How to Develop a Startup Strategy

All startup ideas start as theories. They are conjectures, hypotheses, and predictions about how a firm might make lots of money by solving a problem that the market has yet to solve. As with any new theory, it is impossible to know with one-hundred percent certainty if a startup idea will work. Worse yet, a startup idea is a bet with both an unknown probability of success (P) *and* an unknown payoff (V). When inspiration strikes, and you write down an amazing startup idea on a napkin, you don't know if your idea will work *and* you don't know how much value it will generate.

A good startup strategy helps you effectively *learn* about your idea's chances of success P and the amount of value your firm might create V. The benefits of learning are two fold. First, you generate signals about your idea's potential that can convince others—from investors to employees—to join you. Second, if you learn your idea stinks, you can iterate and pivot to a new more promising idea.

But *learning*—especially about startup ideas—is challenging. Signals are biased and noisy. Designing experiments is non-trivial and running them is expensive. Failure is hard to admit and learn from. Startup ideas are often vague and illogical. Getting to and listening to feedback is never easy. And even when you learn as best as you can your odds of minting a billion dollar company are slim.

This document is structured to help you learn in the face of all these challenges. What you might learn is myriad. You might learn why your idea is actually terrible. You might learn that your idea is loved by consumers, but that the business economics are bad. You might learn what experiment you need to run next to convince VCs and yourself that this idea is worth investing large sums of money in. You might learn that a management change is needed for your firm to thrive. You might learn something completely unexpected from an experiment you run. While you and I don't know exactly what you will learn, I do know this document will cause you to learn. Towards this end, this document will push you to learn in three complementary ways.

The first way you will learn is by writing down the key elements of your startup idea in clear, concise, and causal language. In a few pages, your goal is to convince the reader that your startup idea (a) will solve a real problem, (b) that you can build or have built a real solution, and (c) that with time and scale the startup will generate fabulous cash flows. Given your idea is just an idea, this description of your startup idea is a theory of change; or in the language of strategy, a theory of value creation and capture. You are outlining how if you do X it will cause your startup to generate Y in future cash flows (or Y in measurable social impact for those aiming to start a non-for-profit venture). Generally, your theory needs to be contrarian and unexpected; if everyone believes the same idea is good then why would this startup idea be missing from the market?

However, by proposing a novel startup idea you are—by construction—also proposing an idea that is untested. You might get lucky and your startup idea is correct from the start. In this case, you will go straight from outlining a "theory of value" to running a startup that creates and captures actual value. This outcome is spectacularly rare. Much more likely, your idea will be incomplete, rest on faulty assumptions, and not perform as predicted. Your problem might be a mirage. Your solution might suck. Your business model might yield *negative* cash flows. Even when a contrarian startup idea is correct, VCs and talent

won't invest and join unless you can get them to believe your theory of value. While good writing will help, writing alone cannot resolve all uncertainties and unknowns.

The second way you will learn is by designing and running *experiments* to test if the theory of value at the heart of your startup idea works. Akin to scientists who design experiments to test their theories, you will design experiments to test your startup's theory of value creation and capture. Like a scientist, you must design experiments that you can afford to run, that test the key elements of your theory, and that convince others. Well developed startup ideas will yield multiple hypotheses that you can then test. Incoherent startup ideas will yield confusing experiments and little in the way of learning.

To close the theory-experiment learning loop, you will write up the *inferences* you generated from the evidence you gathered in your experiments. Given your experiment, will your startup idea work? What needs to change? What additional information do you need? How does the problem, solution, or way you plan to make money need to change? Where is your theory of value incomplete or incorrect? These inferences are crucial. Evidence from experiments that can't be tied back to an underlying theory of value will fail to convince.

Your job as an entrepreneur is to run this theory-experiment loop. The inferences you glean from your experiments will help you learn how likely your idea is to work and the value it can create. These inferences will also help you improve your theory of value.

The third way you will learn is that you will develop your startup strategy with feedback and constructive criticism from your peers. Scientists learn by getting feedback from their peers. Modern entrepreneurs at accelerators like YCombinator or the Creative Destruction Lab do the same. You should too. There is overwhelming experimental evidence that we don't get enough advice and feedback from our peers. This document will help you get better feedback from your peers. Feedback both improves your startup idea and your experiments. And learning to give others good feedback is also a crucial skill to develop as you progress with your venture and career.

Beyond helping you learn, this template gives you essentially all the key material you need for a YC application or for a pitch deck. For students in my "Strategy for Entrepreneurs" course you will be required to turn your final version of this document into a short ten-slide deck to present at the end of the semester.

This document is structured into three sections that correspond to how this document will help you learn. The first asks you to outline your startup idea. The second then asks you to outline the experiments you are considering, and if you run an experiment, the results of the experiment and the inferences you have made from it. The third section is an FAQ of commonly asked questions that you have received during your peer feedback sessions.

There is a hard cap at 10 pages! No one—not me, not your peers, not investors—will read more than ten pages. Trust me. Don't play with the fonts and margins. Your text should be 11pt Times New Roman 1.15 spaced (it already is, don't mess with it). You can link to external resources, you can include footnotes,

and you can include exhibits like images, graphs, and more. But you can't go beyond 10 pages all inclusive (images count against the page limit!). I will stop reading. Everyone will stop reading. Seriously.

This document is designed for nascent entrepreneurs in the early stages of the venture creation process. However, it can be adapted to your needs.

- **If you already launched a startup**, feel free to fill in this document for your current venture. It will help you better test your idea's core assumptions and make stronger venture progress.
- **If you are toying with a startup idea**, use this document to work out what experiments you must run next to push your idea forward (or kill it quickly!).
- **If you don't think you are ready to launch a startup**, use this document to learn about a new market or technology. However, it can't just be a glorified analyst report. You need to run experiments to test if your beliefs and theories about this new market/technology are correct. This is best done by writing up a "hypothetical" startup…and, who knows, maybe it will become real!

Finally, you can find links to resources, examples, and cases that might help you develop this document on the public course website: sfehbs.com

A Startup for X

The title should be a pithy couple of word descriptions of what your startup does. You should then include a couple of sentences providing the "elevator pitch" of your startup idea. It should help the reader orient themselves before diving in. It should be memorable. Analogies can be useful, for example, "Stablediffusion for Mechanical Engineers" or "Airbnb for Tractors," but are not necessary. Sequoia calls this your company's purpose. Change the "**A Startup for X**" header at the top of your template to your one sentence description. Generated with the help of ChatGPT, here is an example for Airbnb. It doesn't tell us much about the thesis/theory behind the idea, it just tells us what the startup is doing in the most basic terms:

> *Airbnb is a website that connects hosts selling a place to stay with travelers seeking a short-term rental of a room, apartment, or house. Users can list, discover, and book accommodations worldwide.*

1. Your startup's theory of value

If your description above is all about stating what your startup does in the simplest possible terms (see the examples on YC here), in this next block of text you should focus on describing your unique theory of value creation and capture. For example, if you were starting airbnb back in the day, you might write something like the following (full disclosure, ChatGPT helped with this, but needed me to prompt it to describe the network effects and concerns over trust/safety):

> *Airbnb is built on the idea that people want to rent out their unused spaces, like rooms or homes, to travelers who would like to stay in unused space that they trust will meet their travel needs. As*

more hosts and guests join, the platform becomes more valuable to both hosts and guests. This network effect will allow airbnb to make money by taking a fee from both the host's and guest's payments because the value of joining a platform with many hosts/guests will be worth the fee we charge.

1.1 The Problem the market has missed

Your goal in this section is to convince the reader that there are problems in the market your startup will operate in and that you have a unique and deep understanding of the problems you outline. Why are existing customers unhappy? What are their problems? Why are they dissatisfied with the status quo? Why is no one competing to solve this problem? Have things gotten worse? Have their options always been so limited or bad? What are customers missing? What do they find difficult?

However, identifying a market with a problem is not enough. In describing the key problems and frictions in your market, your goal is to convince the reader that existing customers are underserved *and help the reader understand why*. Why is there no good option in this market? Is it a lack of trust? Information asymmetries? Social biases? Is it that existing technology isn't good enough to make the market attractive? Something else? What evidence will convince your reader you have identified the real reason this market is underserved? What experiment, interviews, or data will convince a VC, your peers, or your professor? How do you know the market isn't working well enough right now? Sometimes a market is just bad, not underserved.

And remember to be specific. Can you include quotes from actual customers in this market, either in articles or from interviews you do yourself? Can you describe why specific competitors don't serve a particular customer type well? Who are the players that a reader should know about or that you need to describe to demonstrate that you know this market well? Sharing information about your team's background is often helpful. Has one of the founders worked in this industry before?

While you will never completely resolve uncertainty around whether you have identified a real problem, your goal, at least initially, is to describe problems that are worth testing. In fact, many of your first experiments will be focused on your theory of the problem. Is there actually a lack of trust in the used car market? Do people really hate waiting in line for restaurants or is that just cheap talk?

As you develop your memo, build on and mention the experiments you have run as evidence to support your claims. They eventually should be your key piece of evidence that there is a real problem to solve.

1.2 Our proposed solution

This is where you lay out how and why your startup can solve the problem you outlined above. What is your solution? Have you built it? If so, tell us that you have a prototype and/or real version of it! If there is a mockup, include screenshots or a video. If not, tell us how you will build it or what your MVP of this product will be.

Once you have described in simple terms what you have or will build, then explain how your solution works at a more theoretical level. If the problem you identified above is rooted in information asymmetries, why does your solution overcome these asymmetries? If the problem was the existing unit economics made serving customers impossible, why does your solution now change those unit economics? Why is your solution different from what competitors offer? What insight do you have about this solution that competitors don't understand?

When describing a yet to be built solution, the product you describe should be opinionated and falsifiable. For example, you might argue that "Our startup uses breakthrough in AI technology to solve the problem of credit scoring." This is a strong opinion! While this might be true, it might not be. For those without products, your goal is to help the reader imagine what you want to build and come to the conclusion that it's worth at least running an experiment to see if the proposed solution can work.

Finally, you should also explain why you and your team are the one to build this idea. Demonstrate founder-product fit. Put differently, would you be better funding these solutions as an investor or are you the person who should build it?

If you face more technical risk, your solution section will most likely be longer than your problem section. For example, Alzheimers is a real, known problem. You would only need a paragraph describing the problem and the vast sums of money you could make if you could solve it. However, potential solutions are not at all obvious. Solutions will rest on complex biological theory and evidence from past studies. How the startup will make money (see below) will not necessarily be obvious either. Are you licensing IP? A method? Actually selling a therapeutic? Something else? For ideas with technical risk you are going to have to describe your solution in detail, but also in a way non-experts can understand and can provide feedback on.

If you face more market risk, your solution section will more likely be shorter than your problem section. For Airbnb, the solution is pretty simple, but identifying the problem—and the key aspects that needed to be solved—is non-trivial. Furthermore, how Airbnb would make money wasn't pre-determined, they could have charged to list, only charged travelers, or something else. Furthermore, given that building a directory of places to stay is super easy, thinking through why a startup like Airbnh can sustainably generate cash flows isn't obvious either. So an essay for Airbnb would talk about the problem way more than the solution.

Again, as you develop your memo, describe the experiments you have run as evidence to support your claims.

1.3 How we will make money and scale

Also known as the "business plan" or "business strategy," this section outlines how you will make money as you scale. This is harder than it sounds!

While you can go crazy building financial models to estimate future cash flow, startups face so much inherent uncertainty that exact numbers are useless. Instead, a better route for early stage ventures is to

start by identifying a handful of existing companies to use as "comps." You can draw on the cases in our course, in your other coursework, and you can find companies on PitchBook. Beyond comps, there are useful calculators and benchmarks you can look up online and find on the course website. The goal is not to identify competitors, instead you are looking for firms with a similar "business model" to the one you plan to build. Are you selling software or food? Do you sell a subscription or one off product? Are you a logistics platform or do you need to manufacture goods? Does your product exhibit network effects or not? Are you a technology business or a "regular" business? Use these comps to think about what type of value your company might generate if successful.

By identifying these "comps" you can understand if your solution will have spectacular economics or more middling returns (higher or lower V for a given investment). Bill Gurly goes into wonderful detail on this point, walking through why revenue multiples are often a messy way to value a business, but are nonetheless useful. In his essay, Gurly notes that firms that are growing faster, they have larger margins, lower capital requirements, stickier customers, exhibit network effects, have multiple VCs competing to invest, and they threaten to disrupt an existing deep pocketed competitor (e.g. Adobe's recent acquisition of Figma) have higher revenue multiples. What does that mean for you? If you check these boxes there is reason to believe your V is going to be higher.

With some "comps" in mind (no more than 3), you should then focus on the basics of how your business will make money. Who will pay you? Once you have an estimate of that, how fast and how big can you grow the amount you get paid? Yes, a Total Addressable Market (TAM) analysis can be helpful here, but it's not necessary or sufficient. As you think about growth, think about what reasonable revenue growth could be and when that revenue will hit. Write down the price you will charge, who you charge, and how many people you expect to charge. This gets you revenue. How often will you charge them? This gets you annual recurring revenue (ARR). How long till a customer churns or buys another product you sell? That gets you a customer's Life Time Value (LTV). How do your estimates of these numbers compare to your "comps"?

Once you have a sense for how your solution might drive user and revenue growth, dive into your startup's unit economics. How much do you think your product costs you per customer (e.g. serving software is free versus a restaurant where you have actual COGS for cooks and ingredients)? What is the expected Customer Acquisition Cost (CAC)? With these numbers in hand you can get a rough sense of what the unit economics for your business might be. Indeed, you might want to experiment (see below!) with different "go to market" strategies to see which yields the most favorable growth trajectory and unit economics. Again, compare the "comps" that you identified to see if your plant to make money makes sense.

Next, think through what fixed costs do you need to incur to build and scale your product. How will you fund these costs, with seed funding? Personal savings? When in the life cycle of your startup do you need to deploy this capital? Up front before you any customers? Or to fund growth once you have a core group or loyal and paying users? How will your organization need to change as you scale in order to serve thousands instead of tens of users?

Tables and graphs can be helpful in this section. In fact, as you run more experiments testing your startup idea you will almost surely show a graph of your revenue growth overtime and your idea's unit economics. These are some of the strongest signals of your "theory of value" as they directly show whether your startup idea generates value. Spectacular growth—be it revenue or users—is a key signal that your startup will work (that P is high), though whether it generates lots of value (V) often remains much less certain.

As you develop your memo, describe the experiments you have run as evidence to support your claims.

2. Your Experiments

As you sketch out your startup idea—your theory of value creation and capture—you will find gaps and assumptions. Can my solution really work? Does anyone other than my mom want to use this product? Will SMBs actually pay for this? Are the unit economics I have assumed even remotely true? If not, why not? While you can try to reason through all these questions, you will quite quickly come to the conclusion that you need to run experiments to test the promise of your theory.

In this section you will outline the core experiments you plan to run to test your idea. For the course, you must design at least two experiments and run at least one, ideally two. Running 5 experiments would be a lot; 10 insane. Below you will find the template for designing and writing up each experiment you run.

The template is designed to help you connect your experiment back to your theory of value creation and capture. Indeed, as you are developing your theory you should be thinking ahead to how you might test it. The value of an experiment lies in its complementarity with theory. Better theories yield more useful experiments. Better experiments help you develop a stronger theory of value creation and capture.

Finally, you are likely to design at least one experiment that will take too long or is too costly to run without real investment. That is expected and encouraged! Indeed, the sequential nature of VC—from Seed, to Series A, to Series B, …—reflects the fact that as you learn more about your startup idea—and assuming the signals are positive—investors will be more willing to fund big experiments. That said, be reasonable, if your idea requires 1bn to test then perhaps think of a more modest experiment to run first. Ideally, your early experiments should produce signals that would convince an early-stage investor to fund the yet-to-be-run larger experiment that truly validates your startup idea.

Experiment #1: Name of the Experiment **(Stage:** Designing or Completed**)**

- **[Pre Exp] Describe your hypothesis. How does it test your theory of value? Your P and V?**
    - Here you will summarize the key hypothesis you plan to test and why evaluating this hypothesis will help you learn. Remember, your theory of value is broader than the falsifiable hypothesis you will test, so when writing up your hypothesis you want to motivate why the specific question you are resting is so important for understanding your broader startup idea. To gauge the value of your test is how informative testing this experiment is for your idea's probability of success (P) and the value it can create (V).
- **[Pre Exp] Describe your experiment. What will you do? What will you measure?**

    - Describe exactly what you will do. Include mockups and pictures if you are building an MVP or landing page. Help the reader visualize exactly what the experiment looks like. And make sure to describe what you will measure. Quantitative measures are better.
- **[Pre Exp] How much will it cost and how long will it take?**
    - One or two sentences outlining the cost and time. As the semester progresses, you are likely to design experiments that you don't have time nor funds to do now. That is okay! The raison d'etre of VC and seed investors is to fund these larger experiments!
- **[Pre Exp] What result would support your hypothesis? What result would reject it?**
    - Be concrete and clear! What evidence would favor your hypothesis? What wouldn't? Can you quantify it? You should try to quantify it.
- **[Post Exp] When did the experiment run? What happened? What were the results?**
    - Describe what the results were and when you gathered them.
- **[Post Exp] For the theory you tested, how have you changed your estimates of P and V?**
    - The "simplest" learning from an experiment is whether the startup idea you were testing is now more or less likely to work and, if it works, whether it will create more or less value. In a sentence or two, write down if you think the likelihood of the idea working (P) is more or less likely now than before and why. In a sentence of two, write down if you think the economic value generated by this startup (V) is now larger or smaller than you originally thought and why.
- **[Post Exp] How have you changed your theory of value?**
    - The deeper learning is how the experiment changed your broader theory of value. Did it change how you think about the problem? The solution? How will the company make money? What did you believe that you no longer do because of this experiment?
- **[Post Exp] What did you decide? (Develop Idea, Pivot Idea, or Kill Idea)**

Experiment #2: Name of the Experiment **(Stage:** Designing or Completed**)**

You will design and run multiple experiments throughout the semester. For each experiment, you will copy the structure above. Feel free to edit, delete and all together change experiments you are in the process of designing. However, once you have completed an experiment, please write up the results, what you learned, and then leave it as is from then on out!

Beyond helping you design experiments, this section of the document will serve as a record of the experiments you have run allowing me and other students to better understand your journey, the pivots you have been through, and how you have learned throughout the semester.

Experiment #3: Name of the Experiment **(Stage:** Designing or Completed**)**
See the text under Experiment #2.

Experiment #N…

3. FAQ

Here you will list questions you think will be frequently asked (duh). Crucially, not all questions are equal! Make sure to include the ones that you think will convert a skeptic into a believer in your startup idea. Sometimes the answers will recapitulate your arguments above; sometimes they will include additional information.

Below I have included my own FAQs for using this document.

Q: Can I write a twenty page memo if I have an amazing idea and have run dozens of experiments and just need more space?
A: No. There is a hard cap at 10 pages. More information in fewer pages is better.

Q: Can I share this document with people outside of the class? Can I get external feedback?
A: Yes! The goal of the memo is to help you take the examples and frameworks we learn in class and put them into action. If you know folks—VCs, entrepreneurs, family—that would give you valuable feedback please seek them out.

Q: Is there any evidence that getting feedback from peers is actually helpful?
A: There is overwhelming evidence that we don't get enough feedback and advice on our ideas and businesses. This large-scale RCT (Randomized Controlled Trial) in China shows that assigning CEOs to meet once-a-month to get peer feedback improved the profits of their manufacturing firms by 10%. In an RCT in Togo I show that teaching entrepreneurs social skills dramatically improves their performance by helping them both find better mentors and peers to learn from and by helping them get more out of their existing relationships. Peer advice between tech startups in India also dramatically improves performance two years after the fact. The advice you give to your peers is likely to be the most valuable take away from this course.

Q: What if I realize I have a bad startup idea after doing this?
A: That is okay! You will be graded on both the potential of your idea and on what you learn. If you learn your idea has no promise, that can result in a good grade! The goal of developing this essay is to help you experiment better. Good experiments will often result in null or negative effects. But if you initial idea is bad, and your experiments don't help us learn anything, then you will receive a lower grade. You are graded on how much your startup strategy essay helps us learn.

Q: I don't have a startup idea, can I write about someone else's startup? A company I want to join?
A: Potentially, but please check with me as soon as you can. If you do write about another startup, you will still need to design and run your own experiments.