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GUEST ARTICLE

THE HARDEST PART OF SCALING A STARTUP

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"The hard part isn't getting the first five customers, it's the time and expense required to get the next 50."

What's the hardest thing for a technology startup to get right in building a company?

A. Hiring the right team?
B. Getting the product to work?
C. Getting initial customers to buy the product?
D. Managing and scaling distribution?

I say "D." Strong leaders will hire exceptional teams. And many teams can get a product to work and can get a few companies to buy it. The hard part isn't getting the first five customers, it's the time and expense required to get the next 50.

Many, if not most, technology startups are founded by gifted technical entrepreneurs with vision and passion for solving problems for enterprises, carriers or consumers. Their relentless drive, and a network of contacts, often helps them soar through the initial company-building stages of prototyping and evangelizing the product. Where the engines start to sputter is when it comes time to cost-effectively scale the distribution.

One of the best examples of innovative distribution has been the way in which open source has revolutionized customer acquisition costs. Rather than selling subscriptions seat-by-seat, the pioneers in this field started giving away scaled-down versions of their software for free, online, requiring minimal human intervention. Revenue came through added features and incremental subscriptions, meaning vendors could allocate their resources against interested, engaged prospects, rather than inefficiently cold-calling.

The companies that get distribution right have figured out one key principal for their business: how to get leverage, whether the sales are direct or through a channel partner or OEM. Getting leverage out of distribution means exponentially decreasing per-unit acquisition costs. It means having others selling on your behalf—others with scale, that cost you increasingly less per unit as sales ramp.

Before joining a venture firm, I had the privilege to work as VP of marketing at **Juniper Networks**. Juniper understood the concept of leverage and was able to negotiate a number of key distribution relationships early in the company's life. Juniper went to **Ericsson**, **Nortel**, **Siemens** and **Lucent** and negotiated distribution agreements with each of these companies in different markets (for example, Ericsson in China). These partnerships helped Juniper scale globally and eventually provided the business model structure for Juniper's IPO.

As an investor, I have seen this process work as well. **Eye-Fi**, a company I invested in here at **Opus Capital**, has had tremendous early growth of its wireless memory card as a result of its partnerships with key online photo sharing sites (including **Shutterfly**, **Photobucket**, **SmugMug** and **Picasa**). In addition, the company has recently announced partnerships with camera OEMs (such as **Nikon**) and memory card OEMs (such as **Lexar**).

The way to develop a plan for leveraging your distribution is by figuring out your critical business metrics:

1. Determine your customer-acquisition cost.

• What did it take to make those first three or five sales? Do a truthful cost-of-sales estimation, including not just hard costs, but estimated costs for time spent by engineering, executives and anyone involved in the process.

• Look at the next 10 customers and perform the same calculation. Was the cost-of-sales an order of magnitude less for the next 10 customers? It should decrease dramatically. If it doesn't, you'll never be profitable.

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2. Determine what your cost-of-sales should be based on industry benchmarks.

• Calculate your sales and marketing costs as a percentage of your revenue.

• Look at public companies in your space and compare what their sales and marketing costs are as a percentage of their revenue.

3. Look at your industry and figure out how successful startups and established companies have scaled distribution.

• What distribution models have they used?

• What can you learn from their successes and missteps?

• Develop a plan to get from where you are to where they are.

4. Finally, ruthlessly measure your progress.

• What was the cost-of-sales for the first 10? The next 30? The next 100 or 1,000?

• Is it converging on the industry standard or target that you set?

• If not, what do you need to do to correct your course?

In the crazy, chaotic stampede to scale their businesses, small companies could be spending $5, $10, $20 or more for every $1 of revenue. The percentage has to be inverted, and they can't do it by hiring more people or by working harder. It has to come from exponential efficiencies, in the form of leveraged distribution.

What's your industry standard?

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