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The Defensible Startup

The ultimate cheat sheet to build early defensibility for startups

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🙏 Acknowledgements

Introduction

In 2011, Eric Ries defined the startup OS with "The Lean Startup". In his book, Ries prones that founders should relentlessly focus on understanding their users' pain points before building an MVP and iterating to improve the product. At its core, Ries' findings can be summarized by "start small and iterate". Adopt a scientific-like approach to product development, and scale as you prove product-market fit.

There you go! Iterate on your product, and you'll find a product-market fit. Iterate on your go-to-market, and you'll find scale. But... what if you can get copied super easily? What if your years of efforts at building a startup were obliterated by simple addition to the product of a large competitor?

The startup OS needs an update that helps budding and seasoned entrepreneurs approach defensibility in a systematic way. It will save them time, and it will save time for investors too – it's for the collective good!

Figure 1: The startup OS needs an update

Startups need a defensibility strategy. They need access to a smartly-defined, up-to-date categorization of moats with recent examples of how startups have succeeded in building long term defensibility.

🏰 What's a moat?

The moat-mino: eight categories of moats to achieve defensibility

Here are the eight categories of moats we've formalized, based on the content we've collected during our interviews. Because there are two categories of four moats, we've created the moat-mino, based on a double-four domino!

🤓 VCs, founders: how to use
the moat-mino

Figure 2: The moat-mino lays out eight categories of moats to achieve defensibility

Moats categories are split into two categories :

The resources moats are what you own. They cover:

- 👨‍🍼 **Core resources**: The "*fuel*" of a startup: human resources and capital;
- 🧠 **Intellectual property (IP)**, which corresponds to the belongings a business can invest in and covers technology, content, and data;
- 🔥 **Social capital**, which translates into the social impact a company has, the community it creates value for – both of which reinforce the Brand it can invest in;
- 🛣️ **Market resources**, or the firm's ability to "*own*" supply and/or distribution, and its innate ability to scale and benefit from network effects.

The strategies moats are tactics you can implement. They include:

- 🚀 **Collaborative innovation**: feedback-fueled product iterations targeted at improving user experience;

- 💡 **Business model**, or how companies turn localization, monetization, supply chain innovation, and vertical integration into assets they capitalize on;

- ⚔️🛡️ **Regulatory positioning**, through which a company can create value by recognizing a 'regulatory arbitrage' and deciding to be less – *or more* – law-abiding than its peers;

- ⛓️ **Switching costs**, which materialize when customers of a company invest time and/or money to adopt a solution – to which they may be legally bound – or when the solution they use knows them so well it would be hard to switch (data compound).
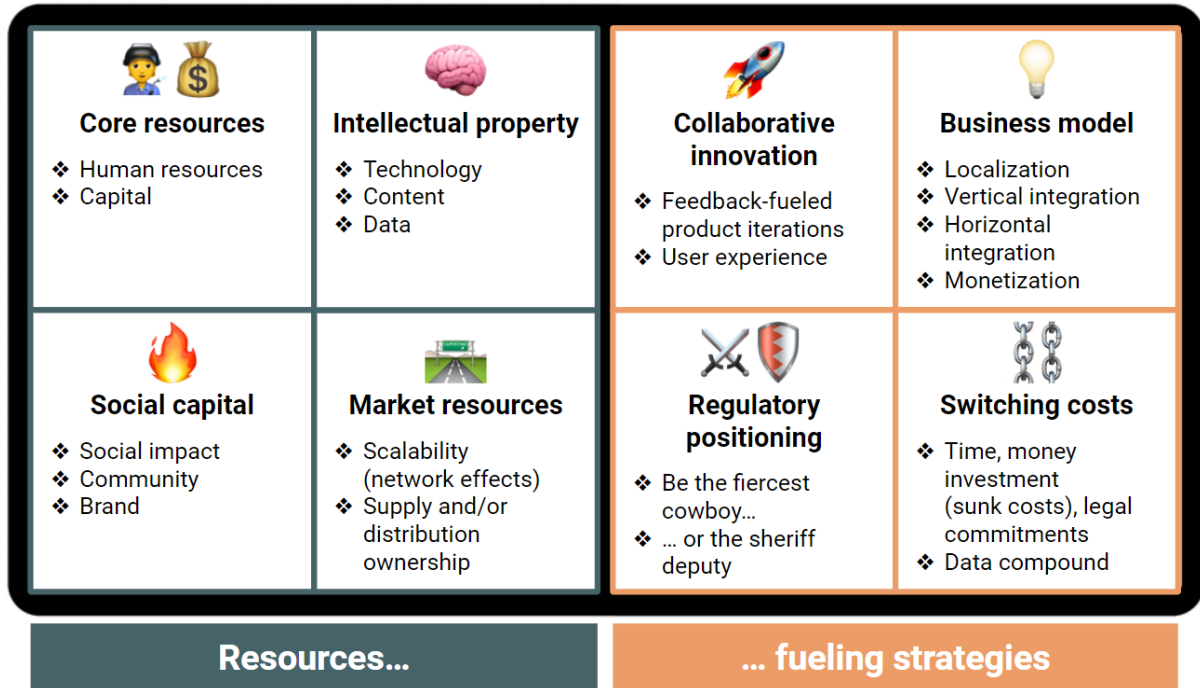

Resources...		... fueling strategies	
👨‍💼💰 **Core resources** ❖ Human resources ❖ Capital	🧠 **Intellectual property** ❖ Technology ❖ Content ❖ Data	🚀 **Collaborative innovation** ❖ Feedback-fueled product iterations ❖ User experience	💡 **Business model** ❖ Localization ❖ Vertical integration ❖ Horizontal integration ❖ Monetization
🔥 **Social capital** ❖ Social impact ❖ Community ❖ Brand	🛣️ **Market resources** ❖ Scalability (network effects) ❖ Supply and/or distribution ownership	⚔️🛡️ **Regulatory positioning** ❖ Be the fiercest cowboy... ❖ ... or the sheriff deputy	⛓️ **Switching costs** ❖ Time, money investment (sunk costs), legal commitments ❖ Data compound

Figure 3: These eight categories of moats contain 20 actual moats

The case studies: mini case studies to illustrate the moats in action

Figure 4: List of companies for which we developed mini case studies to illustrate the moats in action! Klick on the links below under each moat to check them out!

1. Creating <u>resources moats</u>

Core resources, **intellectual property**, **market resources**, and **social capital** are resource moats.

👷💰 Core resources

Core resources are the fuel of your company: people and funding. To quote an investor, we've talked to, core resources correspond to what founders can "*run faster with*."

👷 Human resources

To turn human resources into a moat, ask yourself:

- **How can I improve my team by hiring the top talent in my field?** e.g., former incumbent, scientist, connected salesperson, previous regulator, etc.

- **How can I access scarce human resources by hiring from abroad?** e.g., developers from Eastern Europe, having a distributed team, etc.

- **How can I secure a commitment to join the team by top talent before reaching out to investors?** This way, you don't necessarily need to have upfront money for rock stars in your field

👷 Human resources as a moat: case studies

💰 Capital

To turn capital into a moat, ask yourself:

- **How can I scale my vision to raise more funding?** For instance, explaining how technology can help you disrupt your industry and scale can convince investors

- **How can I raise capital on the co-founders' legacy?** During the interview process, we've heard of several startups that have raised a lot of funding early on, thanks to the previous startup success of their founders

💰 Capital as a moat: case studies

🧠 Intellectual property (IP)

IP refers to technology, content, and data. It can be created internally, licensed from others, or sold as a revenue stream.

🤖 Technology

To turn technology into a moat, ask yourself:

- **How can I create a product 10x better than the incumbent's at solving the problem?** It is possible to disrupt and take over "mature" sectors considered done by the likes of Skype, WebEx, Facetime, Google Hangout, Bluejeans

- **How can I turn my technology into a marketing weapon?** Adopt Dyson-type storytelling: "*this hairdryer costs 10x more than the next one but... the technology!*"

- **How can I create an aura of 'magic formula' around my technology?** Like RedBull, which claimed the magic of its drink was coming from taurine – perceived as a 10x factor coming straight from the bull – when their drink power really hinged on loads of sugar and caffeine (taurine is amino acid without much impact, <u>source</u>)

- **Can I outsource production and focus on R&D and technology licensing?** e.g., semiconductor company ARM, which chose to focus on creating the designs of chips and on licensing them to companies that spend hundreds of millions to create factories that will produce the chips for 6 to 8 years

- **Can I license key technology?** In some cases, you can make a great deal by licensing the technology from a third party (e.g., university, public research center), productizing it, and bringing it to market

🤖 <u>Technology as a moat: case studies</u>

🤖 <u>Technology: additional takeaways</u>

📺 Content

To turn content into a moat, ask yourself:

- **How can I create a 10x better solution with content?** For instance, Douyin (TikTok in China) spent up to $100m bringing the best creators onto their platform. Peloton found the 38 absolute best personal trainers on Instagram and brought them onboard. Having amazing content (e.g., using tools such as HubSpot CRM software) also lowers your Customer Acquisition Cost (CAC), as otherwise companies get "taxed" by Facebook and Google paying a lot to advertise their offerings

- **How can I migrate towards user-generated content? (UGC)** User-generated content is powerful because it uniquely engages content creators and gets them to stay on your platform as they'll stick to their content – and to the social interactions it creates. The smart thing about UGC is that it lowers the cost of goods sold, so the gross margins can be much higher than a business that produce professional content

📺 <u>Content as a moat: case studies</u>

💿 Data

To turn data into a moat, ask yourself:

- **How can I track relevant users' data to improve on my offering?** For instance, by developing novel platforms, you may start to collect new and differentiating data, as Apple does with the Apple Watch, which monitors the heart rate

- **How can I turn the data I collect into valuable insights for end-users?** Simple data visualization and analytics is a starting point. By enabling users to see their data and to understand its meaning easily, you create real value, simply. Runkeeper does this by letting runners visualize their performance and understand how to progress

- **How can I create a 10x solution with data?** Data can enable you: to learn faster by implementing a feedback loop, enable you to provide much more precise service, create lock-in effects making it hard to leave. Think of how Spotify or TikTok can leverage users' consumption patterns to provide more relevant content

💿 <u>Data as a moat: case studies</u>

🔥 Social capital

Social capital is how your environment at-large perceives you and the cumulation of everyone wanting to help your project.

🌐 Social impact

To turn social impact into a moat, ask yourself:

- **Can I build a mission-based product with a well-defined message for the community?** Mission- or value-based products are proven to benefit from a loyal (social media) audience that is engaged with the Brand

- **Can I provide a product that fosters social inclusion?** e.g., identifying consumers disregarded by society and helping them integrate, e.g., migrant workers, seasonal workers, refugees, etc. Companies like Sama and Provider.sg help for the social inclusions of people with such profiles and provide for positive social impact

🌐 Social impact as a moat: case studies

👫 Community

To turn the community into a moat, ask yourself:

- **How can I create a sense of belonging around my project?** Community-driven projects experience strong retention – and growth – as users identify themselves to it. Also, Community drives down CAC and retention costs provided that you can get the flywheel spinning.

- **Can I adopt a "*come for the tool, stay for the community*" strategy?** Popularized by Instagram, this strategy means your users start by using your tools before sticking around to use the social features of your product, growing your community

- **How can I let my community contribute to my project?** e.g., by allowing your community to give feedback that informs your product development cycle, refer friends, post content on your platform, manage itself through forums, etc.

- **Can I use my following to start a business community?** In a recent trend enabled by social media, celebrities launch brands leveraging their fame to gain mainstream appeal

👫 [Community as a moat: case studies](#)

😎 Brand

To turn brand into a moat, ask yourself:

- **Can I leverage the personal reputation of my team?** Some founders and early employees come with a real personal brand to them. Using this Brand as a way to capture people's imagination is a good way to kickstart your branding effort

- **How can I create a narrative to become the standard-bearer of my category?** Find stories that resonate with your customers. Ask yourself the question: "*Which goals are most meaningful for my target customers, and how can I use them as 'hooks' in my brand story?*" Some categories standard-bearers:

  - Exceptional technology experience: Apple

  - Online search: Google

  - Operating system software category: Microsoft

  - e-Commerce: Amazon

  - Social media: Facebook

😎 [Brand as a moat: case studies](#)

🛣️ Market resources

Market resources characterize companies' ability to scale based on their market structure and to them owning supply and/or distribution.

📈 Scalability (network effects)

To turn scalability (network effects) into a moat, ask yourself:

- **Can I grow a platform?** Can you bundle offer and demand to ensure a '*winner takes all scenario*'? Or just one of the two? The structure of your industry impacts the answer to this question. The marketplace is an

attribute so strong that it used to be a public good

- **Can I grow other platforms as well?** Once your core marketplace has grown and reached maturity, why not create another one, like Amazon has after it added its Cloud and its Amazon Prime offerings to its e-commerce one?

- **Can I buy scale?** If scaling makes sense in the context of your offering, but if your market doesn't allow for virality, then buying scale can be a great way to reach market dominance, nationally and internationally. It's not just for B2B, it's also for B2C, which can buy their audience like TikTok has by advertising massively on competing platforms, including Instagram

📈 Scalability as a moat: case studies

📈 Scalability: additional takeaways

🛒 Supply and/or distribution ownership

To turn supply and/or distribution ownership into a moat, ask yourself:

- **How can I become big enough that I get the best deals?** If you have a "***first scaler advantage***", use the strong volume of goods/services that you sell to your benefit: negotiate better deals with your suppliers and distributors

- **How can I own a rare supply?** If what you're selling is hard to create because of skills or production capability scarcity, then it's defensible. Understand how you can differentiate your offering in a unique and impactful way

- **How can I ensure your distributor does a good job?** By giving her a great deal. e.g., incentivizing distributors by giving exclusive distribution rights and possible profit share, based on volume: the more it sells, the bigger the % of profits it gets

- **How can I own premium distribution channels?** e.g., occupying 'real estate' – if you put a payment terminal in a store, you occupy a piece of real estate that often acts as a moat because why change it 'if it ain't broken'; Sandwich company Veat placing its vending machines strategically, directly at companies' offices, or Peloton being referenced by Revolut to its customers during the Covid lockdown;

- **Can I aggregate market supply?** Save time developing a proprietary offering by bundling others'. This way, you become a useful ally to these companies – as you bring them business – and a great supplier to end customers because they can pick the best product/service – like ClassPass has done for gyms, Skyscanner for flight aggregators, PriorityPass for airlines

🛒 Supply and/or distribution ownership as a moat: case studies

🛒 Supply and/or distribution ownership: additional takeaways

2. Creating strategy moats

Strategy moats hinge on transforming the previously mentioned resources moats into moats that fortify your product, organization, and offering.

Collaborative innovation, **business model**, **regulatory positioning**, and **switching costs** are strategy moats.

🚀 Collaborative innovation

Collaborative innovation consists of your ability to address users' feedback and adapt your product systematically and quickly, resulting in a superior user experience.

🔄 Feedback-fueled product iterations

To turn feedback-fueled product iterations into a moat, ask yourself:

- **How can I iterate my product fast?** Once your product is out, test and find out what your best channel(s) – social media, surveys, polls, emails,, etc. - to get customer feedback is (are). You need a lot of feedback, as qualitative as possible, and regularly; then prioritize it and to act on it.

- **How can I follow a clear product development methodology?** Documented in this footnote, the Superhuman product development methodology is a powerful tool to create superior products. It explains how this company – "*not just another email client*", though strictly speaking, that's what it does – managed to charge $30/month for emails.

🔄 Feedback-fueled product iterations as a moat: case studies

🔄 Feedback-fueled product iterations: additional takeaways

😄 User experience

To turn user experience into a moat, ask yourself:

- **How can I be "customer emphatic"?** In 2017, HBR reported that Amazon, Booking.com, Facebook, and Google each optimize their interface through over 10,000 A/B tests, which shows that a science-like approach can successfully second empathy to UX improvement. Revolut and Robinhood are examples of financial platforms that have recently scaled thanks to the simplicity – and the 'user-friendliness' – of their interfaces.

- **How can I focus on the aspects of UX that scale?** Revolut: its 4.9/5 iOS app does wonders at enabling its users to cover their needs at the speed of light. But if you're unlucky enough to fall through the cracks of this

smooth mobile UX or to trigger an exception – you go to customer support hell. **But isn't Revolut right to focus on 95% of its users' experience, rather than on the 5%?**

- **Can I work with partners to improve UX?** Or simply put, does your product provide a standalone solution, or does it integrate with others'. For instance, the hit game Fortnight partnered with all major consoles, and its universality contributed to its popularity. Some companies make it their business focus to improve their customers' experience – like checkout company Kredivo, which provides a 2-clicks checkout (and a credit) solution to merchants.

😄 <u>User experience as a moat: case studies</u>

💡 Business model

Your **business model** ties in with your approach to your value chain: whether you can build and monetize your product in a differentiated way, whether you can tailor your value proposition to specific geography.

🌎 Localization

To turn localization into a moat, ask yourself:

- **How can I contextualize my offering?** Local specificities (e.g., culture) makes a difference in how people buy. Startups in emerging geographies tend to win because they're great at execution and operations: adapting the business model locally plays a more significant role in success than tech per se, which more plays an enabler's role. As security is a big issue in Brazil, for instance, everyone tends to pay by card rather than by cash, and companies addressing the market need to consider this. In other geographies like South-East Asia, it's quite the opposite, and companies doing delivery structurally need to accept cash on delivery, for instance. The other factor why startups win in emerging geographies is when they manage to take the local market before other companies localize there.

- **Am I present enough locally?** In the words of an investor, 60% of a value proposition is universal, and for that, you need to send someone from HQ locally. And 40% of the value proposition is local, and you need to hire locally for this. Amazon tried to open in Mexico from a distance, but they've failed to gain traction initially. Not being present in geography makes it harder to perceive trends in regulations and to sway authorities.

- **Am I ready to expand abroad?** An investor we've talked to tried a Peloton training bike at a luxury hotel in the US early in the company's journey. She tried to convince the Peloton founders to localize the Brand in Europe, where she believed there was potential. They've replied that they first wanted to build enough defensibility around the US market before going international.
- **Does the new geography fit my business model?** A Finish food delivery company expanded to only small cities abroad as they fit better its business model.

🌎 Localization as a moat: case studies

🌎 Localization: additional takeaways

↕ Vertical integration

To turn vertical integration into a moat, ask yourself the following questions

- **Which building blocks I can assemble to create my offering?** For instance, entrepreneurs who want a lifestyle business have understood that they could use company X to build their website, Y to handle their CRM, Z to do their marketing... they just see themselves as the coordinator of all this, ideally one that isn't involved in day-to-day operations.
- **Can I adopt the razorblade business model?** The late 2010s have shown that startups in hardware are at a competitive disadvantage vs. software ones. They face higher prototyping costs, longer product development cycle, need a retail strategy (or to succeed as a Direct-to-Consumer brand), inherently scale at a slower pace than software... and – worst of all – aren't necessarily exposed to recurring revenues! Portable camera company GoPro is the poster child of a company that went from one of the hottest startups in town to a struggling company. It IPO'd at $41 per share, climbed up to $85 per share, and is now worth $4 per share. Sports wearable devices Fitbit follows a similar story.
- **How can I master the value chain 'smartly'?**
- **Can I offer more services?** To differentiate successfully, why not take a pain point away from your customers? That's what second-hand furniture marketplace Chairish understood when they became the first company in their sector to integrate shipping to the value the platform was created for sellers.

↕ Vertical integration as a moat: case studies

↔ Horizontal integration

To turn horizontal integration into a moat, ask yourself:

- **How to rethink my value chain and focus on the highest added-value aspect?** Think about how to generate more profits in a more agile way by outsourcing parts of your value chain that are cost-intensive and focused on high-margin businesses. For instance, Microsoft focused on one aspect of the value chain: at a time when PCs and operating systems (OS) were bundled, it decided to focus on the OS aspect of things – which it did better than anyone else, leading it to become the de facto market leader in the 1990s.
- **Can I run my technology on someone else's infrastructure?** If you don't want to internalize a full product development cycle, an alternative could probably be to licensing is running your technology on a pre-existing infrastructure.

↔ Horizontal integration as a moat: case studies

💰 Monetization

To turn monetization into a moat, ask yourself:

- **Can you sell through a differentiated business model?**

💰 Monetization as a moat: case studies

💰 Monetization: additional takeaways

⚔️🛡️ Regulatory positioning

Regulatory positioning lacks the academic coverage other moats may have. It's about operating in a "grey zone"/"regulatory arbitrage": one that's not regulated yet, or for which the regulation is clearly outdated and/or not enforced for political reasons. How you differentiate yourself strategically here is very important as regulations could be either barriers to or catalysts for growth and early success.

How much you can 'abuse' regulatory loopholes depends on where you are B2C or B2B or whether you act at the municipal or national levels. For example, regulators tend to act faster when it comes to consumer-facing products and slower when it comes to B2B. Besides, while startups like Uber or Airbnb have their own regulatory concerns, they tend to be at the municipal level and, therefore, easier to navigate. In contrast, for example, fintech startups are regulated at every level, making innovation that much more difficult.

⚔️ Be the fiercest cowboy...

To turn a "cowboy" attitude towards regulation into a moat, ask yourself:

- **How can I be a cowboy?** In this case, you interpret being in a grey zone as a green light for maximum action and impact. You believe that you'll achieve scale fast and be able to justify the rules adapting to you thanks to the value you bring users.

- **Spot a regulatory arbitrage, abuse it in your favor but bring value to consumer FAST.** Make your product so good people can't get enough of it. By the time you're big enough for regulators to notice you, you'll be in a position to bargain. Sometimes players try to do it "by the book" and fail mostly because they spend time getting licensed rather than validating product-market fit. "*Experience shows that such companies often 'hit the wall' of product-market-fit and their license has no value because nobody wants their project*" (VC Investor)

- **If you have cash, you can afford "playing with fire."** If you can afford to have a significant legal budget, you can strategically embrace high-risk legal strategies to gain competitive advantages. For example, Apple, using a gigantic legal budget, is backing business decisions that could result in highly favorable or unfavorable outcomes - "*steer the ship as close to that line as you can, because that's where the competitive advantage lies ... you want to get to the point where you can use risk as a competitive advantage.*" (Former Apple general counsel Bruce Sewell, source)

⚔️ A "cowboy" attitude towards regulation as a moat: case studies

🛡️ ... or the sheriff deputy

To turn a "sheriff deputy" attitude to regulation into a moat, ask yourself:

- **How can I be the sheriff's deputy?** You ensure that your offering complies in a smart and impactful manner with the regulation once or even before it's enforced.

- **Put the hard work in from the beginning and increase your chance for acquisition.** You have identified a grey zone with illicit players; by putting time to set up your legal framework upfront, you avoid regulatory setbacks and increase your chance for successful execution. Being compliant gives you a competitive advantage that can attract potential buyers' attention, like in the case of the online ticket marketplace Stubhub, which was acquired by eBay for $ 310m. According to an early angel investor in Stubhub, one of the reasons eBay chose to acquire Stubhub was its legal compliance

- **Help regulators catch up –** If you're in an industry in which technology is hard to grasp, chances are the regulators have a tough time catching up. You can turn your tech into the industry standard. Foretellix did that by open-sourcing its technology. They've decided to create an OpenSource scenario description language (for autonomous vehicles) and pitch it to regulators to ensure 100% compatibility.

🛡️ [A "sheriff deputy" attitude towards regulation as a moat: case studies](#)

🔗 Switching costs

High switching costs – corresponding to strong retention – result from a successful innovation strategy: your product offers a substantial value and translates into accrued activity from users.

⚓ Time, money investment (sunk costs), legal commitment

To turn time, money investment (sunk costs), legal commitment into a moat, ask yourself:

- **How can I turn my product's learning curve into a moat?** Users can be discouraged when they have to start over and learn to use a product. This *learning curve* moat is centered around offering a great value proposition that's only accessible to those willing to train to know how to use it. Think of it as "expert-level" features that people can learn to use through devoted tutorials and training.

- **Can I get customers to invest in the implementation of my solution?** e.g., enterprise software, often accompanied by upfront costs: per-seat licensing, paid support agreements, and consultant-driven onboarding costs. After making a significant investment in technology, companies want value in return and won't easily switch to a competitor. Also, the notion "*why fix it if is ain't broken*" proves that a good enough solution is often all it takes to build lethargy into the system.
- **Can I lock my customers in a legal commitment?** This is especially true for companies that need to spend time and energy onboarding new clients: to be protected from them leaving too quickly; they create a legal commitment. Note this goes against the whole "without engagement" trend that took the world by storm with the software-as-a-service (SaaS) business model.

⚓ Time, money investment, legal commitment as a moat: case studies

🪶 Data compound

To turn data compound into a moat, ask yourself:

- **Can I get my users to own valuable content on my platform?** This situation creates lock-in as there is friction to change platforms as you'll need to migrate your content. This is true for enterprise software as you'll need to port content to get started using it and create content that's specific to this software, for office software with file types, for social networks with the graph you create there, etc.
- **Can I get my users to monetize their content on my platform?** While YouTube was the earliest to monetize creators, Facebook, TikTok, and Instagram are all testing their own ways for creators to earn money

🪶 Data compound as a moat: case studies

To conclude

Moats are relative to your competition, so a modest moat early on, when you don't have much competition, can translate into significant defensibility overtime. It's actually surprisingly easy to bootstrap moats when you get started – it's all down to how you approach it. And in a world in which a third of 'unicorns' ($1bn+ valuation) achieved such status in only 1 to 2 years, success depends on a proactive approach to defensibility.

Moats aren't forever, and companies should keep defending their competitive advantage, once they have one.

See below for more content on:

⏳ Which moat to focus on, base on startup stage

➕ How moats compound

📚 Bibliography