Topic 1.4: Business Model

How do you plan to make money and what is necessary to do that?

A business model is a blueprint for a company. It describes how the company creates the offer and how makes money from it. It is a compact representation that contains everything that is important in order to present a business idea and that is not bloated by irrelevant information.

Founders should start working on their business model early, because it contributes plausibility to their project: there must be a believable and economic way to create the product and bring it to the market. For this reason, the rough draft of the business model is stage 1 of Steve Blank's Investment Readiness Level – it is the first stage of maturity of a startup.

Old and New Business Models

Most newly founded companies use standard business models; in this sense, all restaurants, lawyers' practices and advertising studios are identical. By contrast, startups often use innovative business models, which are also the basis for their success. Airbnb, for example, invented a business model that connects private home-owners and travelers in a new way.

> *A business model describes the rationale of how an organization creates, delivers and captures value.*
>
> Alexander Osterwalder

The Advantages of a Business Model

A business model is a description of a company that is restricted to the few elements concerned with value creation. It has several advantages for startup founders:

- It is compact. The business model can be drawn on a single page.
- Topics that are not relevant to designing the company are not included and therefore do not clutter it up.
- It provides a language for describing a company. This facilitates discussions about the planned company and makes it possible to understand other companies' strategies and possibly also to copy them.
- It helps all participants to gain the same view of their project.

- It facilitates comparisons with competitors.
- Investors are familiar with business models and insist on them. Nowadays, every business plan and every application for funding requires the inclusion of a business model.
- The individual elements can be considered and replaced separately. This makes it easier to adapt and optimize the model.

Typical Elements of a Business Model

There have been many different suggestions for representing a business model. They emphasize different aspects of a company depending on the situation. Some typical elements are:

- **Target Market**. The market or market segment for whom the offer is being developed.
- **Revenue Model**. How and for what does the customer pay? (For example, asset purchase or subscription).
- **Channels**. How the company reaches its target market, for example with advertising or customer support.
- **Customer Relationships**. The type of relationship that the company maintains with its customers, for example personal contact or newsletter.

- **Offer**. What the company provides (usually a product or a service).
- **Partners**. External partners who are needed in order make the offer available, for example advertising platforms or suppliers of unique components.
- **Positioning**. What distinguishes the company or its offer from the alternatives.

Only What is Essential

One important principle when developing a business model is to only include what is absolutely essential. As a matter of principle, only information is important in order to understand how the company plans to make its offer available and earn money. This principle means in particular:

- The model does not contain any quantitative information (for example Euro values in the costs), only qualitative information.
- Activities, costs etc. that do not contribute to value creation do not belong in the business model. Examples are bookkeeping and the CEO's company car.
- Only the resources and partners are relevant that contribute to delivering the offer to the market. (The office supplier, for example, has no explanatory power, even though the company will certainly need office material.)

The Business Model Canvas

There is one template for describing a model that is particularly popular and has become the *de facto* standard for startups. It was originated by Alexander Osterwalder and is called *Business Model Canvas (BMC)*.

Because of its popularity, the BMC is a good starting point for startups, because there are many examples and descriptions to be found on the Internet. Another advantage of the BMC is its simple graphical structure, which makes it good for displaying on the wall of the office.

Business Models and Business Plans

Business models and business plans are not the same thing. A business plan is a comprehensive representation of an entrepreneurial project that is used to make investment decisions. It is a substantial document – often 30 or more pages long – and it contains a business model as just one of many sections. The business plan contains a lot of information that is not appropriate for a business model, for example the structure of the planned company or a detailed financial plan. Business plans are only relevant to startups after they have validated their business model and are looking for investors to finance expansion.

Business plans can be dangerous for startups: they are often viewed as predictions of the future, even though they are based on untested assumptions. This can tempt the founders (and their investors) into slavishly following the plan – even if it has become clear in the meantime that reality is different. This is exactly the error that Lean Startup was designed to avoid.

> *Business plans are made for the kind of people who like sausages but don't know how they are made.*
>
> Yossi Vardi

Looking for Inspiration

It can be valuable to look to other companies to get inspiration for a business model, because an innovative business model can be the key to a startup's success. Some old-fashioned business models are inefficient or unattractive for the customer, so that a new, improved model can have a lot of potential. Here are three examples for modern elements of business model that can be transferred:

- **„Uberization"**. Instead of offering a service itself, a company creates a platform that brokers independent suppliers of that service. Examples: Airbnb, Uber.

- **X-as-a-Service**. Instead of selling a product ("X"), which the customer uses to perform a task, a service is offered that serves the same customer need. This makes ownership of the product unnecessary and eliminates all the associated disadvantages. Examples: Teilauto, Shapeways, Netflix.

- **Crowdsourcing**. Users supply free contributions such as product ideas, designs or media content, that the company otherwise would have had to generate or purchase itself. Examples: Kickstarter, Shapeways, Lego Ideas.

Comments on Business Models

The business model will change many times during the planning stage of the startup. Market research and customer interviews will uncover weaknesses in the original concept and with increased market knowledge, the founders will find better alternatives. Small changes to a business model are called *iterations*, whereas significant changes are known as *pivots*.

There are several evaluation criteria for business models. These can reveal both strengths and weaknesses. Founders should check the quality of their concept, once it has reached a relatively stable form.

If the startup has a multi-sided market, (for example, advertisers and users with Facebook), its business model must take both sides into account.

This Topic's Key Question

- *How can you build a successful company based on your idea?*

Link

- Topic 1.4 at founders-playbook.de:
  founders-playbook.de/plausibility/business-model/

