A Word of Caution

• If you are fundamentally in a lousy business, you will not get very far irrespective of the efforts and the talent.

• No matter how talented you are and how much capital you have, if you have not given your idea a rigorous, critical examination before starting out, you could be heading for a disaster.

• When you buy a car, you take it for a test ride. Why not do the same for your idea?

Some Interesting Statistics…

• Most businesses fail in less than two years

• Fewer than one percent of the business plans submitted to VCs get funded

• Business failures lead to huge “collateral damages”

• Failures are planned by lack of planning

Top Level Issues

• Are both market and industry attractive?

• Does the opportunity offer compelling customer benefits as well as sustainable advantage over other solutions to the customer needs?

• Can the team deliver the results they seek and promise to others?

Important Insights …

• Markets and industries are not the same things

• A Market consists of a group of current and/or potential customers having a willingness and ability to buy products (goods and services) to satisfy a particular class of wants and needs

• A market is a set of buyers (individuals, firms) and their needs. Not to be confused with products

• Example: Businesspeople who get hungry between meals during the workday – market for workplace snacks
Important Insights …

• An Industry consists of sellers – typically organizations – that offer a product or a class of products that are similar and close substitutes

• Example for workplace snack industry – producer level (salty snacks such as chips, candy, fresh fruits) or distribution level (coin vending machine, coffee bars, take-away joints)

Important Insights …

• “Space” or “Sector” are dubious words – they confuse market and industry (Internet space, biotech space)

• Judgments about attractiveness of the market one proposes to serve are very different from attractiveness of the industry in which one plans to compete

• Both micro and macro level considerations are important – markets and industries must be examined at both levels

• Keys to evaluating entrepreneurs or entrepreneurial teams are not simply found in their resumes or in their entrepreneurial character

What are these Seven Domains?

• Market domain – macro level

• Market domain – micro level

• Industry domain – macro level

• Industry domain – micro level

• Team domain – aspirations

• Team domain – execution capability

• Team domain – connections or networks

Seven Domains

• Seven domains are not equally important

• A simple scoring sheet will not work

• Wrong combination of domains can kill a venture

• Sufficient strength in some domains can mitigate weaknesses in others – good opportunities can be found in not-so-attractive markets and industries

Market Analysis – Macro Level

• Overall market – size (number of customers, aggregate money spent, number of usage occasions) (Secondary data from trade publications, business press)

• Where is the market on the “S curve” – is it nascent, growing or saturating (infer from historical data)

• Trends in broad categories – demographic, socio-cultural, economic, technological, regulatory

• Miller Light Beer, 1975 – Baby boomer, health consciousness

• Hero Cycles, 1983 – Population growth and distribution, fuel efficiency, pollution norms, four stroke engines (Fill it, shut it, forget it)

Market Analysis – Micro Level

• Target segment benefits and attractiveness – customers buy benefits, not products or features.

• Large market of entertainment – audio – MP3 players, MP3 players in cars, home systems, memory sticks

• How large is the segment and how fast it is growing – combination of primary and secondary data

• Who you would like to be your FIRST customer – can you name him

• Clearly differentiated solution with value delivery unambiguously stated

• Does an entry in a segment facilitate lateral entry in other segments – Nike Shoes
Industry Analysis – Macro Level

- Standard Industry Classification (SIC codes) – retailing, food, software, logistics …
- Positioning is not obvious (MP3 player makers – electronics or entertainment) – narrow industry definition ignores substitutes
- Suppliers, Buyers, Incumbents, New Entrants, Substitutes
- Competitive rivalry, threat of entry and substitutes, bargaining power of buyers and suppliers
- Which of these forces are favourable and unfavourable (SWOT analysis)

Industry Analysis – Macro Level

- Is it an attractive industry – certain industries are perpetually sick and others are cyclical
- Does the industry as a whole have entry barriers, economies of scale, technology lock-ins
- Every time an industry doubles its size, a new structure for it emerges – consolidation or disaggregation (hospital – basic and support services)

Industry Analysis – Micro Level

- Sustainable competitive advantage – How long will your edge last?
- IP Protection – patents, copyright, trade secrets
- Superior organizational processes that are difficult to replicate
- Economically viable business model – availability of finance for long term and working capital, contract enforcement and revenue collection cycles

eBay: Economic Viability

- Revenues in relation to cost: Plenty; customers are happy to pay transaction fees and investment is modest
- Customer acquisition and retention cost: almost zero, customers come by a word of mouth, no shortage of people having items to sell
- Gross Margin: High, no cost of goods sold
- Operating cash cycle: Sellers pay for listing in advance, no receivables to collect, no inventory

Team Analysis

- Financers give as much importance to team as ideas.
- Accepted wisdom – Ideas come dime a dozen, who will execute?
- Aspirations, motivation and propensity for risk taking
- Ability to execute on critical success factors (CSFs) – unique to each industry market segment – better, cheaper, faster
- Connectedness up, down and across the value chain – ability to move from Plan A to Plan B, identification of the CSFs of the industry

Choosing the Right Business Model

- What is a business model?
- Model of a business
- Mathematical Equations
- Block Diagrams
- Excel Spreadsheet
Confusion about the Concept of a Business Model

• Revenue model
• Distribution model
• Alliance and partnership model
• Payment collection model
• Profit-sharing model
• Cobranding model

Crux of a Business Model

• Find a large number of people who have a lot of money in their pockets
• Find ways to transfer that money from their pockets to your pocket
• Ethically!

Purpose of a Business Model

• What if analysis
• Trade-offs and decisions
• Comparison of multiple strategies
• Growth and profitability in quantitative terms
• EVA – Economic Value Added estimation

Business Model Details

• Projected (Pro forma) Profit and Loss Statement
• Ideally project for three years (why three years?)
• Product portfolio and market share for each product, price points at which products, services, solutions are sold
• Revenue model – revenues in relation to capital investment required and margins obtainable

Business Model Details

• Customer acquisition and retention costs and the time it will take to obtain customers (sales lead time)
• Gross margins and their adequacy to cover operating costs – balance between fixed and variable costs
• Operating cash cycle characteristics – how much cash must be tied up in the working capital such as inventory (work-in-progress and finished goods)
• Customer and supplier payment and credit terms
• There are industry norms on most of these numbers

Business Model Creation

• Make reasonable guesses
• Compare with other companies in the same industry
• Correct for the scale of operation and history
• Worry about other start-ups and unlisted companies (companies in the stealth mode)
• Beware of the manipulated financial statements
• Get an industry veteran on board – first-hand experience in the industry makes all the difference
Business Model Choices

- Original Equipment Manufacturer (OEM)
- Original Equipment Designer (OED)
- Contract Research Organization
- Outsourcing
- Own IP through in-house development
- License core IP and wrap bells and whistles around it (royalty based)
- System Integrator
- Value-Added Reseller