

Ready Set Grow

Season Two Webinar Two

Session Summary

Maximizing the Opportunity: Creating High Performance Business Models

April 15, 2009

Presented by:



Technology Marketing
Resource Centre



Canadian Innovation Centre

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Introduction

The Ready Set Grow series presents webinars featuring subject matter experts and Canadian tech execs discussing topics of interest to the executives of young Canadian technology companies.

On April 15, 2009, Ready Set Grow looked at the topic of Business Models through a session featuring a presentation from Andrew Maxwell of the Canadian Innovation Centre, a discussion with Arjen Bogaards, founder and CEO of Lumina Life Sciences and questions from the audience.

This document captures the content of this session.

Speakers



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.



Arjen Bogaards, PhD., MBA

CEO and Founder, Lumina Life Sciences

Arjen has been involved for over 10 years in research in the development of drug-device combination products. Prior to founding Lumina Life Sciences, Arjen acted as Chief Technology Officer for Steba Biotech N.V.. Arjen has also held a position as Scientific Associate at the University Health Network in Toronto. Arjen holds a Bachelors degree in Applied Physics from the Rijswijk Institute of Technology with a major in Photonics, a Ph.D. in Medical Sciences from the Erasmus University, the Netherlands and Arjen anticipates to graduate for a dual-MBA degree from both Cornell University and Queen's School of Business May 2009.

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Maximizing the Opportunity: Creating High Performance Business Models

What is a Business Model and why do I need one?

The very term Business Model sounds complicated and academic and of little relevance to real entrepreneurs, right? Wrong, even when not looking for investment - every business can benefit from a better understanding of its business model (whether or not it knows it). The business model describes how the company makes money. The right business model will likely determine whether or not the business will grow or dies.

Business Model: A short definition

"How a firm will make money and sustain its profits over time."

Stewart and Shao, 2000

A business model defines how your business makes money, by clarifying exactly what you are selling and who you are selling it to. It identifies the value you are creating for your customer and how you are getting paid for that value. Given this simple definition, you would think that most businesses would have a very clear understanding of their model - but in reality, most do not. In fact, most executives can't even articulate their business model and few have it well documented. It is often difficult to suggest a how business can improve its profitability if it does not have a well thought-out business model that can be discussed and improved upon. In today's competitive economy, a high performance business model provides insights that can maximize the potential value of the business idea or innovation.

Business Model: A more formal definition

A Business model should:

- *Articulate the value proposition*
- *Identify a market segment and revenue generation mechanism*
- *Define the structure of the value chain within the firm*
- *Examine the profit potential given the value proposition and value chain structure proposed*
- *Describe the position of the firm within the value chain*
- *Formulate the strategy to gain and hold advantage over rivals*

Cheeseborough and Rosenbloom
Industrial and Corporate Change, Volume 11, Number 3, 2002

A business model exists at three levels, as shown in Figure 1. Each needs to be addressed, in order to identify how a company makes money so that business model improvements can be suggested to improve profitability and the return on company investments.

"How will you make money?"

This simple question rarely has a simple answer. It requires you to understand many things about your offering, your customers and your competition.

"How will you deliver your solution?"

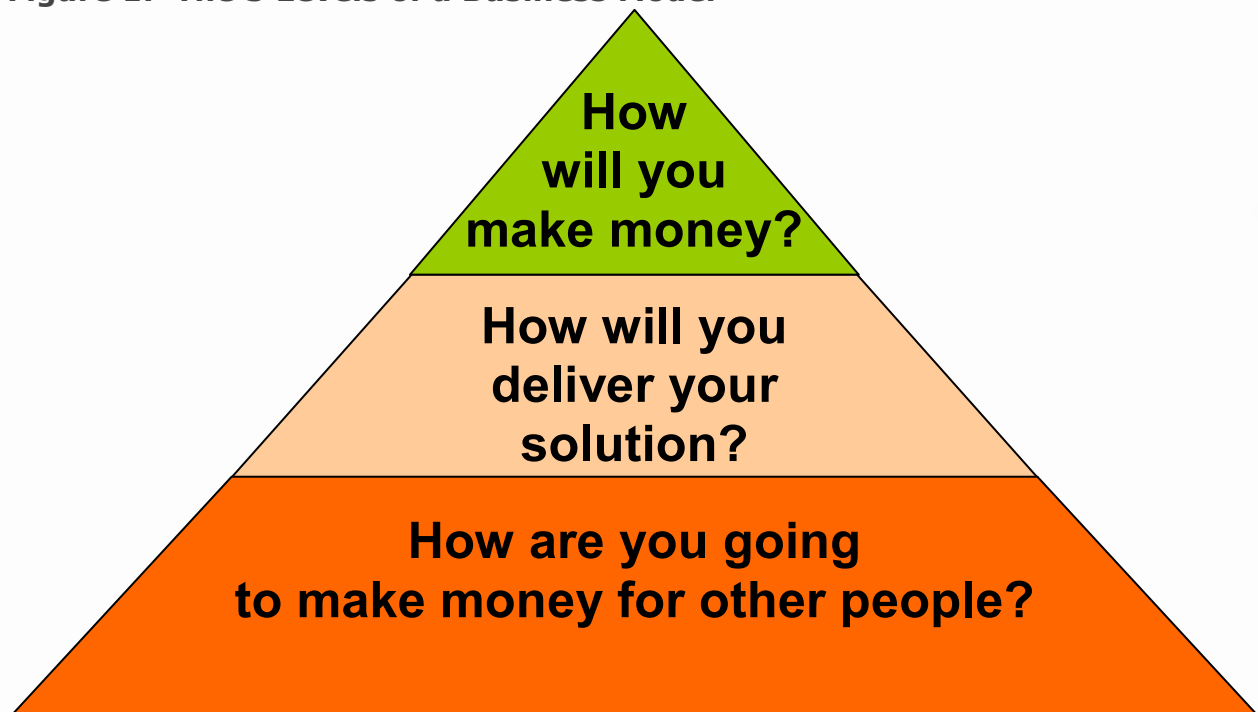
This question helps you to identify questions about how you can optimize your supply chain and delivery strategy in order to both maximize profits and create a sustainable competitive advantage.

"How are you going to make money for other people?"

This question may seem obvious, but it is not. Nor is it only a question to ask if you are seeking investors – although in this case it is vital if you are going to be successful. If you want to work with others, source suppliers, work with distributors, or other partners, this question is vital.

For example, potential investors are often less concerned about the technical features of your offering than they are about your ability to increase the value of their investment.

Figure 1: The 3 Levels of a Business Model



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Why do you need a business model?

The business model acts as a guide for your business, helping you identify and act on the activities that will advance the business. Many businesses operate on a very opportunistic basis and address whatever happens to be in front of them at a point in time. This is not an optimal approach. It can lead a business into distracting or even dangerous situations and can result in missing, or being unprepared for, critical opportunities. A business that is well prepared is far more likely to be able to capitalize on a market trend.

A business model also provides focus, helps ensure that you concentrate on adding value for your customers and ensures that you are doing it profitably.

In addition, a well-defined business model is an important communication tool for engaging with other parties, including investors, partners and even customers.

Further, without a good understanding of your business model, it is difficult to optimize your current business model or identify additional business models that can supplement or replace your existing model.

10 Ways to make money from customers

Most businesses start by assuming that there is only one business model open to them. This maybe for historic or market reasons, or simply because it was the first one considered. While improving your current model seems obvious, there are many times when entrepreneurs are just too busy to find ways of increasing profitability. However, we find the biggest opportunities for improved profitability come from identifying alternate revenue sources. These can include changing the basic business model, to increase value or profit, or adding a new business model to complement an existing one. There are many non-traditional ways to enhance business revenue or profitability; ten of the most common are listed below. You should identify which are the ones you are currently using, hopefully after going through this process, you will identify other business model opportunities that you should consider.

10 Successful Revenue Models

- 1. Make a product and sell it to a customer*
- 2. Buy a product from a supplier and sell it to a distributor*
- 3. Provide a service and charge a fee*
- 4. Give away a product and charge for service/support*
- 5. Provide a free service and charge others for access*
- 6. Create an innovation and license to third parties*
- 7. Create an efficient marketplace for products/services*
- 8. Disintermediation by removing a middleman*
- 9. Network sales model*
- 10. Web 2.0 models (can also enhance existing models)*

The most common way of turning a basic revenue model into a higher performance one is by supplementing your core revenue through additional revenue sources. For example, if your core offering is a product, you can supplement these revenues by charging for training, installation, customization, support, upgrades, process re-engineering and other related service offering that adds value for the customer. Another principle is to leverage your unique technology or business model through partnering. For example, you can license your technology to another company that has a greater ability to generate profit from it, or you can embed your technology in another company's product, so that their sales activities build revenue and customer base for you.

The Internet has also created the opportunity for many new or improved business models. For example, the internet has enabled the creation of new efficient markets, such as eBay or information services such as ZAGAT. These services and their revenue models would not have been possible just a few years ago.

It is important to look at all of the possible revenue streams for your business in order to optimize your growth and your competitive strength.

Examples of Innovative Business Models

Crowd-sourcing: Threadless Tees

Threadless is an example of a business model built on harnessing the wisdom of crowds. Threadless is a community-centred online tee-shirt company based in Chicago. Members of the Threadless community submit teeshirt designs, which are then voted on by the community. A small number of which are printed and sold via the company's online store. The winning designer gets \$2000. Threadless gets a low overhead design process and access to a ready market.

Can you make money by giving something away for free?

Revenue opportunities in Open Source:

- *Selling Support: provide support for an item given away free*
- *Loss Leader : no charge product given away to stimulate sales of other products (e.g. razors / razor blades)*
- *Accessorizing: sell products that are associated with open source products (e.g. manuals)*
- *Brand licensing: to build a valuable brand equity (e.g. Wikipedia)*
- *Service enabler: provides a way to sell additional consulting services*

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Community Support: McAfee forums

McAfee, the well known anti-virus and computer security company, has developed a way to co-opt customers to support each other by creating a user support forum. Users register for free and are then able to post their virus and security problems on the site. Other members of the community provide suggested solutions to the problem, tapping into a worldwide base of expertise. This approach not only reduces McAfee's support costs, but at the same time creates ambassadors for the McAfee brand.

Customer Advocacy: Sierra Snowboards

Sierra Snowboards is a snowboard and accessories company based in Sacramento California. They have created a series of on-line forums for their community of snowboarding enthusiasts. In the forums, community members talk about all things related to snowboarding, including where to go, what to wear, how to get there and what to do when you do. Of course, they also talk about gear, and while you don't have to buy from Sierra – why not? Clearly this highly popular and successful forum has enhanced the company's image as an integral part of the snowboarding world.

Profile: Lumina Life Sciences

Lumina Life Sciences is a start-up biomedical company looking to establish itself within the converging fields of drugs, diagnostics and medical devices. Lumina brings together the Pharmaceutical and Medical Device industries and facilitates the development of drug-device combination products, specializing in photosensitive medications.

For example, Lumina is developing a product to aid in the surgical resection of tumors. A fluorescent drug, TumorTarget®, marks the tumor, and the SurgiGuide® technology provides real time visualization, increasing the likelihood of the surgeon removing all of tumor cells.

Recently Lumina has been exploring an alternate business model whereby the device is provided at no charge, but monthly fees apply for usage and consumables. According to Lumina CEO Arjen Bogaards, "An upfront capital expense is always a challenge in the medical community. By replacing it with a monthly charge, we are able to overcome a purchasing barrier and expand our base of customers more rapidly."

Lumina has also expanded its business model by offering consulting services in device development. They are able to use their medical, manufacturing and regulatory expertise to help their clients design devices for high medical value and ease of manufacture.

Community Localization: 37 Signals

37Signals is a web applications developer, based in Chicago, who has launched an open source web application framework using what is known as the freemium business model (which offers basic service for free, while charging a premium for advanced services or special features).

37Signals applications are known for their simplicity and ease of use. By allowing users to localize their open source product, the product is now available in over 100 languages. This has given 37Signals far greater global reach and a larger user base than they ever could have achieved through traditional means.

Platform: Second Life

Second life is an online interactive 3D virtual world. Users are able to interact with each other through avatars. Several businesses now use this environment to promote their businesses, and some even create revenue by providing virtual services. All of these platform technology users have a vested interest in the long-term survival (and growth) of Second Life.

Which part of the Supply Chain should you occupy?

One of the key decisions in creating your high performance business model is to determine which part of the supply chain you should occupy. This is driven by where you can create the most value and competitive differentiation.

All companies have limited resources, but this is especially true with start-ups. While there is a great temptation to do everything yourself, this is generally not practical or wise. In addition to limiting your ability to grow, it may put you at a severe competitive disadvantage.

Where do you add value in the supply chain?

Some questions to ask yourself:

- What are the costs for delivering the offering to the customer?
- What is required to be bought in to deliver the offering?
- How are prices set? How will customers pay?
- What relationships are important to you?
- What are the market characteristics?
- What are the risks in this business model?

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Therefore, it is important to decide how you are creating value and which part of the supply chain you should own. For those that you do not need to own or control yourself, this then allows you to decide how you should choose and make use of partners

Note as well that investors want to invest in businesses that are in high reward parts of the value chain, not the low margin part of the value chain.

Problems with Business Models

A business model must be based in reality. The value proposition must be real. Competitive advantage must be sustainable. The numbers must add up. There is no place for wishful thinking or unjustified optimism.

Here are some of the things that can create problems for your business model.

"When business models don't work, it is because they fail either the narrative test (the story doesn't make sense) or the numbers test (the P&L doesn't add up)."

J. Magretta
Harvard Business Review, 2002

1. Flawed assumptions underlying the core logic. This is the most common problem. When Carlson first took his photocopying technology to Kodak and IBM to see if they would be interested, the conclusion was that clients would never pay the capital cost of this equipment – instead he worked with Haloid corporation changed the model to a per copy cost...and as they say the rest is Xerography!
2. Limitations in the strategic choices considered. If you haven't looked at all the options, you may be selling your business short or missing major opportunities. For example, if you build your business based on the traditional business model of selling your product to customers at a profit, but your competitors are giving it away free and making money from advertising (such as Hotmail) you are at a possibly fatal competitive disadvantage.
3. Misunderstanding about value creation and value capture. For example, a recent client at the Innovation Centre developed a new rugged street hockey that, which could be assembled and disassembled in 60 seconds. He had invented it because he was fed up with the short life time and reliability of existing nets, and started to market it based on its longevity. Interestingly the real value of the net was that it was easy to transport and store. Commercial

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success did not occur until this feature was emphasized.

4. Flawed assumptions about the value network. Specifically we often find that a company starts by wanting to control its complete supply chain, when this can create high overheads and inefficiencies. A medical device client ordered each of his components from one of seven suppliers, assembled the orders and shipped them from their own expensive warehouse. Focussing on where they added value, they outsourced the whole process to the largest subcontractor, who was happy to order from the others, and use downtime in his factory to complete assembly. This allowed the medical device company to stop worrying about production scheduling and eliminate their overhead cost.

Where to Start

We have focused on two key elements of a business model; how to make money and where to play in the supply chain. Whether you are creating a new business model or evolving your existing model, taking a hard look at these two areas is certainly a good place to start.

Improving your ability to make money begins with assessing the value that you can create for your customer and ensuring that you have examined all of your revenue and delivery options, in order to select the ones that are best for your business. Can you expand the revenue you can generate from your current offerings, customers, and resources? Can you extend into new offerings?

The second area to look at is where you will choose to play in the supply chain. Here you must ask yourself what you do well? What do you want to own and what do you want to outsource? It is important to identify your special expertise and value added and look at all of your options for outsourcing things that are not important for you to own. This will improve your overall efficiency and allow you to make your limited resources go farther.

These are difficult questions to answer and, as we highlighted earlier, it is critical to base your decisions on reality. The first place to turn is to your advisor or mentor, these are certainly issues you can discuss with them. (If you do not have one you should probably be trying to get one). There are also external consultants who can assist, and a number of government bodies can provide access to information and advisors.

Regardless of the stage of your business, time spent developing your business model is time spent improving the prospects for your business.

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Results of Real-time Poll

Below are the results of the three polls conducted during the webinar:

Poll #1 What stage is your business in developing a business model?

- | | |
|--|-----|
| ○ Have no formal business model | 0% |
| ○ Have a defacto business model | 5% |
| ○ Have a partial business model concept | 60% |
| ○ Have a full business model concept but not fully implemented | 15% |
| ○ Have a fully defined and implemented business model | 20% |

Poll #2 What is your current primary business model?

- | | |
|---|-----|
| ○ Make product from scratch and sell to a customer | 52% |
| ○ Buy product from supplier and sell to a distributor | 0% |
| ○ Provide a service and charge a usage fee | 42% |
| ○ Give away a product and charge for service/support | 6% |
| ○ Provide a free service and charge others for access | 0% |
| ○ Create an innovation and license it to third parties | 11% |
| ○ Create an efficient marketplace for products/services | 5% |
| ○ Web 2.0 models (can also enhance existing models) | 0% |

Poll #3 Which of the following business models do you think you might use in the next 12 months?

- | | |
|---|-----|
| ○ Make product from scratch and sell to a customer | 58% |
| ○ Buy product from supplier and sell to a distributor | 21% |
| ○ Provide a service and charge a usage fee | 53% |
| ○ Give away a product and charge for service/support | 11% |
| ○ Provide a free service and charge others for access | 11% |
| ○ Create an innovation and license it to third parties | 42% |
| ○ Create an efficient marketplace for products/services | 5% |
| ○ Web 2.0 models (can also enhance existing models) | 26% |

Note that question 3 allowed multiple answers, therefore percentages will not add to 100%.

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Links of Interest

Canada Business	http://www.canadabusiness.ca/
Canadian Business Online	http://www.canadianbusiness.com/entrepreneur
Export Development Canada	http://www.edc.ca
Business Development Bank of Canada	http://www.bdc.ca
Canadian Innovation Centre	http://innovationcentre.ca
Technology Marketing Resource Centre	http://www.tmrc.ca
Managing the digital enterprise	http://digitalenterprise.org/about.html
Threadless	http://www.threadless.com/
McAfee support forum	http://community.mcafee.com
Sierra Snowboards	http://www.sierrasnowboards.com
37Signals	http://www.37signals.com
Second Life	http://www.secondlife.com

Articles and Books of Interest

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