

The Business Model: A Primer

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Best Practice Series

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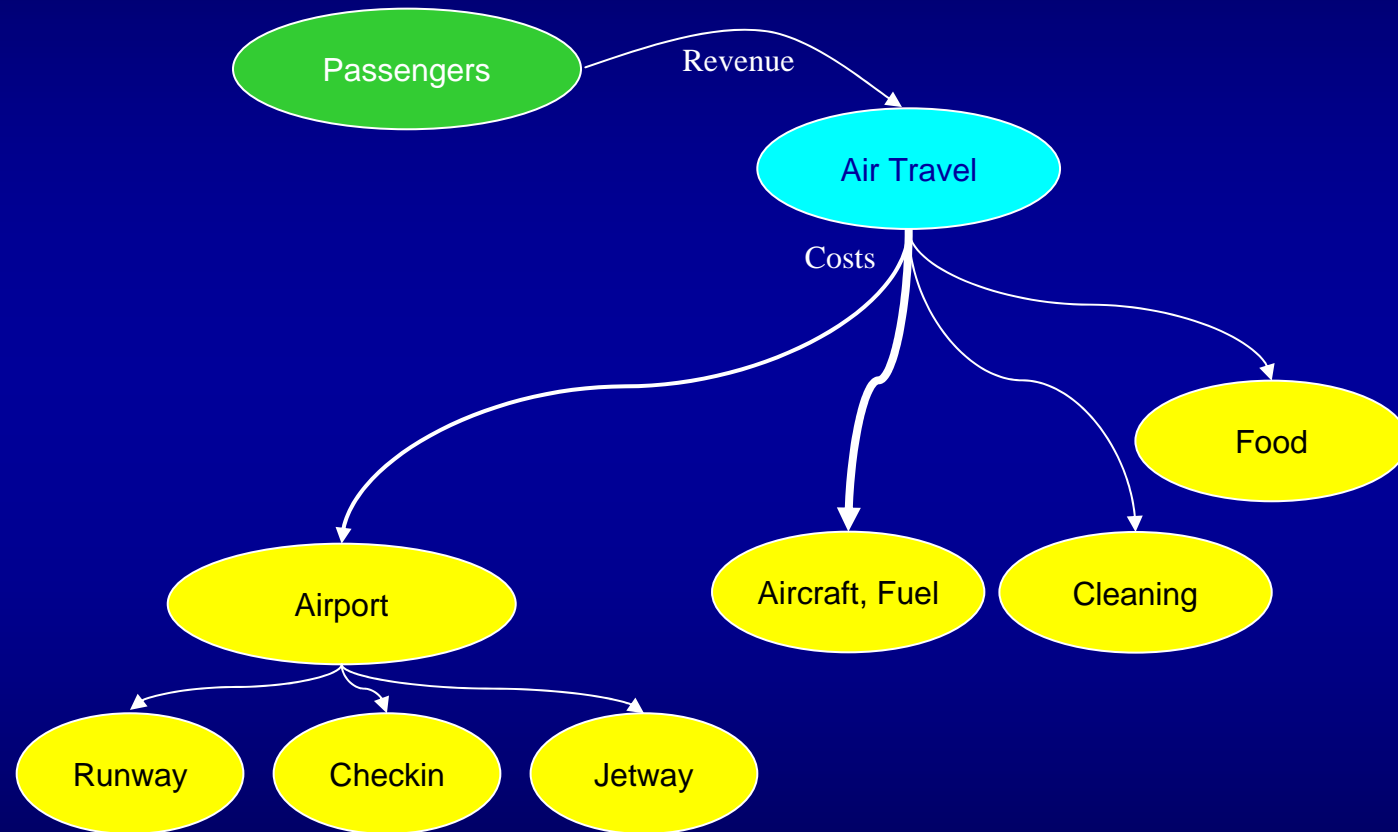
Which would you rather have?

- A great technology?
- A great business model?

Business model > technology

- Microsoft
- iPod
- Dell

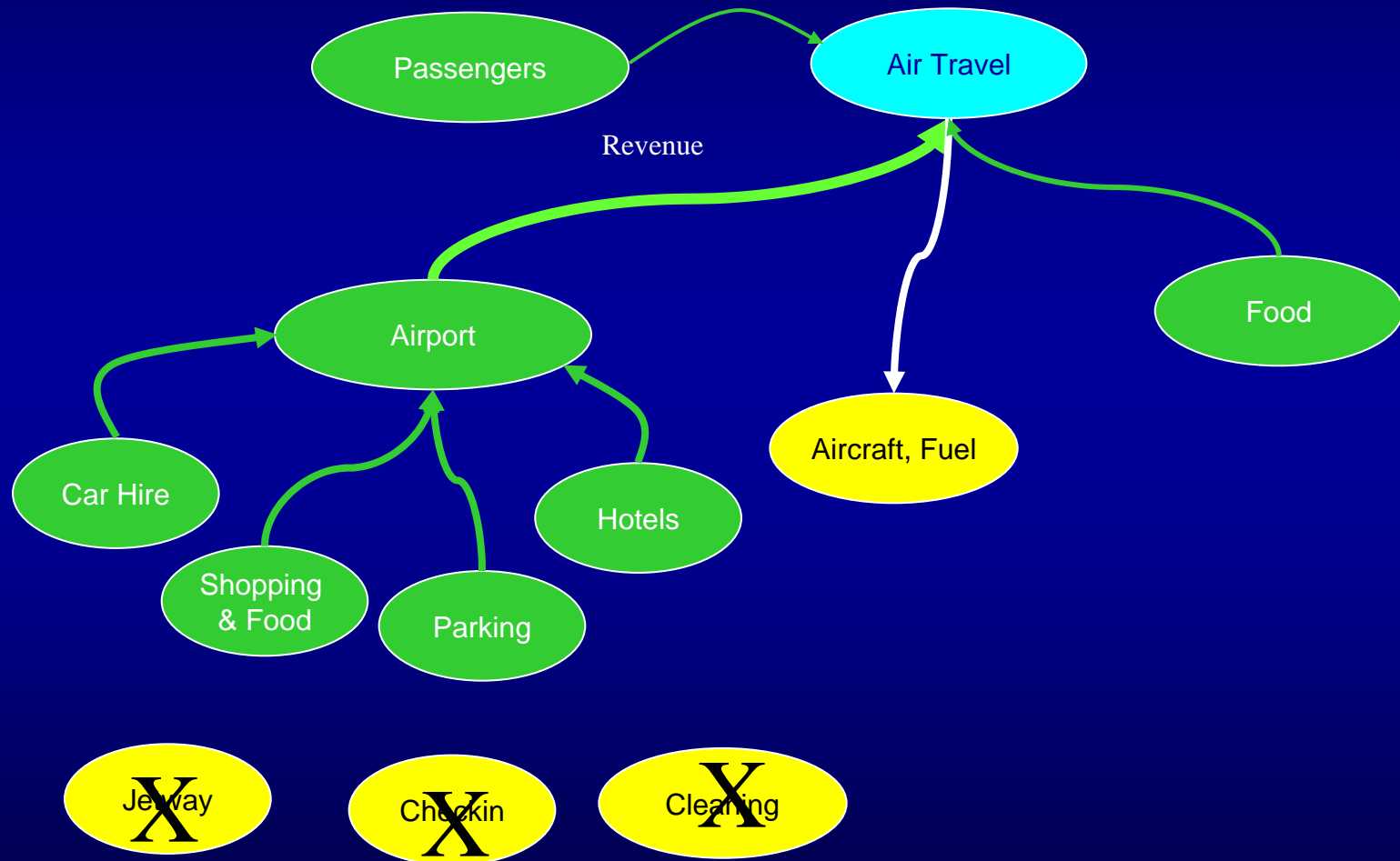
Graphic Illustration of a Generic Airline Business Model



Ryan Air

- Ryan Air is a regional low-fare airline operating in the United Kingdom and northern Europe.
 - Only flies into regional airports, no landing fees.
 - Guarantees airport certain # passengers in their terminal
 - Airport pays Ryan Air to operate out of its airport
 - Airport provides Ryan Air a percentage of the revenues from shops, restaurants, car hire and hotels at airport.

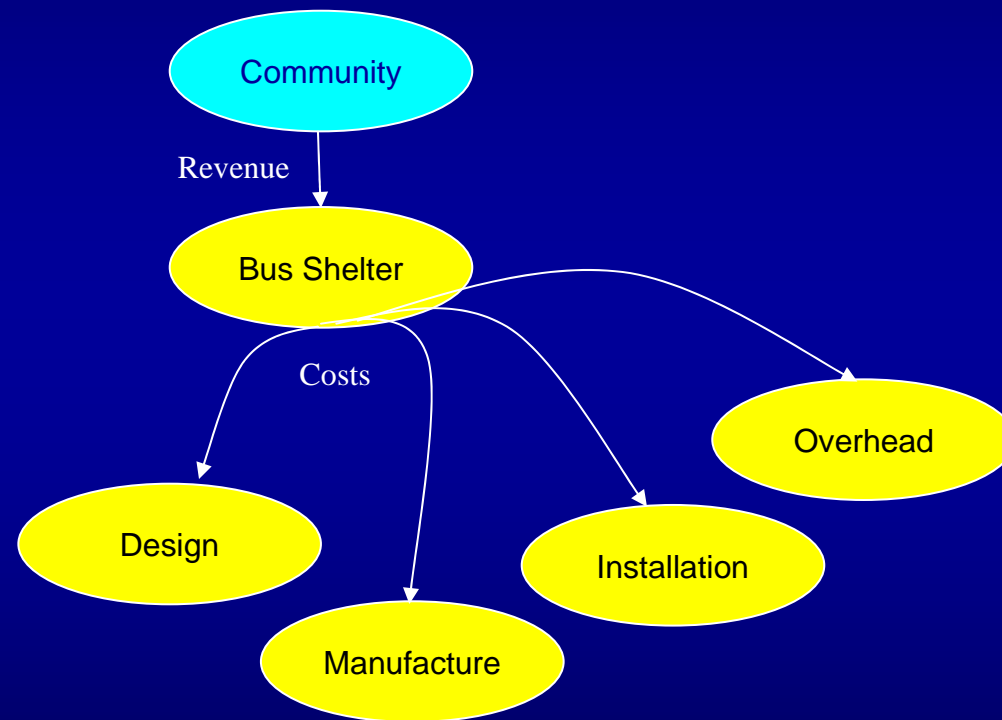
The Ryan Air Business Model



Bus Shelters

- In the 1980's, a manufacturing company made and sold bus shelters to communities in the United Kingdom
 - Their bus shelters were high quality
 - Their pricing was considered reasonable
 - They had a virtual monopoly on the bus shelter market

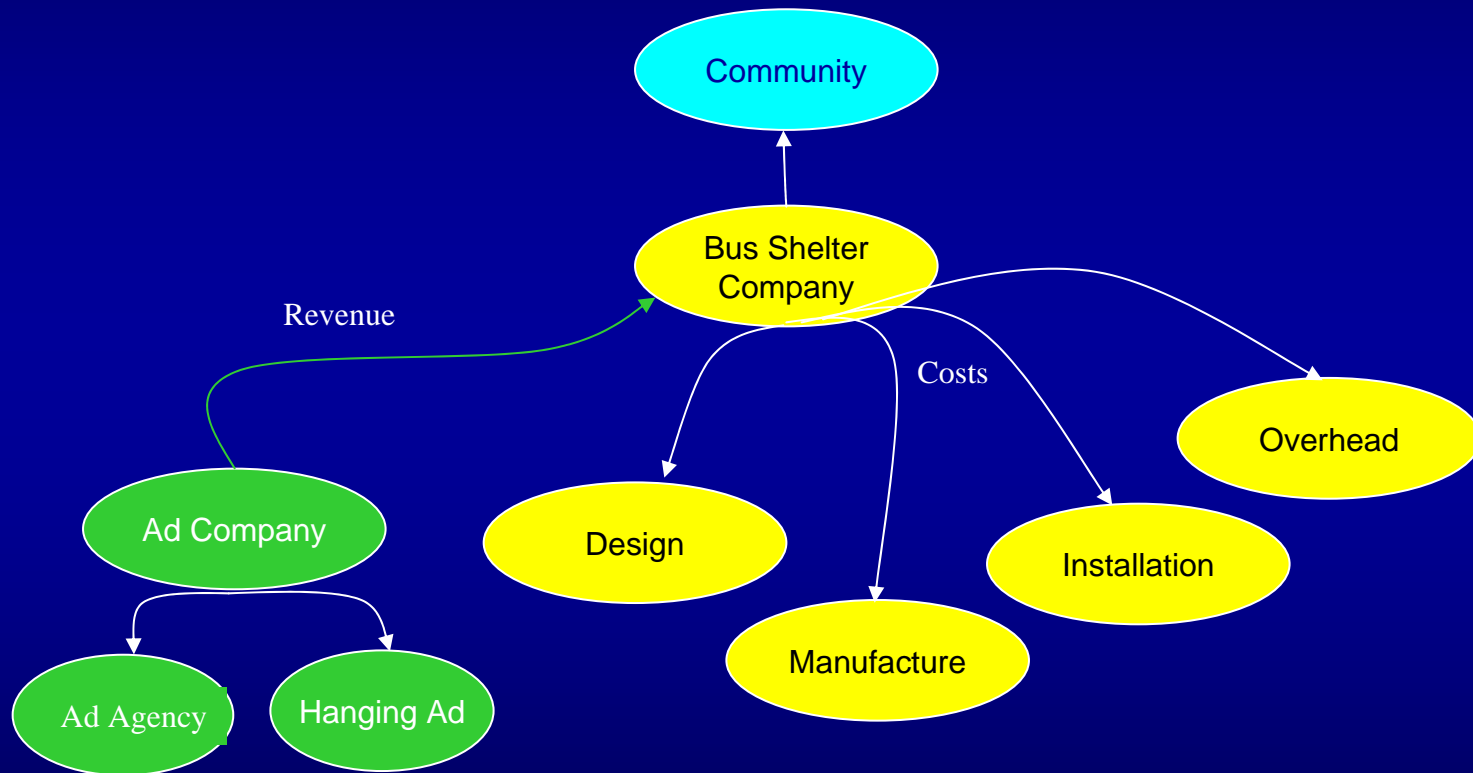
Graphic of a Bus Shelter Co. Business Model



Adshel's business model

- Within a few years, Adshel came into the market, and drove the existing firm out of business
 - Adshel's bus shelters were of no better quality
 - But their business model was entirely different
- **They provided the bus shelters to communities FOR FREE**
 - They charged advertisers for wall space on the shelters

Graphic of Adshel Business Model



What is a business model?

The Business Model

- Identifies a **market segment**
- Articulates the **value of the proposed offering**
- Focuses on the **key attributes of the offering**
- Defines the **value chain** to deliver that offering
- Creates **a way for getting paid**
- **Establishes the value network** needed to sustain the model

Sample Business Model

Revenue Mechanisms

- Per item and “all you can eat”
- Razor and razor blade
- Free trial, follow on subscription (esp. for experience goods)
- Free, with paid advertising (e.g., bus shelters)
- Recruit your friends, and save money
- Market maker/aggregator/switchboard (tolltaker)
- Turn cost centers into profit centers
 - Airport landing fees (Ryanair)
 - Hotel room: TV, phone, robes

A Classic Example: the Xerox 914 copier

- Chester Carlson develops electrostatic method to place toner on paper, a “dry” process for copying documents
- in 1955, existing processes (wet or thermal) used to make **15-20 copies per day**. Machines cost ~ \$300.
- Joe Wilson estimates **cost of building dry process copiers at ~\$2000**
- Wilson seeks manufacturing and distribution partners
 - IBM, Kodak, GE
- IBM engages ADL to study: “Although it may be admirably suited for a few specialized copying applications, **the Model 914 has no future** in the office-copying-equipment market.”

Wilson's Business Model

- ADL's study (and the other companies) viewed the dry process technology **through a traditional business model**
 - charge for the equipment (dry technology very high cost)
 - charge for the supplies as needed (no savings vs. wet)
- Joe Wilson ignored these rejections, and took the technology to market through a new Business Model
 - **\$95/ month** for first 2000 copies, **4 cents each for additional**
 - Low barrier for customer trial, **Haloid/Xerox bore the risk**
 - Enormous usage: **2000 copies per day**
 - Revenues grow **41% compounded** for next 20 years

Xerox's experience with spin-offs

- 2 year field study at Xerox
- 35 companies that commercialized Xerox technology outside the firm
- Criteria for inclusion:
 - technology originated/fermented in Xerox for at least one year
 - at least one Xerox researcher went out with the technology
 - the technology was subsequently commercialized in a separate legal entity

Adobe

- Warnock and Geschke at PARC
 - creating fonts for Star Workstation
 - wanted to make into a standard
 - Xerox said no: “how can we make money if we give it away?”
- They leave, and form Adobe
- Initial plan: turnkey publishing system, complete with own hardware, software, and fonts

“We were originally going to supply a turnkey systems solution including hardware, printers, software, etc.

“Steve Jobs and Gordon Bell were key ingredients in getting things going...

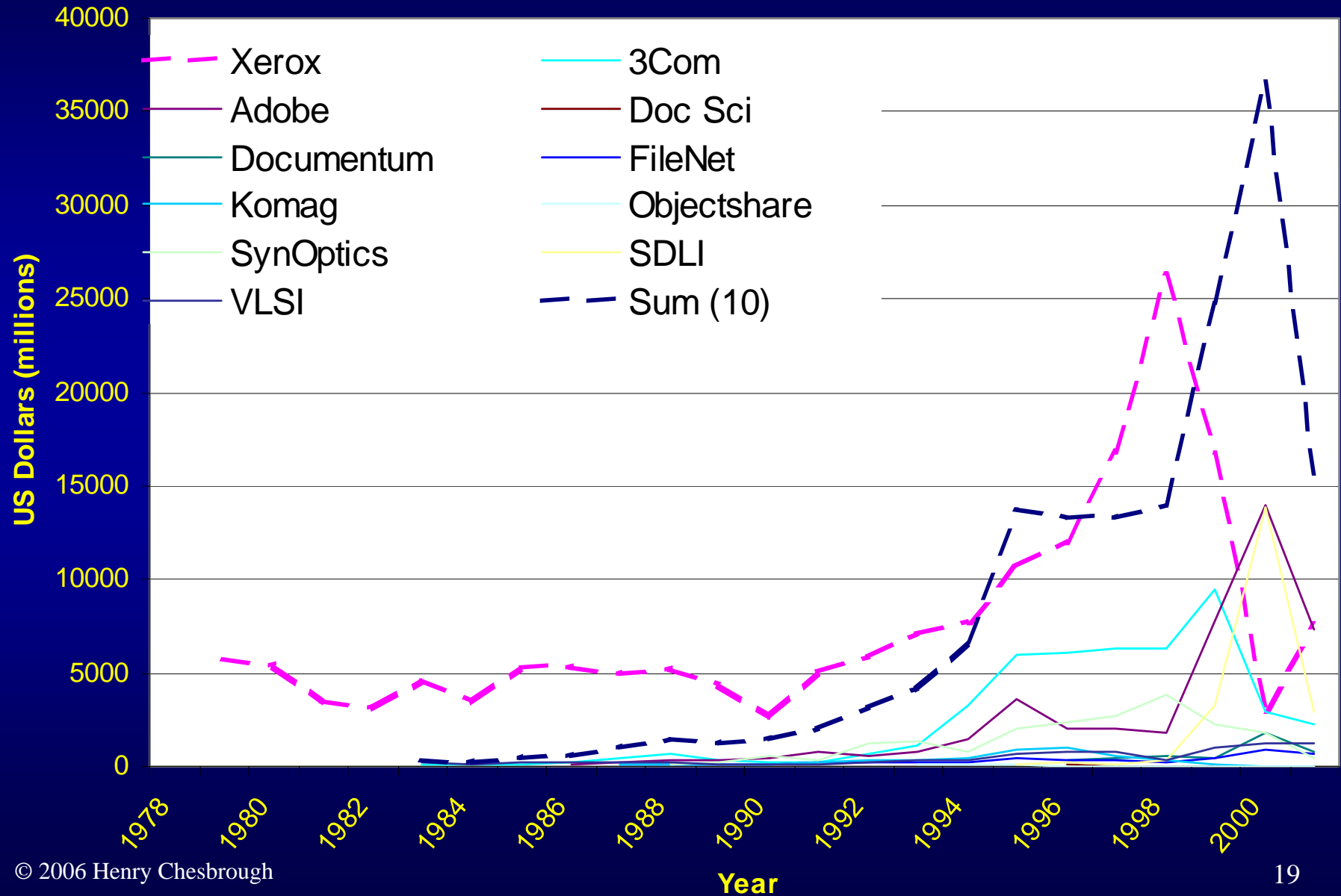
Gordon said, “don’t do the whole system”

Steve said, “just sell us the software”.

That’s how the business plan formed. It wasn’t there in the beginning.”

- Charles Geschke

Xerox: Great at Chess, Lousy at Poker



All Business Models are not Created Equal

- What makes one business model better than another?

Business Model Maturity Stages

6 stages

1. Undifferentiated business model
2. Differentiated business model
3. Segmented business model
4. Externally aware business model
5. Integrated business model
6. Platform leadership business model

Business Model Maturity Stages

6 stages

closed
↓
open

1. Undifferentiated business model
2. Differentiated business model
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5. Integrated business model
6. Platform leadership business model

Stage 1-Undifferentiated

- Commodity
- No differentiation
- Hard work, hustle, luck
- Can't attract capital, can't scale

- Example: most restaurants

Stage 2-Differentiated

- Performance advantage
 - Ad hoc processes
 - Hard to sustain
 - “one hit wonders”
-
- Example: most technology startups

Stage 3 - Segmented

- Can serve multiple segments
- More profit, more volume (low cost)
- More sustainable
- Still too internally focused

- Example: many industrial firms; Xerox

Stage 4 – Externally Aware

- Now harnesses external sources of technology to complement internal
- More “at bats” with same dollars
- Share risks as well as rewards
- Broader market now available to serve

- Example: SAP R/3; Big Pharma

Stage 5 - Integrated

- External sources routinely utilized to fuel your business model
- Unused internal ideas allowed to flow outside to others' business models
- Company becomes a systems integrator of internal and external technologies
- Examples: Millennium, other biotechs; IBM Global Services

Stage 6 - Platform

- Penultimate stage, an ideal
- Company now benefits from investment of others in the platform. Company can induce investment.
 - Suppliers, customers, third parties
- Ecosystem created
 - Company must balance value creation with value capture
 - Cannot become predatory, destroys ecosystem
- Examples: iPod; .NET, WebSphere, Dell, WalMart

How to use a Business Model

- How to pitch your own business to investors
- Understanding customers: what is their business model?
 - How do they make their money (biz model)
 - Segmentation: not all customers are created equal
 - Study the customer's customer
 - One customer < Many customers (leverage)
- Understanding suppliers
 - Ditto
- Understanding competitors

FOREWORD BY JOHN SEELY BROWN

HENRY CHESBROUGH

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