



Session Summary

Ready, Set, Grow Webinar #3

Building a Better Business Model

December 6, 2007



Session 3: Building a Better Business Model

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Introduction

When the word “innovation” is mentioned, most people think of technology innovation – a smaller faster microchip, a new computer language, a more efficient manufacturing process. However, even in the high tech world, the most impactful innovations are often new business models – think Google or eBay.

Every business needs an underpinning business model that defines how they are going to satisfy a customer need and how they are going to make money doing it. Business models are not new and neither is business model innovation (just ask Henry Ford). But too often entrepreneurs place too much emphasis on the technology and not enough on the business model.

On Dec 6, 2007 Andrew Maxwell of the Canadian Innovation Centre gave a presentation on “Building a Better Business Model”. Andrew’s talk explored the nature of business models and how they create value for customer, company and investor. In addition Andrew explored how innovative business models can be a competitive advantage, expanding both the market potential and profitability of a venture.

Joining Andrew was Steve Rankin, President of Client Outlook, a Canadian company that makes an eLearning software solution for the healthcare industry. Client Outlook is in the process of exploring how innovative business models can help the increase their market potential and rate of growth.

Their discussion was webcast to an audience of tech industry executives from across Canada. The notes below summarize the session and the answers to the questions posed by the audience.



Speakers:



Andrew Maxwell
Director –Business Partnerships
Canadian Innovation Centre



Steve Rankin
Founder and CEO
Client Outlook



Building a Better Business Model

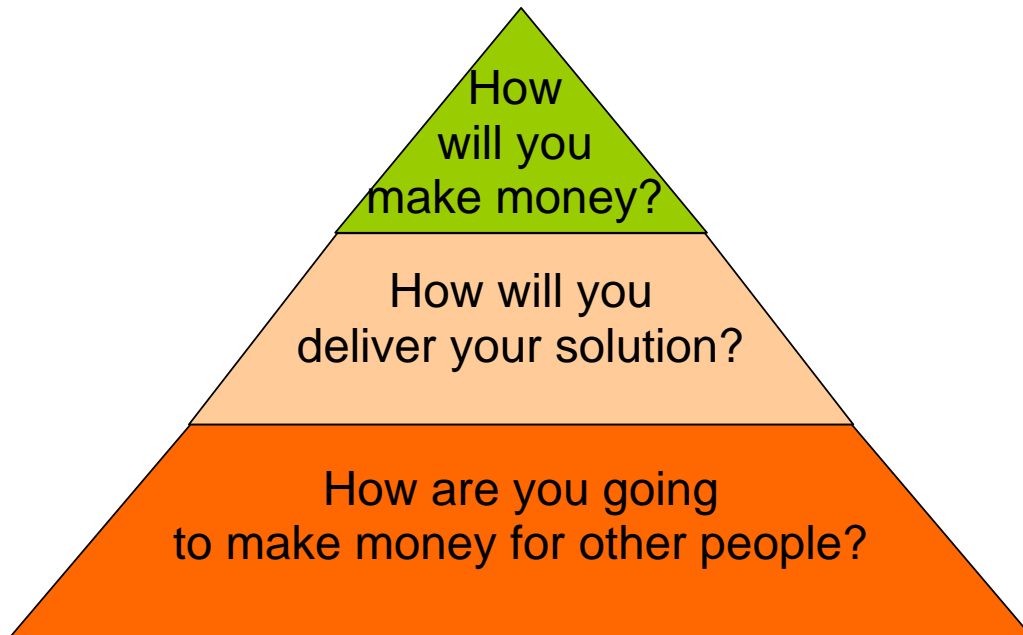
What is a Business Model?

Your business model is the conceptual model of your business that identifies what you do and how you create value doing it . A business model is one of the most fundamental requirements for successfully starting a business. Although a business model can change once the product is developed, it's very beneficial to understand the business model as you do product development, as there are features you'll need to consider.

"Your business model is your 'how-to' guide to grow your business"

Andrew Maxwell

A business model exists on three levels:



How will you make money?

This is the simplest level of the business model to consider, it consists of identifying a solution of value to a customer, developing the solution , and building a profitable revenue and growth model.



How will you deliver your solution?

Once you've identified the product or need, found a solution and identified how to make money, there are several options to consider in regard to how to deliver the solution to market. The options you choose have significant impact on the speed and growth of the business, as well as the risks taken on. Recent global and technology changes have created an increasingly large numbers of options worthy of consideration.

How are you going to make money for other people?

If you want to grow your business rapidly, then you will need to attract investors and develop a business plan. While a core component of this plan will include how you make money and deliver your solution, it is important that it also considers the attractiveness of the investment opportunity for an external investor. You need to demonstrate why people should invest in you now, what you will use the money for and how much they can expect back in the future. All of this needs to be based on realistic assumptions.

Using your Business Model

There are several different ways you can use your business model:

- The model frames the questions you'll ask inside your organization, guides planning of activities and confirms alignment of goals.
- The model allows you to be clear on how you're providing value to your customers. Implementing the business model translates into profitable business and justifies the ongoing growth of your venture.
- The business model is also a communications tool, for engaging other parties. It can be the focus of a strategic partnership. Or a promising business plan itself, of which your model is the keystone, can become a vehicle for attracting investment.

Look to your business model to answer key questions.

How do I create value?

What you do, how you do it.

How do I select customers?

Given there's so many, your business model should help you choose which customers to go after, initially and subsequently



How do I do it better than anyone else?

Customers are faced with a choice, why they should select you and why should they take the risk of working with a new supplier?

How do I differentiate my solution?

This needs to be both well understood and communicated to those making the decision to purchase the product or service. It could be something you build into your product, or how you encourage your customers to adopt your solution.

How do I make a profit?

This is probably the most important question of them all. You need to show that you understand your costs, the perceived value of your solution and how this can grow the business profitably. Although key your product is only one factor in the equation of your business, the customers perceive other costs and benefits in switching to you as a supplier..

How do I grow my business?

Unique solutions or service/quality at a premium price are very important ways to sustain advantage, especially for technology companies. Low cost solutions selling on volume are very difficult for early-stage companies to sustain and support.

Although your business model is often unique in many respects, there are some basic factors to consider when helping both develop the model and explain it to others. These types of questions can include: What is the basis of your competitive advantage and who are competing with? What are your comparative strengths - high perceived quality, innovative or unique product features, or providing increased user efficiency? How will you develop and enhance customer relationships to gain advantage over incumbents? Are you offering a disruptive solution – something that changes the nature of the market and the way competition happens? This can be a great place for early-stagers, as you can target the cracks in/between the bigger guys, that they often ignore.

You also need to understand your weaknesses and how you can overcome w\them both in the short and long term: How do you reduce the risks of switching suppliers? How do you make it easy for users to change practices to utilize your solution? How do you provide after sales service? What happens with the technology solution if you go out of business?

Understanding and anticipating such issues can be crucial to get early adoption rates up.

"Develop your business model to help you address and overcome target customers' adoption issues in advance."

Andrew Maxwell



Shaping Your Business Model for Market

One of the most important things to address in your business model is something you'll be asked constantly by customers: "Your early stage company looks good, you have great technology, I understand what you do, I like you, but why should I buy from you? There's too much risk."

Your focus during business model development must include how to overcome the adoption issues. Every risk of adopting your product is a stroke against your product in a highly competitive market... the ease with which customers may adopt your product is perhaps the single strongest selling point. Make it a key part of your model.

Rogers Innovation Adoption Curve

Everett Rogers developed a model for customer adoption of new innovations, by categorizing the characteristics of technology adopters. This approach has been popularized by Geoffrey Moore in "Crossing The Chasm". He breaks down adopters in four categories based on the speed with which they adopt new innovations. In sequential order they are termed: early adopters, early majority, late majority and laggards. Understanding the way early adopters behave in your potential market is key to success. You need to develop a plan to persuade them to become initial customers, even if they only make up a small portion of the market. This is because one of the characteristics of the majority of adopters is the need to validate their decision to purchase by showing that others (the early adopters) have already done so.

The early innovators can support smaller operations but can also leave you with no opportunities for expansion. As real profitability only begins with attracting the early majority customers, then you also need to plan to "Cross This Chasm". The reward for businesses that can push their product/service through to the late majority customers is higher levels of profitability and company value creation. By focusing on adoption issues, for each of these different markets, you directly influence your chances of advancing from one segment to the next along the curve to bigger and better markets.

Customer insistence for "established" or "trusted" brands and vendors can be a significant obstacle for innovators of all sizes. Gaining people's trust to overcome this risk can be quite a contest and you should come to market prepared to address this and the challenges associated with attracting their attention in the first place

*"Double or nothing:
The customer gained by
you is lost by your
competition."*

Andrew Maxwell



Employ your business model in planning your marketing strategies To overcome these adoption issues. Ask the following:

*How do you overcome perceived risk of buying your product or service?
How do you obtain or circumvent the traditional purchasing pattern?
How do you utilize others to increase awareness or availability?*

The Supply Chain

Once you understand the first level of the business model: understanding what you do, how you provide value to customers and how you can make money, you can move to the next level. Considering the variety and availability of the array of partnerships, outsourcing and strategic opportunities available allows you to leverage others in order to increase impact and sometimes reduce risk.

A traditional supply chain consists of the sourcing of raw materials, their manufacture and assembly into a value added product, their sale to a distributor and retailer before they reach the customer. There are always options on who does what in this supply chain. It is crucial to the long term success of your business that you make the right choices in deciding what you do and what you outsource. Once you identify the core elements that you feel you must retain, often where you add the most value or are critical for success, you can focus your limited resources on improving them and increase the likelihood of long term success.

However, balancing this resource limitation issues with enhancing potential growth rates, also builds extra levels of risk. A crucial supplier going out of business or switching alliances to a competitor can fundamentally impact your likelihood of long term success. Deciding which portions of the supply chain you need to control and which you don't is an ongoing balancing act. Developing an enhanced supply chain with critical partners at key points, offers definite benefits as well as risks. You can leverage partner resources directly and access resources on an incremental rather than a fixed basis. You can also use these partnership to limit competitive activity or threats. Clearly it is an area which requires significant insight and thought. The supply chain can maximize the potential of your venture, which is then unavailable to competitors – another way of creating value. This creates a number of supply chain issues which you need to ask:

*How do you identify your value added in the supply chain?
How do you leverage partner resources?
How do you maintain control?
How do you create competitive advantage?*



Business models are evolving constantly but the last ten years has seen historically unique proliferation. Some examples of radically different business models are provided to stimulate idea generation for your business.

- *Make a product from scratch and sell it to customers* Henry Ford's innovation which made automobiles affordable was less about new technology than a unique business model that increased the market for his products. The model drove change based on changes in manufacturing processes and supplier relationships.
- *Provide a service and charge a monthly user fee*, as is very common now in wireless/Internet access. When AT&T and Bell used a business model calling for customers to pay for connectivity, a set fee for a service rather than payment for individual transactions.
- *Create a new product and sell copies of it to customers*. Traditionally all software had been custom written by programmers and sold to clients. Visicalc was one of the first spreadsheet software suppliers to sell multiple copies of the same programme with revenue derived from each additional sale. with money made on each copy.
- *Provide a free service of value and provide access to users of that service to third parties*. Google's free search engine took its start from the dot.com boom and added revenues from a variety of advertising sources. Their revolutionary business model was all about linking their technology with more focused advertising opportunities.
- *Creating an efficient marketplace*. Until eBay, customers only bought from suppliers they new. EBay allowed people to build trust over the Internet by establishing rating systems and financial exchange mechanisms which people could rely on.

" As businesses advance, and as technology advances, "the future challenge for technology entrepreneurs is more related to overcoming customer adoption issues than developing new technologies. It would appear that the key to future venture success will be the creation of new business models which drive adoption rates rather than innovative technology advances."

Andrew Maxwell

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Ford didn't invent the internal combustion engine nor did Google invent Internet search engines. What they did invent and their competitors did not,



was an innovative business model that gave them enormous competitive advantage by leveraging technology advances.

As businesses advance, and as technology advances, “the future challenge for technology entrepreneurs is more related to overcoming adoption issues than developing new technologies. It would appear that the key to future venture success will be the creation of new business models which drive adoption rates rather than spectacular technology advances.” – Andrew Maxwell

The Importance of Maintaining Control

Where you sit on the supply chain is crucial, build your business model accordingly. For example, if you plan to utilize a partner for sales for your product make that part of your strategy from as early on as possible. Make sure that your partner will be well placed to facilitate customer adoption. Build features into your product or service that not only encourages customers to adopt your solution, but makes your sales partners job of selling easier.

Chose carefully what to outsource and what to maintain in-house. Ask yourself, “what is it I do well that no one else can do as well for me?” You don’t want to outsource or partner key components of your business plan, that make you vulnerable to competition. With the example of sales, be wary of turning over contacts to your sales partner; allies today may not be in the future. There’s a balance to be struck, you don’t ever want to be a weak link in the supply chain.

The stronger the commitment that you can obtain from your partners the better. You may find smaller companies more suitable in this respect – commitment is a traditional niche smaller companies fill in the market. You can be more important to them, than you can to a larger company, so they will devote a higher portion of their resources to your success. Smaller partners often have other benefits too, their values or culture might be much more closely aligned – a positive factor that is often ignored.

As a smaller company, your prospects of vertically monopolizing your supply chain likely are not immediate. The better organized your business plan is from the start, the more capably you’ll be able to assert yourself on the supply chain and maintain strategic control.

“Identify if there are additional opportunities to enhance your sources of revenue.”

Andrew Maxwell



A Contemporary Classic

RIM and their Blackberry™ are an excellent case in point. RIM morphed technology that began as a two-way pager into a really marketable wireless device. Interestingly, RIM's success has not been as a story of a wireless device company but as an e-mail integration company.

All of the services involved in a customer using the Blackberry™ are handled by RIM. So RIM has two sources of revenue in their business model: selling the device units, and selling support, which is the greater long-term value.

RIM targeted large telecom companies, understanding that their unwillingness to adopt something like the Blackberry™ stemmed from the massive support effort these require. So RIM undertook to support the Blackberry™ from the start, selling the support of skilled professionals for a nominal fee. This has the added benefit of connecting RIM directly to their customers and acts as a constant source of innovation ideas (every trouble ticket). All this without the trouble and expense of RIM having to manage the delivery and accounting issues associated with establishing relationships with millions of users. Their partners do this through co-operative marketing, existing reputation and relationships.

An example of the choices required

For example a typical choice might be one of three basic go-to market strategies:

- A. Establishment of an organization to develop, manufacture and sell the product through an existing sales channels,
- B. Manufacture of the product and labeling it for existing suppliers in the industry.
- C. Licensing the idea to a major player and just collect the license fees.

We illustrate this with a real example. You develop a new street hockey net that could be assembled and disassembled in 30 seconds and comes with a five year unlimited warranty. (If you currently have a net you will understand why this would take the suburbs by storm). Which option, A,B or C would you chose. Option A will require the greatest time and effort, and may offer you the best chance of selling your company for a high value, while option B could allow you to sell more nets quickly and make faster cash flow. However your attractiveness as an acquisition target diminishes, as you are reliant on others for success. Option C has no exit strategy, but would produce a nice income stream and minimum effort for a period. What would you chose? The majority of our webinars participants chose option A. You can see the hockey net at www.canadianballhockeynet.ca



We have talked to a limited extent about creating value for investors, but this example shows how the strategy you chose can impact the investment decision. More attractive investments are not necessarily based on company profitability, but frequently on how the acquirer can leverage the increasing venture with their resources to create even greater value. This requires significant further thought and evaluation.

Conclusion

Conceptually, business models are as much about the ambitions and motivations of the entrepreneur as they are about what is the right solution. Often there is no right answer, without the benefit of hindsight. Sometimes you have to go on gut feel without the benefit of someone to help you. Sometimes you may need to make the choice before you decide the type of help you need. Choosing a business model is not just a matter of predicting which model would produce the most revenue. There is a very personal lifestyle choice to consider, as well exit objectives. Ultimately, entrepreneur and business model must be as well matched as pet owner and their pet.



Results of Real-time Poll

Below are the results of the two polls of attendees conducted during the webinar:

Question 1

What is the current stage of your business?

- | | |
|--|-----|
| ➤ Business or technology concept stage | 7% |
| ➤ Business plan development | 7% |
| ➤ Seeking initial financing | 0% |
| ➤ Product development stage | 21% |
| ➤ Product launch stage | 21% |
| ➤ Have clients and revenues | 21% |
| ➤ Seeking expansion capital | 14% |
| ➤ None of the above | 7% |

Question 2

How would you say you make or plan to make money?

- | | |
|--|-----|
| ➤ Sell on service/quality at a premium | 33% |
| ➤ Sell on high volumes to obtain a cost advantage | 0% |
| ➤ Unique solution which solves known market need | 33% |
| ➤ Disruptive solution which addresses new market opportunity | 20% |
| ➤ New way to facilitate adoption of an existing product | 13% |
| ➤ Don't know or none of the above | 0% |

Question 3

Where have you turned in the past for advice on how to grow your business?

- | | |
|------------------------------------|-----|
| ➤ Government Programs and Services | 15% |
| ➤ Financial institutions | 0% |
| ➤ Consultants | 15% |
| ➤ Education & Training (e.g. EMBA) | 15% |
| ➤ Mentor | 31% |
| ➤ Other | 23% |



Speaker Bios

Andrew Maxwell, Director Business Partnerships, Canadian Innovation Centre

Andrew Maxwell's experience includes the founding of two environmental technology companies, the creation of a wireless, medical device and web company and a technology incubator that helped create 30 technology businesses. He is currently with the Canadian Innovation Centre and pursuing a Ph.D. in the area of new venture creation at the University of Waterloo. He teaches at UTM and Waterloo in the area of technology entrepreneurship.

Steve Rankin, founder and CEO, Client Outlook Inc.

Working within health informatics, Steve enjoys helping clinical teams work with IT towards building solutions that fit their needs. He has held positions in product management and technical product management. He previously worked at Mitra Imaging Inc. / Agfa HealthCare where he had the fortune to support, manage and develop solutions with many of today's leading health informatics vendors. This experience gave him a practical perspective on the health informatics market. A perspective he sums up simply as, "never lose sight of what the patient needs from this project, that's why were here."



Suggested Readings

Christensen, & Raynor, **The Innovators Solution**

Moore, Geoffrey **Crossing The Chasm**

Rogers, Everett M. **New Product Adoption and Diffusion** *The Journal of Consumer Research*, Vol. 2, No. 4. (Mar., 1976), pp. 290-301

Wise, Sean **Wise Words**

Useful Links

www.innovationcentre.ca

www.1000ventures.com/business_guide/business_model.html



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