day free trial), creating an account manager role to help ensure customer success during the free trial, and generating enough leads to feed a single salesperson.

Delivering Value ThriveHive decided to focus on delivering more value than it captured. While it might seem obvious, there are many successful companies built on exactly the opposite philosophy. Think about infomercials that sell you products you buy and never use; they can be great businesses, but ThriveHive felt that the only path to long-term success in this very small business market was to generate more value than it captured. The cost of acquiring the customers was going to be too high in order to survive if they left too quickly.

In order to measure progress on the value delivery front, ThriveHive tracked three critical metrics: monthly churn, customer referrals, and qualitative success metrics (what the customers were saying). On the churn front, ThriveHive decided to start without any contracts (even though the product is fundamentally one that delivers value over time). This left the company as exposed as possible to feedback.

By the time the market access and sales process had been vetted, ThriveHive was able to show results on all three value delivery fronts, which led the team to believe that they were successfully delivering more value than was being captured:

- Churn was already at the low end of industry comparables, even with a very immature product.
- More than 15 percent of the customer base was consistently being driven by existing customer referrals (without incentives).
- More than 50 percent of the businesses that had been with ThriveHive since the launch of the paid product were expanding their businesses due to marketing success that they attributed in large part to ThriveHive.

It was only when all three of the areas came together that ThriveHive felt that the dogs were genuinely and repeatedly eating the dog food in an economically and scalable manner.

SUMMARY

Take your Minimum Viable Business Product to the customers to see if they will actually use and pay for the product. Collect data to see if they are really using it and how engaged they are as users. Determine if they, or someone associated with them, will pay for it and also if they are advocating for your product with word of mouth. After you collect data over time, analyze it and especially look for trends and understand underlying drivers. Make sure you are intellectually honest and rely on real-world data and not abstract logic.