Designing a New Business Model

Finding an Ordered Structure to Unlock Creativity

Excerpted from

Seizing the White Space:
Business Model Innovation for Growth and Renewal

By

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Designing a New Business Model

*First comes thought; then organization of that thought, into ideas and plans; then transformation of those plans into reality. The beginning, as you will observe, is in your imagination.*

—Napoleon Hill

Ratan Tata looks out over a road in New Delhi and conceives of a car that can compete with scooters. Marco Meyrat comes up with a brilliant plan to transform Hilti’s tools from a commoditizing product into a high-end service. Hindustan Unilever creates thousands of new hair-care customers by radically reconceiving the nature of distribution. Dow Corning’s Don Sheets envisions a new way to capture the low end of the silicone market. All of these inspiring stories can be downright depressing. No one wants to depend on something as fickle as inspiration to create a new business.
BUSINESS MODEL INNOVATION AS A REPEATABLE PROCESS

No one should have to. Conceiving of a truly innovative new business model does not need to be purely (or even mostly) a matter of imagination, inspiration, serendipity, or luck. It can be an orderly process that, like Stanislavsky’s acting exercise, uses structure to unlock creativity, rather than the other way around.

At its heart, the four-box business model is a framework for generating the right questions and assumptions, for organizing and categorizing them in a constructive way, and for implementing, testing, and learning about them in the right order. As we walk through jobs, customer value propositions, profit formulas, and key resources and processes in detail in this chapter and the next, keep in mind that business model innovation is an iterative journey. You may need to move back and forth between the boxes before you come up with the right design that makes all four components work together correctly.

It bears repeating that my point here is about new business model creation, not extensions of your current model, or a competitor’s, or what everybody else in the industry is doing, as comforting as those approaches always are. This is about the pursuit of game-changing, transformative new growth opportunities, and that pursuit starts with finding important, unfulfilled jobs, the first challenge in seizing your white space with business model innovation. This is hard because it often requires looking at your market in a new way.

Nothing is more natural, or more difficult to stop doing, than thinking about the market from the inside out—that is, from the perspective of your own company and your existing products and services. But abandoning the inside-out viewpoint is exactly what you need to do. Remember, we’re talking about unmet jobs, which by definition are those your company is not filling, perhaps to customers it’s not serving. You must give up any conviction you may hold that after successfully delivering your products or services to your existing customers for so long a time you necessarily know all their unmet jobs. Essentially, you should be thinking not
like a corporate executive but like an entrepreneur, as if you had not yet sold anything to anyone.

So let’s start at the beginning, with the search for an important job a real customer needs to do. I’m sure lots of people have already admonished you to be customer-centric. But what does that really mean?

**DISCOVERING THE CUSTOMER’S JOBS**

To explain, let’s consider a case study. A dental device company I’ll call DentCo had carved out a profitable niche with a disruptive technology that broke the skills barrier to consumption. The product allowed general-practice dentists to perform a tooth-straightening procedure that once only orthodontic specialists could do. When competitors started offering similar products at much lower prices, DentCo faced a choice: It could engage in a price war that would devalue the entire market, or it could find another way to counter the opposition. DentCo turned to its customers to figure out its next step.

Most companies in DentCo’s situation would begin their market analysis by asking the dental practitioner (either directly or through a market study): “What attributes do you seek in a dental product?” This is called the *needs-based* or *voice-of-the-customer* approach. This seems like a sensible way to be customer-centric but it’s really not, for two reasons. First, asking customers what they need from your products tends to elicit predictable answers that relate to your products, such as “less expensive,” “less invasive,” “easier to use,” or “more features.” Second, a needs-based approach typically segments the target market according to attributes like product features or demographics that don’t necessarily align with jobs customers might need to do. That approach either lumps together individuals who want different jobs to be done or, more rarely, separates groups that actually need the same
job done. When DentCo originally defined its market segments demographically as general practitioners and orthodontists, it created such “phantom market segments.”

Not surprisingly, companies like this approach. It’s relatively easy to collect data on products and demographic segments, and needs-based questions reinforce what incumbents do best—create sustaining product innovations (like dental products with more bells and whistles, in DentCo’s case). If DentCo sets out to meet the “needs” of these phantom segments, it will continue to push its current products and start a price-and-features war with its competitors.

I believe needs-based analysis is the wrong approach to conceiving of transformative, growth-generating customer value propositions. To become truly customer-centric, you must stop asking your customers “What do you need?” and start asking them “What are you trying to get done?” This is the question that will set you down the road to a jobs-based approach.

When DentCo asks dentists and orthodontists what they are trying to get done during the course of their workday, that question yields a very different set of market segments and some real answers. To start, DentCo realizes that all of its customers want to build a successful practice. That may sound obvious, but it upends phantom segment thinking. It’s an important indication that instead of being rigidly separated by specialty all dental practitioners have much in common. As DentCo digs deeper in asking jobs-based questions, it learns what building a successful practice truly means: offering patients the most current care, managing a successful business, and establishing a reputation. Through the course of asking what gets in the way of accomplishing these jobs, DentCo identifies the major barrier to consumption of existing solutions for these jobs: time. New products and procedures that would fulfill the job of building a successful practice require new skills and time to train staff members. And to dentists and
orthodontists, time is money, since they are typically paid by procedure, no matter how long it takes.

Now DentCo possesses a truly constructive understanding of its market: What it needs is a value proposition that centers on convenience, one that can help dentists and orthodontists deliver the most current level of care to their patients while minimizing the time required to adopt new technologies. Armed with this customer insight, DentCo can avoid a ruinous price war with competitors. Instead of adding more features and functions to its products, DentCo can develop a suite of value-added offerings that satisfies the true job-to-be-done for the large general market of all dental practitioners. That could include a time-saving expert clinical support hotline, an online forum for sharing best practices, and a staff-training program, all in customizable product bundles. Employing the four-box framework, DentCo can now begin to determine whether it can deliver these new services and capabilities with its current business model or if it needs to create a new one to capture this opportunity.

Focusing on the job-to-be-done gets at the real root of consumer decision making. In his book *The Innovator’s Solution*, Clayton Christensen aptly illustrates the concept with the example of a fast-food company trying to improve sales of its milkshakes. Initially, its marketers did exactly what they shouldn’t have done—defined the market in terms of its product (milkshakes) and then segmented it further by profiling the demographic characteristics and personalities of the customers who frequently bought them. The marketers then invited representatives from these phantom segments in for a focus group, further intensifying their inside-out orientation by asking the group to evaluate the existing product and—even worse—supplying categories of answers by inquiring whether it should be thicker or more chocolatey or cheaper or chunkier. Participants gave clear answers, and the company made changes accordingly.
After the corresponding improvements failed to increase sales, though, the company brought in a new researcher. He made no assumptions about customer segments and didn’t ask anyone for suggestions about improving the current product. Instead, he spent a long day watching people in one of the restaurants to see what they were trying to get done when they “hired” a milkshake. He noted what time it was when each milkshake was bought, which other products were bought with it, who was with the customers when they made their purchases, and whether people drank the shakes on the premises or sped off in their cars before downing them.

Seen from the job-to-be-done perspective, it turned out purchasers hire milkshakes to fulfill two distinct jobs, and the primary user in both cases is the same person—a working father. In the morning, Dad is rushing to get to work and doesn’t have time to eat breakfast before he hits the road for his long daily commute. But in the afternoon or the evening, Dad takes the kids out for a fast-food dinner and wants to reward them for good behavior with a milkshake after their meal (as we all know, the official Rule Book of Kids says that the most important thing in the world is a treat at the end of the day).

These two distinct jobs dictate two different solutions. In the morning, Dad is using the milkshake to overcome his hunger and, as an experience, to alleviate some of the boredom of his tedious commute. He wants the shake to fill time as well as his belly, so he prefers it to be highly viscous, and perhaps have chunks of fruit to make it and the drive more interesting. In the evening, Dad wants the kids to hurry up, so he prefers a less viscous and fruit-free product that they can slurp up pretty quickly. None of that information could ever be obtained by asking people how they liked the milkshake, no matter how marketers sliced and diced the segments, since the same person needed two different jobs done.
Ideally, maintaining a focus on the jobs customers need done is not something you hire a marketer to do when your sales start flagging. That knowledge should spring from paying close attention in a more ongoing and systematic way to the jobs your customers are having trouble fulfilling. Hilti, for example, would never have spotted its opportunity to escape commoditization in the tool market if it had not already been in constant touch with customers through regular surveys, both formal and informal, that asked not only about product performance but also about worksite needs and desires. Hilti also sends videographers and observers to worksites to watch how its customers use its products and conduct their daily tasks. Had the company simply asked customers what they wanted or needed from its tools, it would probably have gotten various replies like “more reliable tools” or “cheaper tools.”

A jobs-based approach applies as much to business-to-business companies and to multistakeholder situations as it does to direct consumers. DentCo could, for instance, build an even stronger offering, and eventually a more robust business model, by deeply considering the jobs of the patient, third-party payers, and regulators—all of whom share a common interest in the jobs-to-be-done of the practitioner—and then building an offering that accounts for various jobs.

**SATISFYING EMOTIONAL AND SOCIAL JOBS**

It’s critical when searching for unfilled jobs-to-be-done to realize that you must think not only about the *functional* aspects of a job but also about its *social* and *emotional* aspects—which together make up the experience that customers desire in accomplishing the job. Hindustan Unilever, for instance, realized that the Shakti Ammas would be more successful if they were able to deliver
something more valuable to village life than branded products. So as the initiative went forward, the company found it could help boost their social standing by reinforcing the illness-prevention aspects of personal hygiene. This made the women more than salespeople; they became purveyors of important social benefits.

Shai Agassi realized early on in the development of the value proposition for Better Place that no matter how much people wanted to be environmentally conscious, they were not willing to give up their emotional relationship with their cars to do so. You couldn’t, say, ask them to drive a three-wheeled plastic electric cycle just to save gas; they wouldn’t buy something they didn’t feel was socially acceptable. They were also range-anxious, meaning that although most people drove less than twenty miles a day, they were generally uncomfortable buying a car that clocks fewer than three hundred miles before needing to be refueled. Better Place developed its business model to explicitly address these respective social and emotional aspects of the job-to-be-done.

These jobs are less tangible and thus harder to pin down, yet they remain important, and sometimes critical, considerations in the development of a new business model. In fashion, for example, social and emotional jobs dominate customer-purchasing decisions. The job of fashion is to “Help me feel good about the way I look.” It has functional aspects—“Provide something appropriate to my body type, in colors that match my complexion”—but far more significant social and emotional ones—“Help me fit in, look current, attract a mate, feel confident and sexy, and impress others.” By focusing on these aspects of his customers’ job-to-be-done, Spaniard Amancio Ortega transformed the business model of his retail chain, Zara, and created what Louis Vuitton fashion director Daniel Piette called “possibly the most innovative and devastating retailer in the world.”

In the 1980s, mass media exposed consumers around the world to diverse ways of dressing, and tastes changed rapidly. A new
video from a trendsetter like pop star Madonna or rock band Duran Duran, for instance, could be seen everywhere in days, igniting a fashion craze that might last a summer or a year—no one could predict. At the same time, however, the fashion industry itself was slowing down. Globalization began to open access to new markets of cheap labor. To be more profitable, most fashion houses disaggregated internal functions like design and marketing from fabric sourcing, manufacturing, and finishing. Since each step in the value chain required additional time to coordinate, designers found themselves having to finalize looks up to a year in advance of the selling season. So while customers were demanding faster and fresher fashions, designers were pushing last year’s looks.

Recognizing this dynamic, Ortega envisioned a new type of company, one that addressed the important social jobs by creating “instant fashions”: clothes that could be designed and brought to market as fast as demand arose.7

Zara needed to fundamentally redesign its key resources and processes—and integrate them in an entirely different way—to deliver its new customer value proposition. It employed advanced automated systems to tightly integrate its retail, inventory, and design processes. It built a state-of-the-art communications system that turned store managers into trend spotters and linked them to in-house designers. It assembled most of its clothes locally and built a just-in-time shipping system capable of delivering goods to every store twice a week. Zara used the best technology of the day to build an integrated supply chain that could produce garments virtually on demand and ship only the number of items required. With this efficient and responsive operation, Zara could deliver new fashions to market not fifteen months after they were designed, or even fifteen weeks, but in as little as fifteen days.8

Guided by the social and emotional aspects of its customers’ job-to-be-done, Zara reshaped virtually every part of its business
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model and became a leading global fashion business. It grew spectacularly by adopting an outside-in approach that better served its market, delivering a level of customization and freshness never before seen in the industry. And it did so largely before the information revolution and the Internet made customer-centricity a much easier approach.

THE INTERNET AND CUSTOMER CENTRICITY

The Internet—and Web 2.0 tools in particular—now give businesses an unprecedented ability to deeply understand their customers. Companies can now connect directly with customers and potential markets to learn highly specific information about them, abrogating the need to rely on phantom segments, trend spotters, or needs-based analysis. More important, customers can connect with companies to demand what they want.

Rising apparel maker Threadless built a unique business model to exploit this new reality using social networking technology to sell T-shirts entirely designed by its customers. Threadless accepts design submissions on its Web site from its rapidly growing community of amateur designers and young trendsetters and lets them vote on the products they want to buy. It can then manufacture popular designs within hours using mass-customization technology, fulfilling the job of keeping its customers’ fashions up to the minute through the efficiency of a just-in-time supply chain.9

By giving the customer direct control of the company’s product design, Threadless has built a thriving community of consumers who feel an ownership stake in its brand. Producing a predetermined demand keeps costs low and margins above 30 percent. And because community members tell it precisely which shirts to make, Threadless never has a flop; every product eventually sells out. “Threadless completely blurs that line of who is a
producer and who is a consumer,” Harvard Business School pro-

fessor Karim Lakhani told Inc. magazine. “The customers end up
playing a critical role across all its operations: idea generation,
marketing, sales forecasting. All that has been distributed.”

The Threadless model illustrates the power of the customer in
a networked world. Success now more than ever flows from the
outside in, from the market to the company. Incumbents there-
fore need to think creatively about how they can cultivate discern-
ing insights into the full range of functional, social, and emotional
customer jobs-to-be-done.

**DESIGNING THE NEW CVP**

Having identified an important job-to-be-done for a customer,
you need to create a blueprint of the business model that will sat-
ify it. Designing a new model begins, of course, with the cus-
tomer value proposition—the offering that addresses the job at a
prescribed price. As you may recall from chapter 2, a comprehen-
sive customer value proposition combines in an offering not only
what is sold (product and/or service) but how it is sold. That
includes the ways in which a product or service is made available
(access) and the ways the customer can pay for it (the payment
scheme). And also remember, the more important the job, the
better the match between the offering and this job, and (usually)
the lower the price of the offering, the greater the overall value
generated for the customer.

I recommend you begin by thinking in the most basic of
terms. With the job-to-be-done firmly in mind, ask yourself: Can
I fulfill it with a product? A service? A combination of the two? In
considering the offering as a product, continue to ask questions
like: Will it be a durable or a consumable? Will its feature set
be limited or extensive? Will it require light or heavy customer
support? Will we supply it directly or through suppliers? Will
customers need to access it frequently or infrequently? Questions about the nature of pricing and payments are similarly basic: Will customers pay in cash or by financing? Will the price be fixed or variable? Will they pay once or in installments? To visualize these choices, I like to think of each as a lever that you can push up toward one choice or down toward the other. A final offering can, of course, fall somewhere between the two extremes, but I find this exercise to be a helpful starting place for thinking broadly about possibilities. The following figures illustrate a

**FIGURE 25**

The customer value proposition formula

How do you maximize a CVP?

1. Identify an important job-to-be-done that is poorly satisfied today for a customer
2. Devise and develop an offering that does the job better than alternatives at the lowest appropriate price

**FIGURE 26**

Thinking expansively about different CVP components

<table>
<thead>
<tr>
<th>CVP component</th>
<th>Key questions from the customer’s perspective</th>
</tr>
</thead>
<tbody>
<tr>
<td>Offering</td>
<td>• Does the offering satisfy my job-to-be-done?</td>
</tr>
<tr>
<td></td>
<td>• Does it offer the right trade-offs?</td>
</tr>
<tr>
<td></td>
<td>• Are the elements that matter most good enough for what I need?</td>
</tr>
<tr>
<td>Access</td>
<td>• How do I get the offering?</td>
</tr>
<tr>
<td></td>
<td>• From whom do I get the offering?</td>
</tr>
<tr>
<td></td>
<td>• How often will I need to purchase the offering?</td>
</tr>
<tr>
<td>Payment scheme</td>
<td>• What am I paying for? (pay per unit, pay per use, pay when value is added)</td>
</tr>
<tr>
<td></td>
<td>• When do I pay? (pay up front, subscription, etc.)</td>
</tr>
<tr>
<td></td>
<td>• What is the form of payment? (cash, credit, finance, exchange)</td>
</tr>
</tbody>
</table>
Designing a New Business Model

As an illustration, consider Dow Corning’s model once again. Before it developed the Xiameter low-cost business model, the company’s customers bought a combination of silicone products and technical service directly through a highly trained, specialized sales force. They chose from a wide array of silicone product offerings and had an almost unlimited choice of volume options. Ultimately, they purchased a customized offering to suit their unique needs and negotiated individual price and financing contracts. Xiameter sought to serve a new price-driven customer job with a CVP that flipped the levers to the other side. It limited order sizes and the number of product offerings, all of which were

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**FIGURE 27**

A sampling of product/service levers

<table>
<thead>
<tr>
<th><strong>Type</strong></th>
<th><strong>Features</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Product</strong></td>
<td><strong>Focused</strong></td>
</tr>
<tr>
<td><strong>Service</strong></td>
<td><strong>Extensive</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Form</strong></th>
<th><strong>Custom</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Tangible</strong></td>
<td><strong>General</strong></td>
</tr>
<tr>
<td><strong>Intangible</strong></td>
<td><strong>Custom</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Breadth</strong></th>
<th><strong>Lifetime</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Single</strong></td>
<td><strong>Consumable</strong></td>
</tr>
<tr>
<td><strong>Bundled</strong></td>
<td><strong>Durable</strong></td>
</tr>
</tbody>
</table>
accessible only online. Lead times, pricing, and payment terms all were fixed as well.

In the case of Hilti, the levers flipped the other way, moving from a commodity product to a high-end service and from a generalized product to a highly customized one tailored to the requirements of the individual construction-site customer. Access switched from light support to heavy service and support available practically anytime. The payment system moved from pay-for-product to pay-for-service, with payment now being made in monthly installments.
Dozens of levers could be considered when designing your CVP, depending on your particular context, but to begin focus on those you deem most crucial to the offering. Hindustan Unilever, for instance, zeroed in on the need for a lot of customer support right from the start in the form of training and education of the Shakti Ammas.

**DEVISING THE PROFIT FORMULA**

Once you have an idea of your CVP, it’s time to devise possible ways your company can make money delivering it. In this regard, I advocate for a very different approach than the one most companies use when contemplating new business development.

In a customary business development process, executives work in a deliberate, somewhat mechanistic way. They assess the facts
FIGURE 30

Contrasting offerings

<table>
<thead>
<tr>
<th>Dow Corning</th>
<th>Xiameter</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Customization</strong></td>
<td><strong>Customization</strong></td>
</tr>
<tr>
<td>General</td>
<td>Offering has limited or no ability to be customized</td>
</tr>
<tr>
<td>Offerings can easily be customized for individual needs or preferences</td>
<td></td>
</tr>
<tr>
<td>Custom</td>
<td>Offering has limited or no ability to be customized</td>
</tr>
<tr>
<td>Offerings can easily be customized for individual needs or preferences</td>
<td></td>
</tr>
<tr>
<td><strong>Breadth</strong></td>
<td><strong>Breadth</strong></td>
</tr>
<tr>
<td>Single</td>
<td>Single offering delivered to customer</td>
</tr>
<tr>
<td>Multiple offerings delivered to customer simultaneously</td>
<td></td>
</tr>
<tr>
<td>Bundled</td>
<td>Multiple offerings delivered to customer simultaneously</td>
</tr>
<tr>
<td><strong>Support</strong></td>
<td><strong>Support</strong></td>
</tr>
<tr>
<td>Light</td>
<td>Customer is provided with little or no support while purchasing</td>
</tr>
<tr>
<td>Customer is provided significant support while purchasing</td>
<td></td>
</tr>
<tr>
<td>Heavy</td>
<td>Customer is provided significant support while purchasing</td>
</tr>
<tr>
<td>Heavy</td>
<td>Customer is provided significant support while purchasing</td>
</tr>
<tr>
<td><strong>Price</strong></td>
<td><strong>Price</strong></td>
</tr>
<tr>
<td>Fixed</td>
<td>Price of offering is fixed on the spot market</td>
</tr>
<tr>
<td>Price of offering is negotiable and customized</td>
<td></td>
</tr>
<tr>
<td>Variable</td>
<td>Price of offering is negotiated and customized</td>
</tr>
</tbody>
</table>

and assumptions about the future business environment and then project a growth plan that falls within the core enterprise’s usual way of making money. When a new business idea emerges that seems to support this plan and conform to the existing financial model, it gets serious consideration and perhaps a green light. But if the idea calls for a different way of making money, the finance
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people tend to put on their green visors, sharpen their pencils, and try to graft the established profit formula onto the developing new venture. If the new CVP can’t conform to the established overhead structure, margins, rate of return, and so on it often gets killed, a phenomenon I’ll revisit in greater detail in chapter 8.

It is far better to take a flexible approach to business model design that keeps the focus squarely on the job and on value creation for the customer, not on the profit formula. To that aim, I suggest working up a range of financial projections appropriate to the new CVP that represent various ways value could be delivered to the company. The goal is to establish a set of reasonable assumptions that can be tested and modified during implementation in an iterative fashion.

The best you can do at this stage is to develop reasonable assumptions about possible combinations of resources (people, technology, facilities, and so on) to deploy that imply different unit margin assumptions in support of the value proposition. Different volume or quantity assumptions can be developed but cannot be absolutely confirmed in a market that doesn’t yet exist. So the right financial approach hinges on assumptions that can only be tested during implementation. In other words, at this point, you should be taking a much looser approach to making money.

“A loose approach to making money?” you might be thinking. “You must be crazy.”

But take a moment to consider it. First, it’s a given that the blueprints you design at this stage are likely to be wrong, or more precisely, they’ll probably evolve substantially before you get the formula right. But business, being business, tends to be numbers-driven. So when executives see numbers that look good, they want to lock them in and then do whatever it takes to achieve them. This approach can lead to all sorts of deviations from the goal of fulfilling customer jobs: Offerings will be redesigned, superfluous features added, and essential ones eliminated; resources will be
allocated according to short-term financial objectives rather than according to how they serve the CVP. If you finalize a profit formula too early or, worse, are compelled to conform financials to the core business’s profit formula, then when things change—as they inevitably will—you’ll end up making wrongheaded compromises.

Moreover, although it’s necessary to arrive at a focused CVP during the blueprinting process, the financials to support it—How much will it cost to make? What is our unit margin or the volume we need to cover our overhead costs? What kind of profit do we need to commit to it?—typically involve a great many assumptions. As understanding of the new business develops, the choices contingent on the greatest number of assumptions will tend to change the most. Executives who don’t understand this are often too quick to kill new initiatives that don’t hit their projected numbers right away.

The fact is, implementing a new business model is mostly about managing assumptions. To manage assumptions, you must define them clearly, then test them during the implementation process. That will give you the evidence you need to confirm those assumptions or find out that they are unfounded in some way and adjust accordingly. If in the course of considering profit formulas you develop several potential avenues of profitability, you will be better able to adapt to the needs of the CVP without derailing or compromising the offering. This is what I mean when I advocate for a loose approach to making money. Having a range of choices that you can pursue intelligently as the new model evolves will help you converge on the ultimate profit formula and resist falling back into old habits.

To work up that range of choices, begin by brainstorming as many financial scenarios as possible. One way to help jump-start your creative juices is to think by analogy—to consider how the model for an existing business in another industry might be applied to your context. Better Place, for instance, is applying a cell
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phone service model to electric cars. Apple’s iPod/iTunes model and Amazon’s Kindle e-book apply the reverse of King Gillette’s blades-and-razor model to digital media. Not every new game-changing business model must be cut from whole cloth; sometimes it’s enough to employ a familiar one in a new way.

### FIGURE 31

**Business model analogies**

<table>
<thead>
<tr>
<th>Type</th>
<th>Example</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Affinity club</td>
<td>MBNA</td>
<td>Partner with membership associations and other affinity groups to offer a product exclusively to its members, exchanging royalties for access to a larger customer base.</td>
</tr>
<tr>
<td>Brokerage</td>
<td>Century 21, Orbitz</td>
<td>Bring together and facilitate transactions between buyers and sellers, charging a fee for each successful transaction.</td>
</tr>
<tr>
<td>Bundling</td>
<td>Fast-food value meals, iPod/iTunes</td>
<td>Make purchasing simple and more complete by packaging related products together.</td>
</tr>
<tr>
<td>Cell phone</td>
<td>Sprint, Better Place</td>
<td>Sell a service through multiple plans featuring a range of prices depending on varying levels of usage.</td>
</tr>
<tr>
<td>Crowdsourcing</td>
<td>Wikipedia, YouTube</td>
<td>Outsource tasks to a broad group who contribute content for free in exchange for access to other users’ content.</td>
</tr>
<tr>
<td>Disintermediation</td>
<td>Dell, WebMD</td>
<td>Deliver directly to the customer a product or service that has traditionally gone through an intermediary.</td>
</tr>
<tr>
<td>Fractionalization</td>
<td>Time-sharing condos, NetJets</td>
<td>Allow users to own part of a product but enjoy many of the benefits of full ownership for a fraction of the price.</td>
</tr>
<tr>
<td>Freemium</td>
<td>Skype, LinkedIn, Pandora</td>
<td>Offer basic services for free but charge for upgraded or premium services.</td>
</tr>
<tr>
<td>Leasing</td>
<td>Xerox, luxury cars, MachineryLink</td>
<td>Make high-margin, high-cost products affordable by having the customer rent rather than buy them.</td>
</tr>
<tr>
<td>Low-touch</td>
<td>Southwest, Walmart, Xiameter</td>
<td>Offer low-price, low-service version of a traditionally high-end offering.</td>
</tr>
<tr>
<td>Negative operating cycle</td>
<td>Amazon</td>
<td>Generate high profits by maintaining low inventory and having the customer pay up front for a product or service to be delivered in the future.</td>
</tr>
<tr>
<td>Pay-as-you-go</td>
<td>PG&amp;E, metered ISPs</td>
<td>Charge the customer for metered services based on actual usage rates.</td>
</tr>
<tr>
<td>Razors/Blades</td>
<td>Gillette, personal printers</td>
<td>Offer the higher-margin “razors” for low or no cost to make profits by selling high-volume, low-margin “blades.”</td>
</tr>
<tr>
<td>Reverse auction</td>
<td>Elance.com, OnForce.com</td>
<td>Set a ceiling price for a product or service and have participants bid the price down.</td>
</tr>
<tr>
<td>Reverse razors/blades</td>
<td>iPod/iTunes, Amazon Kindle</td>
<td>Offer the low-margin “blades” at no or low cost to encourage sales of the higher-margin “razors.”</td>
</tr>
<tr>
<td>Product-to-service</td>
<td>IBM, Hilti, Zipcar</td>
<td>Rather than sell products outright, sell the service the product performs.</td>
</tr>
<tr>
<td>Standardization</td>
<td>MinuteClinic</td>
<td>Provide lower cost standardized solutions to problems that once could only be addressed through high-cost customized products or services.</td>
</tr>
<tr>
<td>Subscription club</td>
<td>Magazines, Costco, Netflix</td>
<td>Charge the customer a subscription fee to gain access to a product or service.</td>
</tr>
<tr>
<td>User communities</td>
<td>Angie’s List</td>
<td>Grant members access to a network, generating revenue through membership fees and advertisements.</td>
</tr>
</tbody>
</table>
To fully develop a viable profit formula, you naturally must build an actual profit and loss statement. One very useful tool for working up the projections for a business with a new profit formula is a reverse income statement. Rather than start with revenue, as you would with a traditional income statement, arriving at profits by figuring costs and then margins, you create a reverse income statement by starting with a profit goal that answers the question, “How big does the aggregate profit need to be in three to five years for this opportunity to be worthwhile?” Then you work backward toward defining a viable revenue model, cost structure, and unit margin, using the elements of the profit formula described in chapter 2:

- Revenue model (price \times quantity)
- Cost structure (direct costs and overhead)
- Target unit margin
- Resource velocity (inventory turns, staff utilization in professional services firms, etc.)

Revenues are figured by estimating the total quantity of the offering that will be sold and then multiplying that by the price required by the CVP. With that estimate of total quantity sold, combined with the cost of the direct materials and labor required per unit, you can determine the associated allocated overhead cost and then confirm the unit margin needed to reach your profit targets. The $2,000 price point of Tata’s Nano, for example, required dramatically reducing not only the direct costs of the car but also the nonrecurring costs of design, administration, and other overhead to make the car profitable.

The resulting profit and loss statement represents a set of assumptions about margins, cost structure (including cost of goods sold and marketing and advertising budgets), resource velocity, and
the like. In this way, the profit and loss sheet becomes a planning
document that helps you build a set of testable assumptions.

Ultimately, with a newly formed customer value proposition
and basic profit formula, you are trying to answer two simple
questions: Can you tell a story that explains how delivering the
new CVP will create strong growth? If so, can you articulate a
range of financial scenarios about how you might achieve that
success? Each of these scenarios needs to be what musicians call
“pure tones.” In other words, the options you develop need to be
clearly differentiated from each other so that you can clearly ana-
lyze the pros and cons of each one.

IDENTIFYING THE KEY RESOURCES AND KEY PROCESSES

In the process of working out a reverse income statement and
profit formula, you will naturally begin to identify the key
resources and processes needed to deliver the CVP, and you will
also begin to make assumptions about their cost, availability, and
feasibility. Zara knew that to deliver its clothing to widely dis-
persed retail locations twice every week and still remain competi-
tive, it would have to cut costs elsewhere in the business model. So
it understood that a key process would be its centralized manu-
facturing-to-shipping value chain. Dow Corning quickly realized
that IT infrastructure would be a critical resource for Xiameter
and so put its development at the top of the new venture effort.
And for Hilti, backroom contract management processes were
essential.

But while you will be able to identify some key resources and
processes during this early design phase, they will become more
important in the implementation phase that follows. That’s when
you will test them to see if you have selected correctly, if you can
tightly integrate them with the other elements of the business
model, and if your processes will really work.
Before moving on to the implementation phase of a new business initiative, it’s wise to stop and compare its blueprint to the business model of your core enterprise. Identifying points of compatibility and differentiation will help guide the next stage in two critical ways. First, you will see which of the key resources can be taken from (or must be shared with) the core so you can develop a strategy that will allow you to pull them in when you need them. And second, you will be able to identify early on those potential points of conflict where the expectations and habits of the core could interfere with the new effort’s success, understanding just how much business model change will be required.
Chapter 6

1. The following case study comes from an actual project undertaken by Innosight, although company names have been changed for purposes of confidentiality.

2. Or, if you must start with an existing product, the question is not, “What do you need from my product?” but rather, “What is my product for, and is it the best way to do that job?”


10. Ibid.


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