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The business model is key to raising outside capital

FINANCING

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It is assumed that businesspeople not only understand what a "business model" is, but that they also know how to identify, assess and create one. Sounds simple, right? Think again. The term means many different things to different people.

Recently while visiting a New Hampshire business owner/CEO, he shared his frustrations about the company's inability to raise outside capital. The company seemed to have all the ingredients for success: an outstanding management team; a professionally prepared business plan; a unique product; and customer references from marquee accounts. But after nine long months, the company failed to raise a dollar.

Frustrated, the CEO gave up and scaled back his growth plan.

I have observed this situation countless times in my career: A competent management team has a great idea, but lacks the ability to uncover the nature of its profit engine and translate the concept into a viable, profitable business venture.

The business model explains who your customers are and how you plan to make money by providing them with value. Simply defined, a business model is the summation of core business processes that enable the company to earn a profit.

> Nearly everyone has heard the term, but how many people really understand what it means?

Business model attributes

According to Adrian Slywotzky, author of "The Profit Zone," a company's business model is composed of four elements: customer selection; value capture; strategic control; and business scope. Let's take a look at each dimension.

• Choosing what customers to serve is one of the most difficult decisions a business can make. Some customers can't be serviced profitably, and for those who focus on sales growth, choosing to turn away business can be a gut-wrenching decision. To be successful, choosing the right customers that enable the business to make a profit are paramount.

• Value capture refers to how a company gets rewarded for the value it creates from its customers. Most companies are "product-centric" — they compete on the basis of a superior product but ignore opportunities for downstream value capture, such as ancillary products, licensing, service solutions and many others. Managers must think in broader terms than just the product in order to present a compelling value proposition to customers.

• Strategic control refers to the ability of a company to protect its profit stream. Patents are the most obvious example.

• Scope refers to how narrow or broad a company's business activities are. For example, managers must determine which functions should be performed in-house and which should be outsourced to a business partner. Focus is the operative word.

Clarity is essential

Now, let's take a look at our CEO's situation and see how addressing each of these business model attributes turned the tables on the company's success.

• Customer selection: Historically, the company had focused on selling to purchasing agents whose job is to buy goods and services at the best possible price. The challenge for the company was to reach higher in the organization and sell to economic decision-makers who purchase on the basis of service and quality, as well as price. As the company shifted its customer focus away from purchasing, sales accelerated and repeat purchases increased.

• Value capture: Historically, product sales comprised 80 percent of the company's revenue. Using the framework above, the company identified new recurring revenue opportunities. No longer was money left on the table.

• Strategic control: Although the company operates in a very competitive industry with few barriers to entry and no patent protection, opportunities existed to "lock in" revenue streams through long term service contracts and by offering outstanding customer service. Simple concepts to be sure, but they require focus and commitment in order to make a difference.

• Scope: The company expanded its focus away from selling products and towards selling solutions which solve real business problems. By taking a step back and asking their customers what business problems they are trying to solve, the company was able to present a compelling value proposition to its customers.

History is littered with flawed business models, but it does not have to be that way. Clarity about your business model is essential if you are to build a valuable business with enduring characteristics. Fortunately for our entrepreneur, by re-examining the business model, profitability increased and his funding need was met by internally generated cash flow. By critically examining your business along these four simple business model dimensions, you can significantly enhance your success the next time an opportunity knocks at your door. NHBR

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