Business Models: Relevance to Startups

Abstract:
Startup businesses represent a wide range of risk factors. Typically, there are questions regarding technology and the ability to scale in an economic manner; likewise, there are often parallel questions regarding customer acceptance and growth. Failure in these endeavors revolves around the burn rate of cash associated with creating an elegant solution that is not attractive to potential customers. Addressing this issue requires an iterative process that focuses on generating alternative value propositions that can be reviewed with perspective customers. The objective becomes one of discovering a minimal design that is saleable to customers using a repeatable sales process. A template, referred to as the Business Model Canvas provides a tool that startups can use to generate ideas to test with potential customers. This white paper provides an overview of the template and its relevance to creating startup success.

Small Business Vs Entrepreneurship

From an econometric perspective, it may be very convenient to classify all companies of a certain size as a small business; however, when one considers the development of these businesses, this type of classification is inappropriate. From a development perspective, it is useful to consider a small business operator as a person who extends an existing value proposition within the marketplace. In contrast, an entrepreneur creates a new value proposition and introduces it into the marketplace. The two approaches represent vastly different risk profiles and therefore require a different development and management process/discipline.

Entrepreneurship and the Startup

For purposes of simplicity, assume that a startup implies a situation where there is inherent risk in the ability to scale a new technology and therefore at its inception the company has no customers. On the surface this may appear as a chicken/egg type of dilemma but in fact, it is a situation where rapid iterations become the order of the day.

If one wishes to conserve cash, the management of product risk and market risk need to be accomplished simultaneously. The objective is to discover a viable version of the value proposition that provides sustainable growth at a profitable level. It is an iterative process of configuring value propositions and testing them with potential customers. Inherent to this process is defining a version of the product that is scalable and saleable. This approach conserves cash while managing time to market. Many successful Internet startups have demonstrated the wisdom of this strategy.

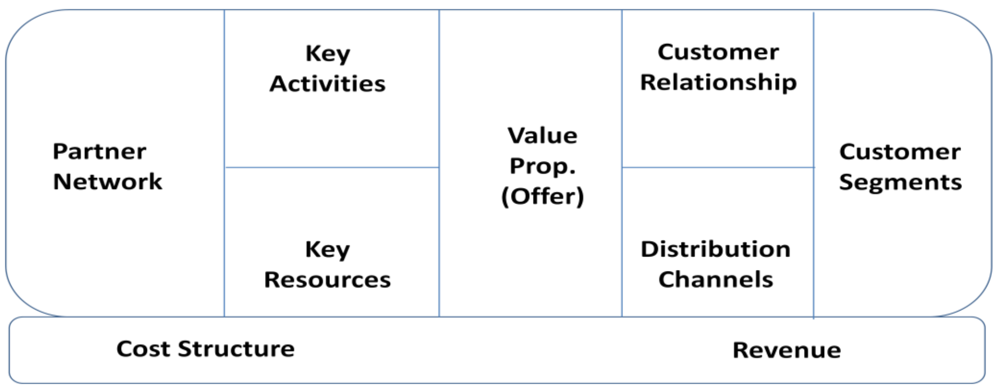
Large Company Tools Vs Startup Management

Management of large companies is based on efficient scaling of operations and control (predictability); whereas a startup is an exercise in managing risk. Large company disciplines such as functional hierarchies, operating reports, and even business plans tend to be impediments to the iterative tasks associated with establishing a viable value proposition. The operational mantra has to be to get out of the building and discover what customers want/need. This is one of the key reasons why large companies fail when attempting entrepreneurial initiatives.

The Startup's Friend: a Business Model

In its simplest form, a business model is a tool that visually presents the elements required to create value, deliver value, and capture value (profitability). In order to move from startup mode to viable business, the entrepreneurial team must establish a business model that is repeatable and sustainable at target levels of scale.

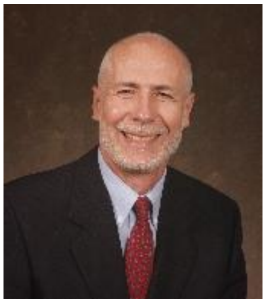
Ideally the model should be easily understood, rapid to configure, and adaptable to group input. Fortunately, such a model exists. It is called the Business Model Canvas and it was developed by Alexander Osterwald. The elements of the model are outlined below:



Most startups are created with some combination of product/service in mind. If the product is scaleable, the challenge is targeting the right customers. In this situation, the startup team is challenged to identify potential target segments and define what problem they are solving and how to present it to prospective customers. Once defined, the team can test the approach with members of that segment and assess the response including pricing considerations. If the reaction is tepid, alternative segments or value propositions can be tested. Once a viable segment definition and value proposition have been established, the team can move on to considerations such as delivery channel etc.

If there are risks regarding scaling the product, the process regarding the business model continues to be iterative one, but the focus must shift to identifying the least complex configuration that is saleable to target customers. Once determined, the team can move forward with a clear direction.

Startup failure is often associated with a team that believes it knows what customers want without this value validation process and proceeds with certainty. The result is too often an unacceptable burn rate and mediocre sales response. A startup is iterative in nature until a repeatable and sustainable sales process can be demonstrated. The Business Model Canvas fits this need perfectly because it can be created quickly and lends itself to group input which keeps everyone involved and up to date.



About The Author

Glen S. Petersen is an internationally recognized speaker, writer, practitioner, and thought leader. Mr. Petersen has held senior level management positions with systems integration and end user organizations and is the Managing Director of GSP & Associates LLC, a consulting firm dedicated to helping organizations leverage their competitive capabilities.

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