Entrepreneurship Essentials
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Lecture – 10
Business Model Generation – II

Hello and welcome to this session of Entrepreneurship Essentials. Today, we are continuing our previous session discussion on Business Model Generation.

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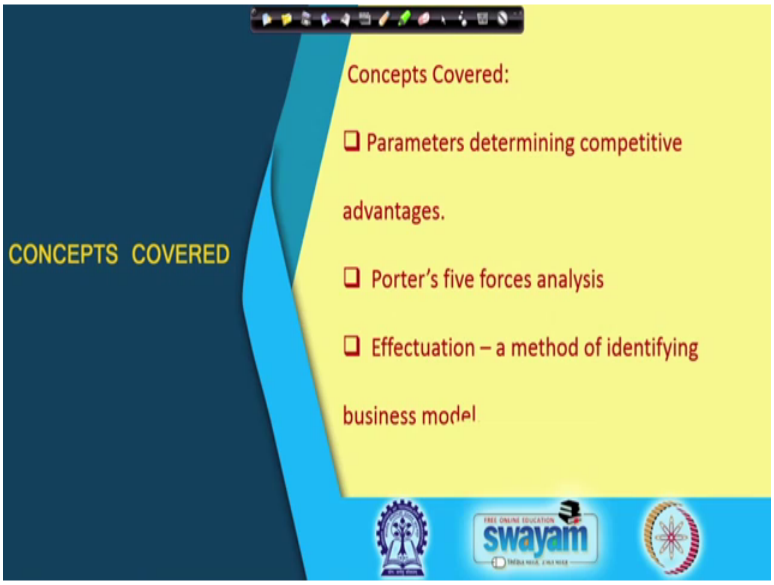

Our discussion today will cover topics like what are the parameters for determining competitive advantage of a business model. Then in between will be talking about Porter's five forces analysis. We have almost like a template it is kind of a process that has been propounded by Sharashwath on effectuation will be talking about that.

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We will start with market structure because, many a times we will be talking about market structure during the discussion. Let us have a clear understanding on what market structure means; market structure actually provides a holistic view about the competitive landscape of the industry. Including its different players in the market and the market share and how much is their competitive advantage etcetera. And what is it gives a kind of a sense of the attractiveness for a new business to start in the same market some industry.

So, it includes something like present market growth for any business. In a new business the present market growth is a very important metric to understand; the market is not growing well. And if the market is not likely to grow well in the future then this is not a attractive business proposition. So, with this two metric itself one can decide that this is not a good business model. One is the growth at present should be quite and growth moving forward should be ok, total market size should be good otherwise after certain growth and mark get saturated and there may not be any possibility of further growth.

So, business is not attractive in that kind of kind of a market. And then if anybody has any company has a as a leading market share that company is likely to wield a lot of power on the price and on other players; like they can dominate the marketplace. So, parameters like this all include or together is known as market structure.

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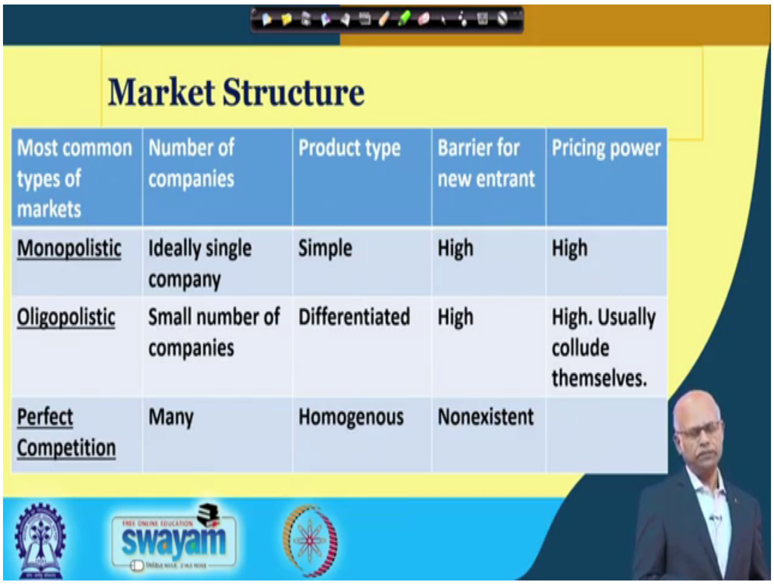

Then in economics there is a definition for market types of market like monopolistic market, oligopolistic than perfect competition. So, these are the; these are the types of market which are very important to know understand before entering into particular marketplace; as to what kind of market that is. If the market is monopolistic and if you have the kind of force to enter into that market that would be a wonderful proposition. Monopolistic market is kind of you do not have to bother much about the product because, whatever you produce customers are likely to buy.

So, for entry barriers are high because its monopolistic. So, that there will automatically because, the entry barrier is high that is why there are means new entrants are not entering inside; they are not allowed to enter. And there is huge pricing power well be talking about pricing power moving forward. Oligopolistic is limited number of seller particularly and large number of buyers. So, because there are limited number of sellers they collude with themselves and they kind of operate almost like a monopolist, but then they do not actually then they are not actually in a monopolistic market.

So, whenever they intent to increase the price they will be consulting among all the players and then they decide. So, between the oligopolists they have product differentiation. So, they do not sell the same kind of products; every company has some kind of a different flavor of the product some kind of niche. But, normally pricing power is quite high because they collude among themselves. Perfect competition is that there are many many sellers many buyers and products are all homogeneous.

So, entry barrier is almost non-existent, there is almost no pricing power if anybody increases the price you will be out of market something like that. So, monopolistic will be something like a very lifesaving drugs or say anything that comes with maybe technology that somebody has the technology and other people do not have it. So, any product that you can identify where it is driven by technology, so, they the facility may be one single seller they definitely are controlling so, they are monopolistic.

Oligopolistic may be something like say steel manufacturer or cement manufacturers they there are limited number of players and then many at times they collude themselves and then command the price. Perfect competition majority of the products are in perfect competition you take any daily use products they are kind of many many sellers and products are homogeneous.

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Now, whenever we talk of new business model and we talk of competitive advantage if the business model comes with unique competitive advantage; we say that this business model is good or is can be adopted and then someone can start a business. But, then what are the characteristic features of this business. This business so, as to make it attractive for entrepreneur; there is no actually one size fits all kind of a formula. But, then there are there are features which definitely gives comparative advantage. So, let us see some of them; these are a subset of all the features; one is attractive marketer structure meaning, that as I said marketer structure ah.

Firstly, the growth of the market should be good at present, even if it is not good at present moving forward the future growth must be good. Unless the market is growing well in the future its going to be a kind of a drying time for new entrant into this market. So, definitely the market growth should be good, market size also should be good. If the market is growing and become is becoming saturated then existing player themselves will try to capture more and more market and new entrant may not be; may not be able to penetrate much. So, even if the market grows a new entrant may not grow much.

So, that is not a market to grow to enter into; entry barrier can be from both sides. Like suppose you are inside a market so, you think of creating barrier for others against others to enter into the same market, so, that there is the competition does not increase. At the same time you may be outsider and you are trying to enter into the market. So, if there are barriers you have to kind of alleviate or get rid of the barriers to enter inside. So, barrier can be from both sides, but barriers are mostly maybe technology barriers maybe some someone may have a wonderful brand and majority of the customers are loyal to the brand.

So, it will be difficult to snatch customer from existing players; there are many other points we have a slide on that. So, we will discuss more on that scalability is the mantra for new edge businesses because, we will talk about network business based on network model. So, were scalability is everything; particularly internet based or social app based businesses are all dependent on huge registered number of users. The more the number of users the better is the business initially customer acquisition is very costly. So, you spend a lot of money to acquire customer, you have to be very fast to acquire. And then once you have a huge customer base then you can gradually enter into profit otherwise at the beginning it would be very difficult.

Means, you have to keep on spending money to really scale this up; the basic business does not scale its almost like failure of the business. Pricing power; so, some companies have like the dominant player in the marketplace say for example, Tata Steel they have dominant market share. So, if they and their brand also is quite well just regarded respected. So, if Tata Steel increases the price perhaps customers will not go away from

Tata Steel rather they will think that we must buy this they will attach more quality into that. Whereas, if some lesser known company increases the price people will not touch that product.

Repeatability so, repeatability is a customer once you acquire a customer you spend a lot of money; now you actually look at the lifetime value of the customer. So, the customer must come repeatedly again and again only then you have a business, you have a; you have a business proposition otherwise you end up spending a lot of money to acquire customer and then nothing happens. Compelling nature; your product or service should be compelling nature to the customer; customers should feel that I cannot live without it something like that is a compelling nature of your product to the mind of the customer. Growth potential, the technological edge, ownership of IP so, that gives you monopolies; easy product extension meaning that you create some kind of a brand.

So, you get family you become familiar to the customer and then customer customers know that you your product is good then you launch another product and under the same brand with a different name or same name a little bit of a change and then you do not have to spend so, much money. And so, that is what is product extension you have one product as a flagship then other products actually follow.

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Logistic advantage that is distribution and maybe one side is the distribution the other side is the raw material nearness. If the raw material source is closed then you do not have to spend a lot of money for transportation. Say you are just thinking of a steel plant if you are not close to the iron ore mines or coal mines or say cooking coal manufacturing unit then logistic is going to be a huge problem. Means, transportation cost is going to be defining on your pricing or costing and then that defines your success. So, our first term in the list of parameters is market structure.

So, your market structure for your marketer stresses were attractive there are these points market size and present growth, future growth, growth potential. Then the market size should be sufficient to accommodate a new entrant, market demand and supply and there should be gap between demand and supply.

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So, profitability also is very important. Now entry barrier as I said depends on many many factors I have listed some, but then it is not exhaustive there might be many more through which companies create some kind of relationship with the customer. Or, they create some kind of core competency will define core competency later otherwise it is going to take a lot of time. So, they create some kind of competences that is very difficult to emulate or copy by competitors some kind of competencies; like say in operation management in production in product, in financial management or holistically in all the management they have some kind of competences that is difficult to copy by others which is not even visible.

So obviously, it cannot be copied. So, through whatever process they create gradually they create this competences. And then other people without these competencies will not be competitive means their either their quality will not be good or their cost of production will be high or their miss whatever way we look at it they are not going to be able to compete. So, there are many more points actually on entry barriers.

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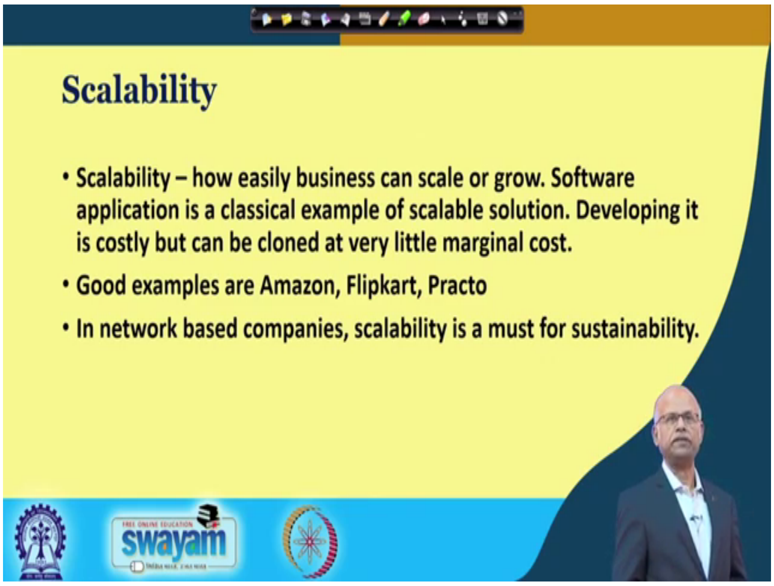

So, once you create an entry barrier around your company its like a moat; moat means people cannot cross and come to you something like that it is almost like a canal around your house your maybe castle or something. So, there may be crocodile in that earlier days people used to do that and in the night there will be no road will be closed. So, people would not be able to enter into that which is a moat.

So, you create a moat around your business. So, other new entrants would not be able to enter into your business and you will have almost like a monopoly and you sustain your business for a long time. So, you have to really try to create entry barrier. Alternately you have to explore or assess new business model and then try to understand whether you can create kind of entry barrier for others; once you are in the marketplace how you are going to create value that will work as if its an entry barrier for other companies. So, they would not be able to enter inside and you have a monopolistic business; monopoly gives healthy profit.

Scalability; so, scalability is very important to develop prototype if you have a pain point develop prototype get it validated by customer then you are you have to scale. And unless you are capable of scaling your cost will be so, high that profit will be very difficult to achieve. So, the more you scale the quickly you will scale the better it is, but then it should be controllable scale up. Like say Flipkart, Amazon, Practo these are all internet based companies and they are still trying to scale up.

So, they have they have reach out there the kind of diverse diversify into many many other areas and then just scale in that manner. So, we did not discuss about this network based company I do not know if I missed something no. So, I was talking about network based companies like Flipkart, like Amazon, like Practo they are dependent on registered users. So, unless they grow into millions of registered users they would not be able to recover the initial cost of acquisition of customers; so, that is very important.

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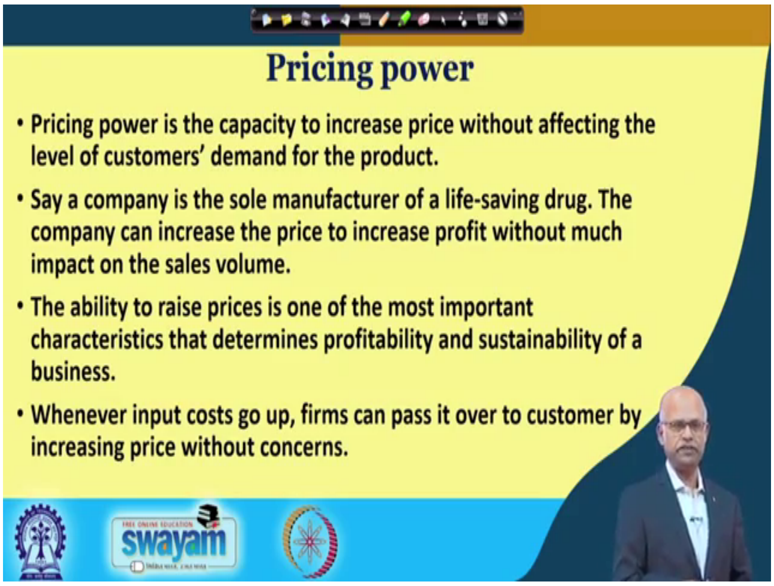

Pricing power capacity to increase price without affecting level of customers demand meaning that Tata Steel increases the price, but their demand is not reduced. So, they are they are well off. The car companies perhaps is a good example for example, of oligopolist because there are fewer number of car companies and they can also be normally, there is a news that Tata's and other companies together are going to increase the price with all they always go together otherwise one company increases the price loses the market. So, pricing power actually is a normally is available for companies who has a unique product and other car there is no competitor something like that; like lifesaving drug and I have a wonderful example here.

So, let us move forward with the example. So, whenever input cost goes up then you can pass it over to the customer without really bothering that customer is going to go away if I increase the price, that is what is pricing power. So, like say interest rate goes up so, you increase the price accordingly. So, customers are not going to you know go to your competitors that is what is pricing power.

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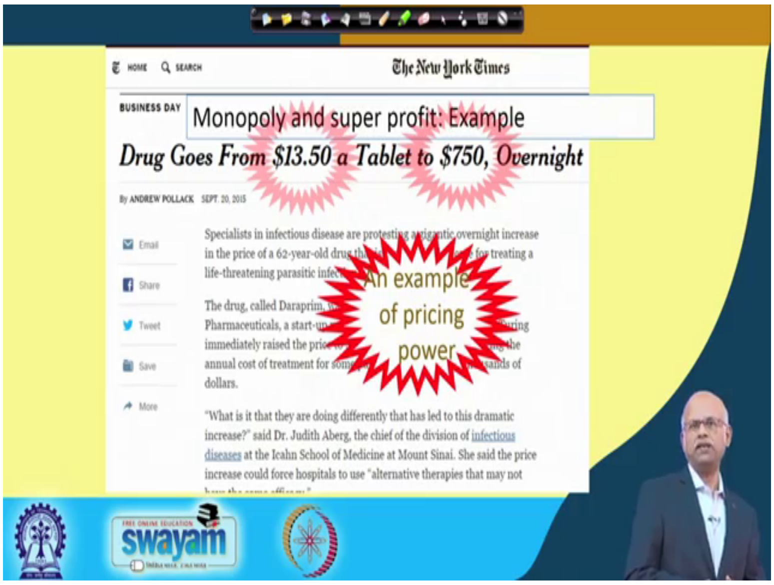

But if the go then you do not have the pricing power. This is an example it is a wonderful example, but then say kind of a nasty example. There is a company and they used to manufacture a product called Daraprim and that there is a drug for treatment of AIDS and then the company is a new companies a start-up company they were selling each dose at 13.5 dollar.

So, people are happy there is a treatment and there was no other drug available. Then suddenly one guy he suddenly realized that this is a monopolistic business and they are selling for 13.5 dollar a dollar a door. So, I can take over the company and increase the price make super profit. So, he took over this company and next day he increased the price to 750 dollar and because this is the only drug available at that point of time. People had no alternative, but to buy this drug at 750 million dollar 750 a piece.

So, that is the power of pricing, but then one has to be one should be very very careful about you know phenomenally increased in the price. But that may kind of attract more people to enter into the domain even though the technology is not available, but then any technology that has been developed by anybody can be developed by another the other people. So, if the attraction is so, high even though market size may be small, but then the price differentiation is so, high then other competitors will enter within no time.

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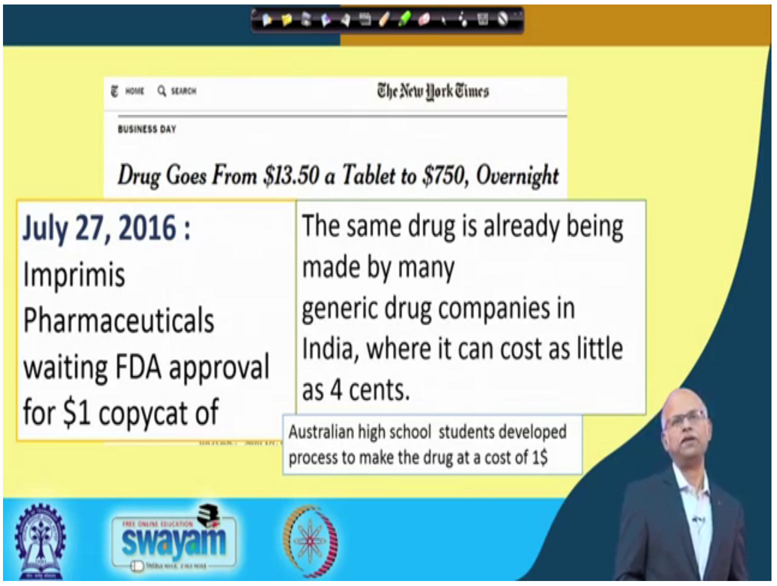

Look at this slide next slide in that this happened in 2015 and in 2016 another company came up with a drug which is a copycat of the same drug and that is to be sold at 1 dollar not even 13.5 dollar. So, with this kind of super increase in price you may actually lose the market altogether means, now you cannot even charge 13.5 dollar. In India the drug is now available for 4 cents; that means, 0.4 dollar a piece.

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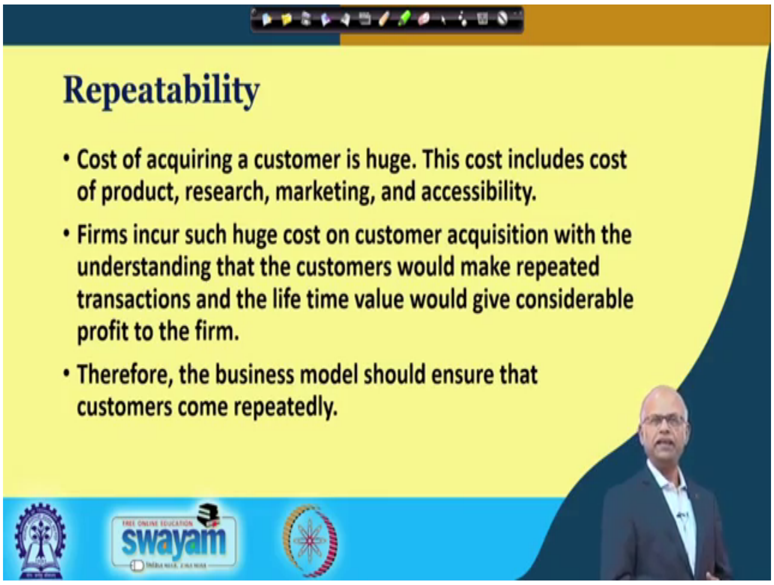

So, if you have a monopolistic business model then do not try to extract the all the golden eggs in one day. You try to increase the price in a very calibrated manner understanding the mood of the customer, their affordability etcetera. Repeatability I just mentioned what is repeatability, customer your business model should be such that customer will come repeatedly throughout their life.

So, that the lifetime value is good. So, you have to think whether this business model gives this features or not. If it is one time something like a one time like IIT Kharagpur has come up with a contraceptive if you take 1 injection and for 12 years you are sterile. So, no company actually was willing to take this technology because, there is no repeatability of the customer that is very important. Even though its a wonderful drug for from customers point of view its wonderful, but then from business point of view because this is not repeat this repeatability issue is not there; so, entrepreneurs are not interested.

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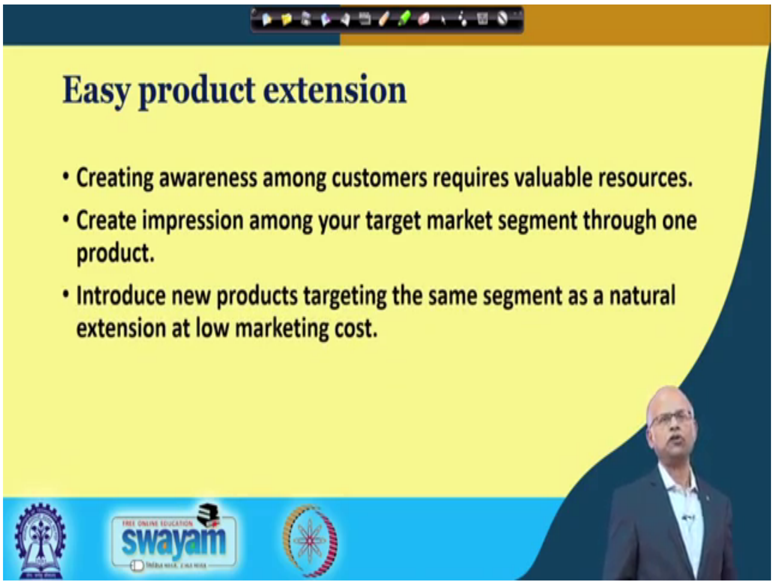

Easy product change and I explained that to build a brand around the product. So, around the brand now you keep on launching new product so, your initial cost will be low. So, you can keep on moving forward.

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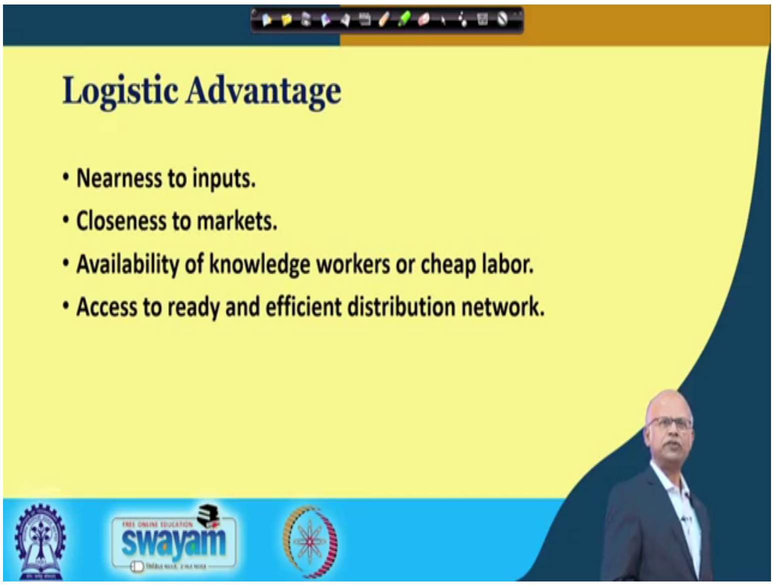

Logistical advantages it is kind of common sensical. So, its closeness to the market closeness to the inputs, then availability of knowledge workers cheap labour etcetera.

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Like software companies they start in Bangalore because, more people are interested to go to Bangalore and settle etcetera. Now, we move to the another model altogether a different thing, but then if you are thinking of a business model then you think of its competitive landscape; how you stand we say your competitors. So, you have to think so, many things like as I said throughout these slides there were many many points which I discussed. But, then again there is a template like business model canvas. Here we have a template for competitive landscape which is called Porter's five forces.

Porter's five forces are like the central thing is the competitive rivalry that is that is your business around the competitors. What is the marketplace, this actually is the market structure whole market structure meaning who are the competitors, what are their market share, how the market is growing. Growing is not in particularly they here, but it is all about competitors. So, if there are tremendous competitive rivalry it is not wise to enter there because existing businessmen are already fighting for survival. If the rivalry is not very aggressive then that means, low then the market is attractive; that means, there is a space for another player to enter inside.

We start from the top so, competition from new entrant like you become a new entrant and if you realize that any new entrant can enter meaning there is no entry barrier for new entrant, then your advantage will kind of evaporate within no time. So, you have to be careful what is the entry barrier? Suppose you are smart and you have a kind of a proposition maybe technology maybe whatever. So, how long you are going to sustain; so, that is number 1. Then bargaining power of customer, say if you are going to sell and then if the customers have many many choices.

So, they may not come to you unless you have a superior value proposition. So, you have to be you have to understand how many players are there. You are coming with maybe some differentiation, then how superior is this differentiation where the customers have choices or there is alternative products or things like that particularly market structure, price sensitivity. Meaning, that suppose you have to increase the price at some point of time you increase the price by maybe 1 percent then customer go customers go away to your competitor.

So, they are price sensitive so, that is not a good proposition. Threat of substitute meaning, that you are going to develop going to make some kind of a product or service or for some kind of product or service. Now, if there is a substitute suppose a customer has an option to either take your product even though there is no; there is no other product in the market, but then he can manage with a substitute product. Then obviously, your competitive advantage is reduced bargaining power of suppliers here again the suppliers may have many many choices.

So, definitely suppliers would like to get maximum they would like to maximize their profit. So, you have to see what are their strengths and strengths and weaknesses. Even suppliers are in a market place because, they have to buy something to convert that into raw material that becomes your raw material. Like suppose you think of a car company you are trying to manufacture maybe a battery driven car.

So, you are in your a new car come new kind of a technology, but then you have to depend on component suppliers who may be supplying to other companies as well. So, you have to this component suppliers are in a market place where they buy primary raw material like steel like aluminium like other things. So, they also are dependent.

So, whenever they have to face competition; competition in their marketplace they will immediately try to transmit that competition to you. So, you have to understand their market a structure to assess your position. We need to understand Porter’s five forces well before we really embark on a business model. So, we need to study all the points that I mentioned here.

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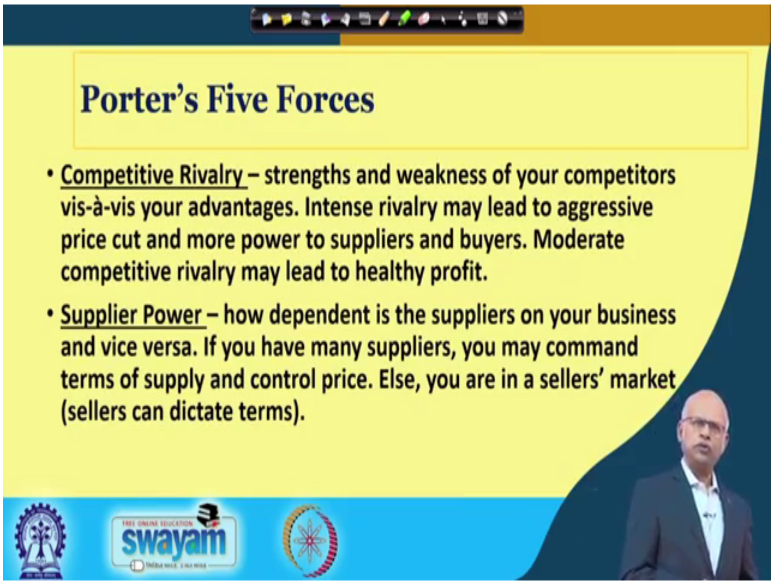

So, the discussion actually are there are slides discussing all the 5 points, but since I have covered them I will not elaborate on them. So, these are the other three.

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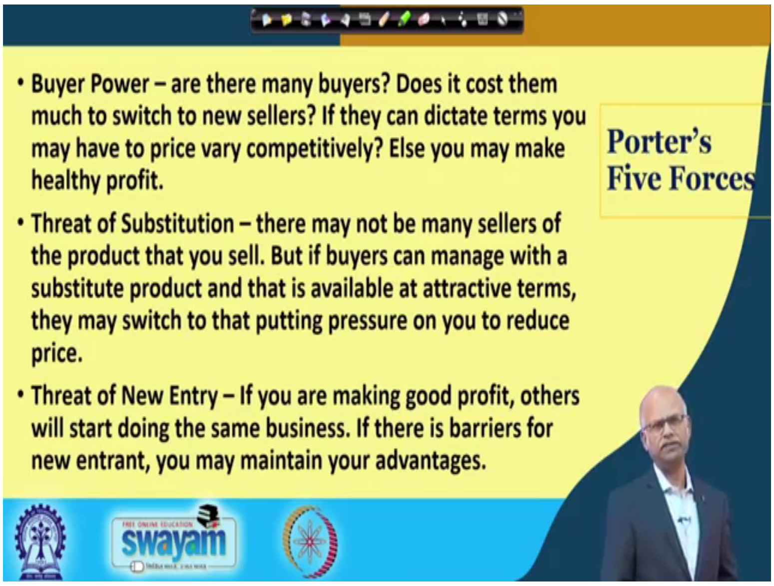

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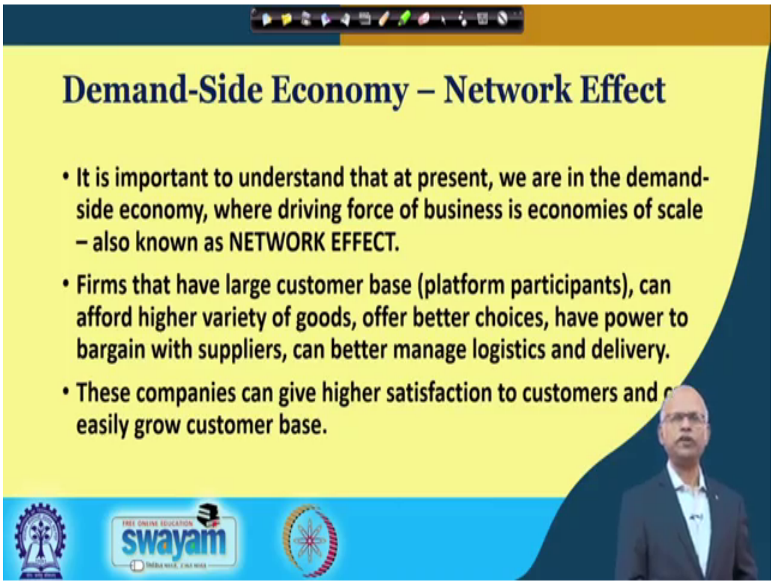

Now, I talked about network effect; we are let us understand that what we meant by that. It is almost repeatedly mentioned like we are in a demand side economy, meaning that we are in an economy where scale matters the most. Meaning that the driving force of our business is economies of scale like Flipkart, like Amazon where you must have a huge registered users. So, they are there they keep on demanding means they are so, large and number that there is huge demand from customers.

So, that is what they normally is referred to as network effect. So, in a network effect scenario this Porter's five forces analysis or the parameters that I discussed about competitive advantages that gives conceived competitive advantages these are not so, pronounced they are important, but then they are not so, pronounced.

Here firms have to continuously strive to create to grow customer base; they have to kind of try to increase the customer base spending money, time, resources and talent everything. So, that they have a huge customer base; once they have huge customer base they can afford to bring variety. If you have 10,000 customer out of them maybe 5 will be if I will have some kind of interest.

But, you have 10,000,000 customers anything that you bring there will be some people who will be interested in that. So, once you have a huge customer base you can give you can afford to give variety; you can afford to give better choices then because you have you buy in huge quantity. So, you can bargain with your supplier and you can manage your logistic.

Because, there will be you can optimize your logistic both in the supply side as well as in the delivery side, because your customer base is huge like Flipkart has their own supply network. So, they can afford it because their turnover is huge, but suppose you start new and then your customer base is small you would not be able to afford to have your own supply network. So, these companies can give higher satisfaction to customers and can easily grow customer base. It is a kind of a cascading effect or chain effect, you have higher customer base you give more satisfaction then you have better custom more customers. So, it keeps on increasing and increasing and increasing.

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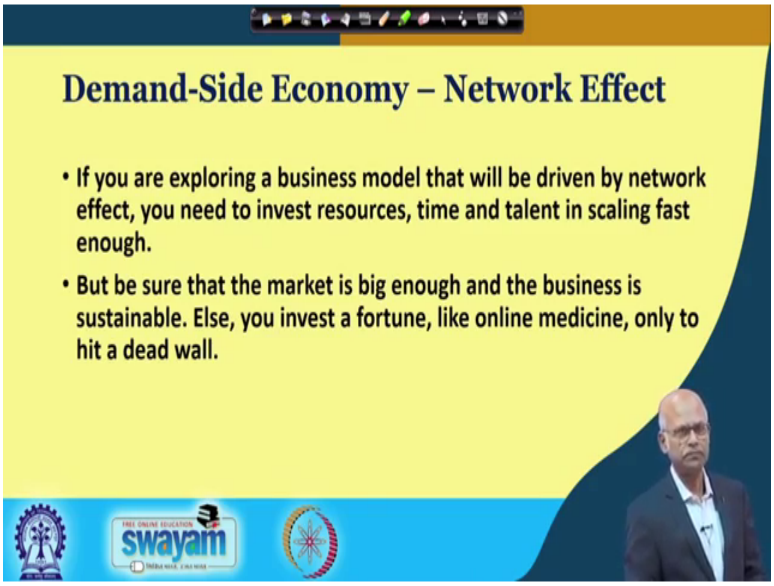

So, if you are exploring any business model in this network based model means network which is driven by network base then you have to; you have to calculate differently means your entire scheme of things thought should be different. So, you have to invest a lot of resources time and talent in just acquiring customer. So, initially you are going to burn a lot of cash Flipkart is still burning cash, but then they are on right track that is why investors are investing more money to for them to create more customer base.

But, then be sure wherever you are trying to make this business grow make sure that this market actually is large enough for you to justify initial investment to acquire this customer base. Like this many online medicine online the company started and then suddenly ministry of health has stopped this company from operation. So, all the money that has been spent went down the drain.

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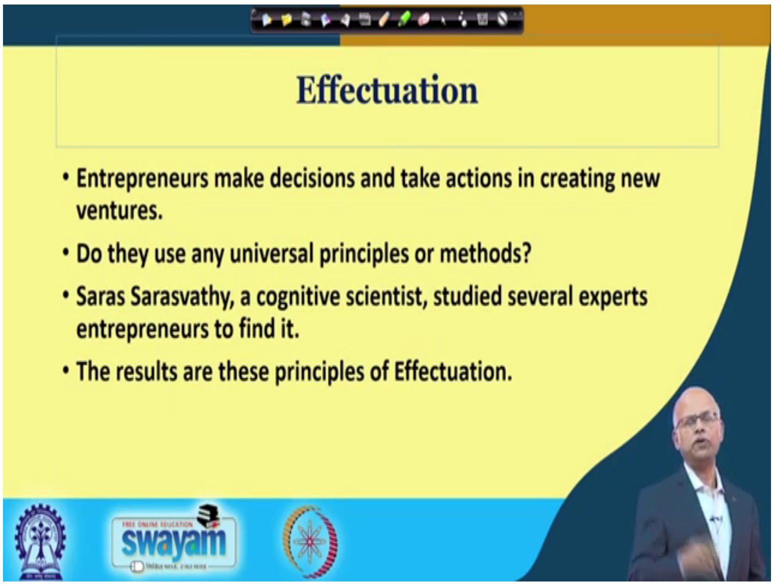

Very quickly I will be talking about this philosophy called effectuation; actually we have this Sarasvathy is a cognitive research scientist. He posed that question as to what do a smart entrepreneur do to decide to select business model. So, they talked to different successful entrepreneur and then posed question and try to capture as to what are the statistics that follow to find out winning business models.

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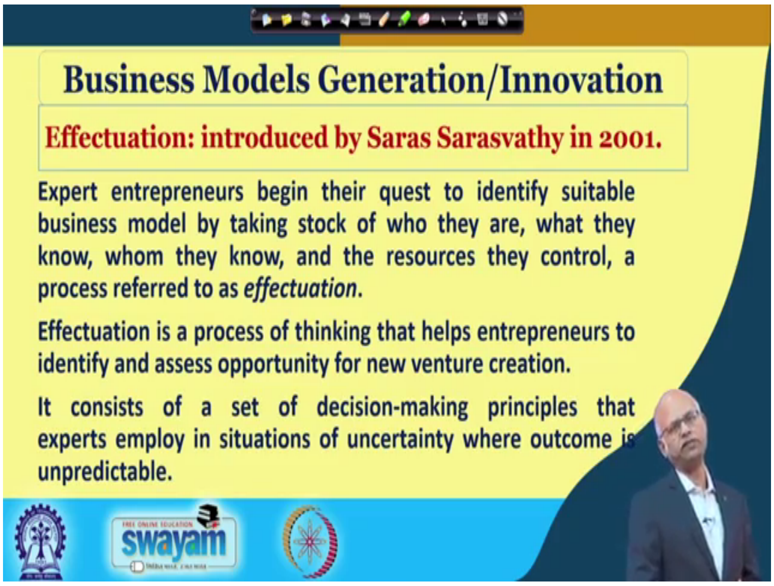

So, here are they. So, export entrepreneurs begin there begin their quest to identify suitable business model by taking a stock of who they are. Meaning that who they are means, what are their strengths, weaknesses, opportunities and threat the SWOT. So, they try to understand what is their qualification, experience. So, they try to start a business in that domain because, their domain expert into that. What kind of money they can bring, suppose a business needs initial capital of 5 crore rupees and if you do not have a crore also; so, its better to not to waste time exploring that business.

So, you try to see your strength and weaknesses and then try to understand what kind of loss you can tolerate etcetera. So, a fixation is a process of thinking that helps entrepreneurs to identify and asses opportunity for new venture creation in that manner. It consists of set of decision making principles which I am going to discuss that smart entrepreneur implies.

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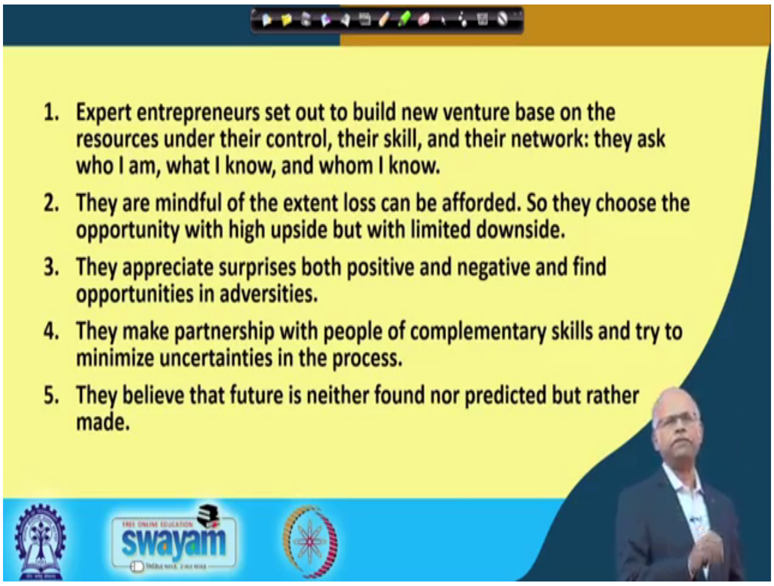

Particularly there are 5 decision making means 5 steps of decision making or 5 types. So, number 1 is what is already discussed mean they try to understand themselves. So, they look inward and then see what kind of skill they have what kind of money and then what kind of network they have; meaning how many what kind of people did not know. So, that they can they will realize that these people are going to hold our hands and then make us success with something like that. They are mindful of the extent of loss they can sustain. So, if a business has a very high downside they will not enter into unless they are sure that they can take care of like the Flipkart is burning rate is2000 crore rupees a year.

So, they know that we can actually raise more money to make good this loss unless they are confident they definitely would not enter into that business. They appreciate surprise meaning, that they do not sit and calculate what if this happened what do we do etcetera. There they just take action calculated action, but then whatever is the outcome then know that outcome may be far away than what we expect. And they are ready to ready for that they kind of fight back and then move forward.

They make partnership with people that they know, with complementary skill and then they try to minimize the uncertainties. People with skills so, kind of everybody contributes their share and then they reduce uncertainty. Last but not the least there are people who do not believe that everything is luck. They believe that they can create their future, future is not decided or not cannot be predicted they build it.

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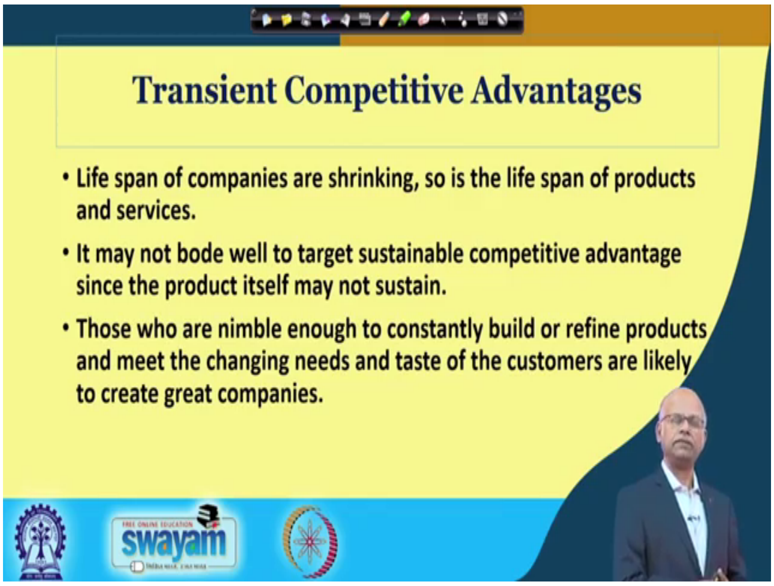

Another philosophy is that it is related to this network base also in a way not directly the transient competitive advantage. We have been talking about competitive advantage throughout this presentation. But, then one should not be besotted with this philosophy that unless I have a sustainable competitive advantage for 20 years or something I should not start, it does not exist actually no longer. It used to exist earlier now things are changing, now the company lives are shrinking like Fortune 500 company lives used to be 60 plus years earlier; now it has come down to something like 15 years.

So, company life itself is changing, product life is lifespan is shrinking even faster. So, you have a product today and then likes a VCR that product was there and suddenly it was not there. So, invest all of money create infrastructure suddenly you see that this product is no longer; no longer interesting to customers. So, everything goes down the drain, that is why it is important to understand that things are changing very fast. So, unless you are ready to churn new product very frequently or refine your own product.

So, that it gives new experience to the customer or new value to the customer then perhaps it is not wise to think of sustainable competitive advantage. Those who are nimble enough to constantly build or refine products and meet the changing needs and tests of the customers are likely to create sustainable business great business.

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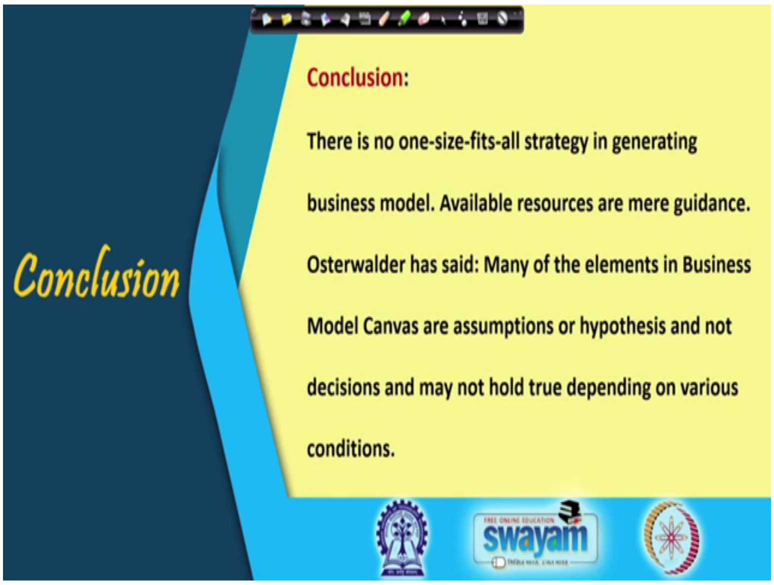

Some references. And then in conclusion even Osterwalder has said, that there is no one size fits all strategy as per him, many of the elements in business model canvas are actually assumptions or hypotheses and not decisions. So, it may not hold true under different conditions. So, which one should be very careful; this templates are for guidance not really as a decision making tools.

Thank you.