SME Toolkit - Business Model

The Idea in Brief

Business model is the recipe of business success. While the quality of ingredients – product, process, people and resources – are important; a business model guides us to deploy them in a manner that they reinforce each other. Business model is essential for an entrepreneur to seize an opportunity and extract value for self (profits) while delivering a value proposition to the customer.

The process of articulating a business model starts by identifying a 'need gap' of the customer. Every business must then identify the formula to convert the 'need gap' into profit, with optimum deployment of resources and processes.

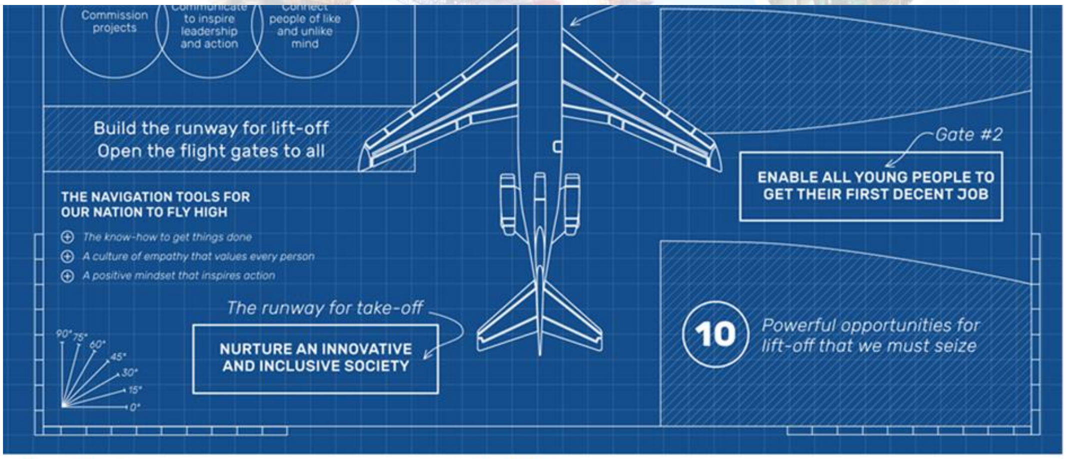
How to use this document?

This guideline has been written and designed with the intention of assisting entrepreneurs to design their own Business Model, with a 'Do it Yourself' approach. Emphasis has been given on providing a step-by-step explanation to design a Business Model. This document forms a part of the SME Toolkit, which would help the entrepreneur to plan and execute his/her growth journey.

The contents in this guideline have been based on some of the best practices in the industry which are available in the public domain.

Wherever relevant, hyperlinks have been inserted which would direct you to the original source of information. Please hover your cursor over underlined text to visit the information sites.

At some places in the document, the following icons may be appearing. Following is an explanation of what the icons signify.



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"How can you make all of your development projects make a lot more money – and have more fun at the same time?"

Dr Allen C Ward

Author of 'Lean Product & Process Development

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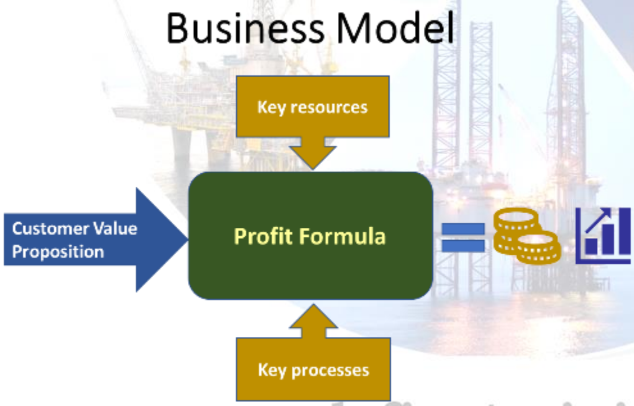
Preface

What is your business model? Every entrepreneur confronts this question in various situations and stages of his/her business. It could be while seeking funds from investors; seeking partnership with a B2B customer or potential channel partner; explaining a challenge to employees. Entrepreneurs then often look to consultants to get their business model framed. Ideally the entrepreneurs themselves are better suited to define the business model. For they are the one who had spotted the opportunity to serve customers and make money by delivering value to the customer.

This document is prepared with an objective of facilitating the entrepreneurs to design, review and improvise their business models. Even if a business does not have a business model articulated, this document will help in doing so.

What is a Business Model?

A business model is recipe of business success. Successful entrepreneurs have their business model mentally coded in their brains and manifest in the way they design the value delivery process and deploy resources. As every business seeks to differentiate itself from the competition, its business model must be unique. It is imperative for every entrepreneur to diligently articulate and review his/her business model while launching the business or when there is a competitive threat. A business model consists of four interlocking elements that taken together, create and deliver value.



1. **Customer Value Proposition (CVP):** A successful company is one that has found a way to create value for customers – that is, a way to help customers get an important job done. Opportunities for creating a CVP are at their most potent, when alternative products and services have not been designed with the real job in mind and you can design an offering that gets that job done perfectly.
2. **Profit Formula:** The profit formula is the blueprint that defines how the company creates value for itself while providing value to the customer. The profit formula is arrived by playing with causal variables like – Revenue model; Cost structure; Margin model; and Resource velocity. Successful companies are adept at identifying the Price that customers would be willing to pay for the CVP and then work backwards on Revenue model and other variables.
3. **Key Resources:** The key resources are assets such as the people, technology, products, facilities, equipment, channels, and brand required to deliver the value proposition to

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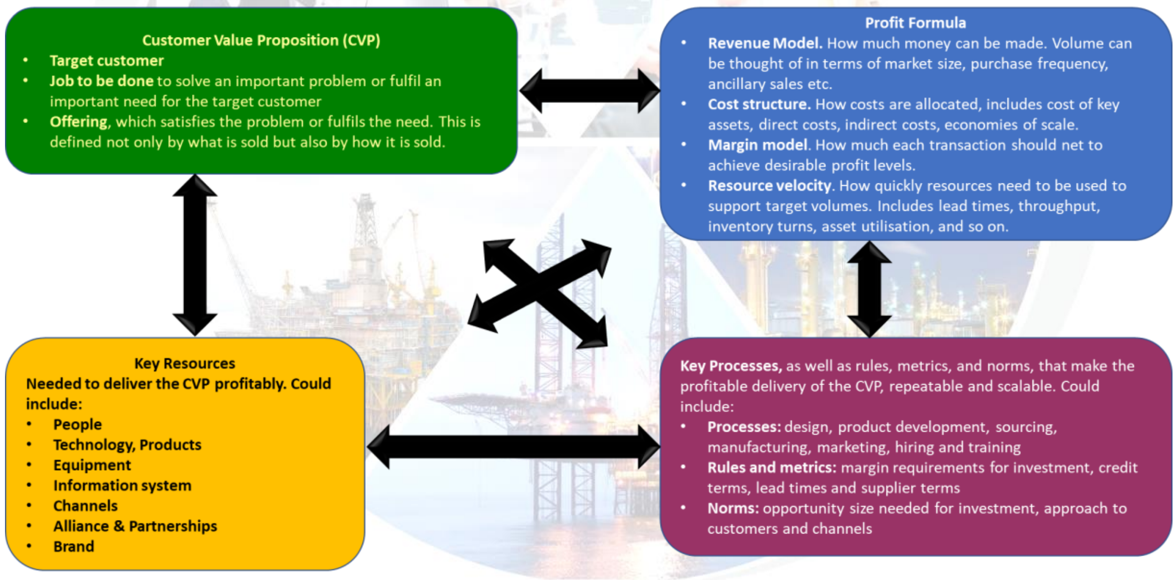
the targeted customer. The focus here is on the *key* elements that create value for the customer and the company, and the way the elements interact.

4. **Key processes:** Successful companies have operational and managerial processes that allow them to deliver value in a way they can successfully repeat and increase in scale. Key processes also include a company's rules, metrics, and norms.

These four elements form the building blocks of any business. The CVP and the profit formula defines the value for the customer and the company, respectively. Key resources and key processes describe how that value will be delivered to both the customer and the company.

Describing the business model may appear to be simple, its power lies in the complex interdependencies of its parts. Successful businesses device/evolve a stable system in which these elements bond to one another in consistent and complementary ways. By systematically identifying all its constituent parts, entrepreneurs can understand how the model fulfils a potent value proposition in a profitable way using certain key resources and key processes. With that understanding, they can then judge how well the same model could be used to fulfil a radically different CVP – and what they would need to do to



Elements of a Successful Business Model

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construct a new one, if need be, to capitalise on that opportunity.

If you want to study a successful Business Model in action, you can see it in the state of Tamil Nadu – Aravind Eye Care Systems. It is a world-class healthcare system which a

subject of study at reputed institutions like Harvard Business School. Refer Annexure 1

After developing appreciation for the concept, let us now understand the process of articulating/ reviewing or re-inventing a Business Model. Though start-point of this process may vary as per the circumstances, it is often recommended to start the process from the customer. The broad steps of the process are described in the following section.

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How to design a business model?

1. Define the Customer Value Proposition

It is recommended that entrepreneurs segment the market based on 'job to be done' rather than based on product rating or price-points. A "job" is the fundamental problem a customer needs to resolve in each situation.

The great Harvard marketing professor Theodore Levitt often used to tell his students, ***"People don't want to buy a quarter inch drill. They want a quarter inch hole!"***

One can start the process of defining the 'job to be done' by following steps:

1.1. **Identify the target segment**: Entrepreneurs can start by looking at –

1.1.1. **current customer base** – many times customer use a product for a job to be done sub-optimally for lack of an alternative. This gap would pave the way for you to create your differentiated value proposition. Sometimes, customer gives an idea for new product innovation, like when Videocon found that their washing machines were selling in large numbers in Punjab, where customers found them to be most apt for making *lassi* (sweetened buttermilk).

1.1.2. **Customers who use competition's product** – these customers are buying your competitor's products for some subtle differences in performance, price point or positioning. Analysing these differences with reference to 'job to be done' could give significant insights.

1.1.3. **Non-customers** – this group usually presents disruption opportunities. These 'non-customers' also want to get a 'job' done but are constrained by the complexity or price points of existing solutions in the market. Companies like Sujatha Biotech and Tata Motors identified this group to launch their disruptive CVP products like shampoo sachets and Tata Ace. Annexure 2

1.2. Study the nature of customer

1.2.1. **When the customer is a business** – it is advisable to form a cross-functional team – from the entrepreneur to line operator – and interact with customer organisation across hierarchies to get insights about not only the 'job to be done' but also about the desired profit formula and key processes to deliver CVP to the customer. For example, online platforms like Amazon, Flipkart have joined with their competitors – the local kirana (grocery) stores – to synergise resources and offer prompt response to the end-customers.

1.2.2. **When the customer is an individual** – based on increasing level of business's engagement with the customers, any of the following approaches can be deployed:

1.2.2.1. Interviews and surveys – It is advisable to start the interview and survey with a small focussed group of customers.

1.2.2.2. Observation – Akio Morita, legendary cofounder of Sony, was a strong proponent of this approach. He used to urge his colleagues to observe what people were trying to do and then search for the appropriate technology to fulfil the 'job to be done'.

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1.2.2.3. Emphatic observation – swimming with fishes – this approach requires high level of customer engagement. Here, the designer/s work like the customer/s in the customer environment with an aim of identifying gaps in CVP. Gillette India deployed this approach to launch its 'Guard' razor system. Refer Annexure 3.

1.2.2.4. Coevolution or cocreation – when a potential technology is new to customer, this approach is adapted by businesses to arrive at a CVP. The business and customer come together and discover the product. This requires that the business comes out with a flexible product concept quickly and discover with customers, value adding ways to use it. Jewellery maker Tanishq used this approach for launching its Mia range. Refer Annexure 4.

1.3. Synthesize the insights to define the CVP

1.3.1. The insights from observing the customers trying to do 'job to be done' should be then converted into situations.

1.3.2. These situations should be prioritised based on your understanding of the products.

1.3.3. Against these prioritised situations, rate the delivery of the CVP by the existing competition products. The rating scale could be defined by you. A representative hypothetical table to explain the step is given below:

Situation	Priority	Competition A	Competition B	Competition C
Take me from point A to B quickly and safely	1	4	4	5
Affordable to operate	2	2	3	2
Environment friendly	3	3	3	3
Scale: 1 to 5, where 1 stands for poor performance and 5 stands for highest performance level				

1.1.1. Frame your CVP around that situation where the gap is significant.

2. Design your Profit Formula

2.1. Identify the price that customer would be willing to pay for the CVP. This is a very qualitative decision-making process. A general guideline could be that you could charge a premium if the gap in CVP from current products is significant.

2.2. After arriving at your price point and referring your cost of capital, work backwards to major components of the profit formula: the revenue stream (volumes and payment policy), the cost structure (including variable and fixed costs) and the supporting margins and transaction velocity.

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2.3. It is recommended to have a fresh review of all Fixed costs. In today's world of Gig, Digital and Circular economy, all costs could be made variable. Leverage the ecosystems of your partners in doing so.

2.4. Explore all 'Pay as you use' models available for products and services. This will ring down your fixed costs. Nowadays, even software companies like Solid Works are offering 3D CAD service on cloud. This does away the need for high-end computers and steep licence fees.

3. **Identify your Key Resources**
   3.1. Apart from capital, employees, equipment and facilities, identify your partners (channel partners, suppliers and service providers)
   3.2. The more you leverage your partners, the lower would be your financial capital requirements.
   3.3. Leverage the services and knowledge repositories available with academia. It could be a great source of innovation and insights.
4. **Identify your Key Processes**
   4.1. You may use the tools like 'Value Chain' and 'Quality Function Deployment (QFD)'.
   4.2. Remember to inculcate the principles of 'Lean Thinking' like "customer pull"; "flow"; "visual communication" and "value stream" while identifying and designing the key processes.
   4.3. Leverage Digitalisation enabling technologies like 'Internet of Things (IOT)' and Blockchain in identifying key processes.
   4.4. Look good practices within and outside your industry.

When should you review the Business Model?

The answer to above questions is: "When significant changes are needed to all four elements of your business model." This need for change may arise out of the following circumstances:

1. When a large portion of the market segments are left unaddressed due to unaffordability or complexity. For example, solution providers like 'Go Daddy' have made the job of website design affordable and given the design levers to customers. Earlier only big corporates could afford to design and maintain a web presence. Godrej used this approach to disrupt the refrigerator market through 'Chotu Kool'. 👉 Refer Annexure 5.
2. When a new technology is available for creating a new Business model. For example, 'Internet of Things (IOT)' and Blockchain technologies are revolutionising businesses from Agriculture to Aviation.
3. When there is an opportunity to focus on 'job to be done'. For example, ready-to-cook food maker – Dhanashree Foods – identified the challenge of making difficult but nutritious Maharashtrian food items and launched the Dhanashree food mixes for Maharashtrian customers in India and the US.
4. When there is David versus Goliath situation. For example, media content development company – Bhartiya Digital Party – is challenging big media and entertainment companies through its regional focus (Marathi) and nimble structure.
5. When there is a threat of commoditisation. For example, Asian Paints offers 'Authorised Home Painting Service' to fend off unorganised paint suppliers and

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painting contractors. Asian Paints is the front end for the customer and customer pays a single amount for paint, inclusive of painting services.

Frequently Asked Questions (FAQs)

1. *Can Business Models be generic for an industry or business segment?*

   No. It could happen that multiple businesses are targeting similar CVP. However, the Profit Formula, Key Resources and Key Processes would differ. These are the levers of differentiation. But if all the four elements of the Business models are same across the players in a segment, then one can infer that the product/service has been commoditised and there is a need for reinventing the business model.
2. *Can I benchmark the Business Model of a World-class organisation within an industry or outside the industry?*

   Yes. One can take ideas from the business models from within or outside the industry. For example, Dr V of Aravind Eye Care studied the business model of McDonalds' while evolving the Aravind Eye Care System. It widely understood that Indigo Airlines of India has attempted to replicate the 'South West Airlines' business model from the US. However, it would be practically impossible to copy any business model in totality. It is advisable to benchmark an approach from either of the four elements. Like Kiichiro Toyoda took inspiration from the American Supermarket business model to evolve the now world-famous Toyota Production System.
3. *If I document the Business Model for my venture, I would be giving it on a platter for copying?*

   No. In fact the documentation exercise helps in bringing clarity and conviction. When the exercise is done along with a cross-functional team, the output gets refined through the review and inputs from various stakeholders. And success comes after putting the elements into practice. Your competitors may copy your Business Model document but, they would find it very difficult to copy the interdependent processes, approaches and management systems. Always remember the quote by Peter Drucker, "Strategy is commodity, Execution is art!"
4. *What if I do not get my Business Model right the first time?*

   Do not worry. All the world-class business models in practise are result of continuous evolution. Remember Dr Deming's approach of Plan-Do-Check-Act (PDCA) cycle. Every deviation in business performance from the target should be analysed and improvement opportunities identified in either of four elements of the Business Model. Once the desired gain is achieved the key is to document and standardise the process or practice.

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Annexures

Annexure 1 - **Aravind Eye Care Systems**

Aravind, with its mission to 'eliminate needless blindness', provides large volume, high quality and affordable care. Over 4.5 lakh eye surgeries or procedures are performed a year

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at Aravind, making it one of the largest eye care providers in the world. Since its inception, Aravind has handled more than 5.6 crore (56 Million) outpatient visits and performed more than 60 lakh (6million) surgeries. The Aravind Eye Care System now serves as a model for India, and the rest of the world.

Dr G Venkataswamy – known as Dr V, the founder of Aravind Eye Care got his inspiration from McDonalds' business model to increase the efficiency and effectiveness of operations. McDonalds' is very good at producing & delivering products in the same consistent way all over the world. It's been able to standardise food delivery using high volume methods. A similar idea is at the core of Aravind's management philosophy.

Watch the movie "The Founder" to understand how McDonalds' standardisation model evolved. "The Founder" is a 2016 American biographical comedy-drama film directed by John Lee Hancock and written by Robert Siegel. Starring Michael Keaton as businessman Ray Kroc, the film portrays the story of his creation of the McDonald's fast-food restaurant chain.

Aravind Business Model

Aravind is not just a health success, it is a financial success. Many health non-profits in developing countries rely on government help or donations, but Aravind's core services are sustainable: patient care and the construction of new hospitals are funded by fees from paying patients. And at Aravind, patients pay only if they want to. The majority of Aravind's patients pay only a nominal amount, or nothing at all.

Dr V's vision was ambitious: to eliminate preventable blindness in India by providing high-quality, high-volume, compassionate eye care to all. The business model he established is deceptively simple. Aravind provides care to those who can afford to pay market rates and then uses the profits to fund care for those who cannot. Each fully paying patient cross subsidizes the care of three or four others. Patients who cannot afford to pay are given cataract surgery for free. However, the government reimburses Aravind with $10 for each procedure.

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At an eye care hospital, about 80 percent of eye health care costs are fixed; the variable cost component is only 20 percent. Dr V realized that both types of costs had to be addressed forcefully if they wanted to make the business model work and use the profits from fully paying patients to cross-subsidize care of others.

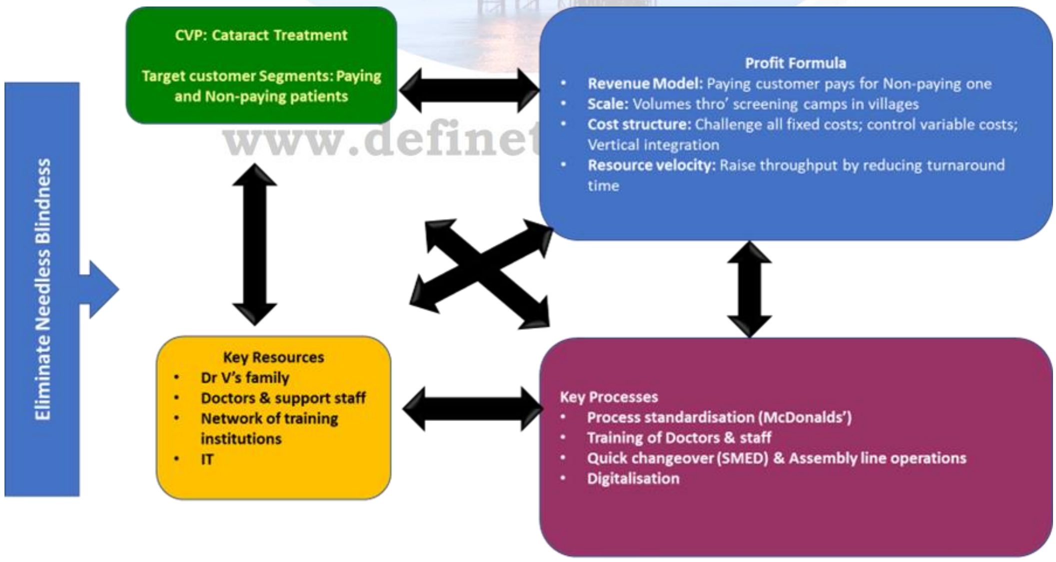
To address fixed costs, they decided to maximise the use of infrastructure & productivity of staff, especially surgeons. To Improve their fixed costs, they looked at patient-centric care and explored ways through which they can make their processes more efficient. Replication and improvement of the McDonalds' model is at the core of Aravind's management philosophy.

They also aggressively pursued opportunities to lower variable costs. In early 1990s, there was a great deal of debate about the relevance of Intra Ocular Lens (IOL) to developing countries. Though widely accepted as a better procedure, it was argued that developing countries should not go in for it as the IOLs were expensive costing them 70$, though a normal Indian patient could only afford to $10 per IOL. Taking on this challenge, in 1992, Aravind established Aurolab as a non-profit charitable trust for manufacturing ophthalmic consumables at affordable prices to developing countries. Though its primary focus is on ophthalmic industry, Aurolab is also diversifying into related health care areas where its existing capabilities can be leveraged, such as cardiovascular sutures, microsurgical hand sutures, antiseptics and disinfectant solutions etc.

Today, Aurolab products are exported to 120 countries around the world and accounts for a total of 7.8% of global share of intraocular lenses.

Most people blind from cataracts in rural India have no idea why they are blind, nor that a surgery exists that can restore their sight in a few minutes. Aravind attracts these patients through its eye camps. First, it holds eye camps - 40 a week around the states of Tamil Nadu and Kerala. The camps visit villages every few months, offering eye exams, basic treatments, and fast, cheap glasses. Patients requiring surgery are invited with a family member to come to the nearest of Aravind's nine hospitals; all transport and lodging, like the surgery, is free. When Aravind surveyed the impact of its camps, it found to its dismay that they only attracted 7 percent of people in a village who needed care, mainly because they were infrequent. To provide a permanent presence in rural areas, Aravind established 40 storefront vision centres. They are staffed by rural women recruited and given two years' training by Aravind. They have cameras, so that doctors at Aravind's hospitals can do examinations remotely. These centres increased Aravind's market penetration to about 30 percent within one year of operation.

Elements of Aravind's Business Model



Elements of Aravind Eye care Business Model

The success of Dr V. and Aravind lay in their masterfully constructing—over many years—a health care system in which many components were chosen/ designed and brought together under a well-defined Business model.

Five key choices are particularly notable.

1. The first strategic choice key to Aravind's success has been the organization's unstinting focus on the elimination of cataract blindness. In founding Aravind, Dr V could have gone in many directions to eliminate blindness. He chose cataract blindness. That first singular choice was the most important in Aravind's development.
2. The organization's second key strategic choice—to pursue a "hybrid" business model—was initially driven by necessity. While Aravind's mission from the outset was to serve the under-served, particularly the rural poor, Dr V and his early core management team recognized that in order to achieve this mission they needed funding. Lacking other options, they decided to raise revenue by building a clientele of paying customers seeking specialized services. They soon recognized that their improvised, hybrid business model had many advantages over the alternative of offering only one level of service to patients unable to pay; earning revenue to cross-subsidize their core mission was only one of the many benefits.

   The core motivation behind the hybrid operating model was the ambition to reach a scale of operations that matched the scale of the challenge. Dr V's main obsessions was to study the principles that enabled retail systems, such as McDonald's to attain scale. That led Aravind to adopt and refine the channel of "screening camps" as a way of reaching out to the rural poor.
3. Having put in place a strategy for gaining volume, the next big challenge lay in building the capacity to take care of the massive volume of cataract surgery that was being targeted. This led to Aravind's third key strategic choice: to design an operational system that would be low-cost, without compromising on the quality of care. The design of an "assembly" line system was a direct outcome of this effort.
4. Clearly a low-cost assembly line system would produce quality outputs at affordable cost only if the components going into the assembly were high quality at low cost. This logic led Aravind to its fourth key strategic choice: vertical integration of key production inputs.
5. Ultimately none of these systems would have had staying power without the fifth key choice: to have doctors and support staff work together as the human engine to design and run such a system. The healthcare delivery model needed to be supportive of the highly disciplined and motivated work force. This was the behind-the-scene crucial fuel that provided the energy to sustain the other four key elements of strategy. Every one of these strategic elements that we have briefly alluded to was critical to Aravind's success. If even one element failed, the entire system could unravel, but if they all clicked the synergy would be exponential.

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Annexure 2 – Disruption through Sachets

Sachetisation has been one of the most successful penetration strategies in rural India. The first instance of sachets in India was in the 80's with the introduction of 10ml sachets of Velvette shampoo (a product of Sujatha Biotech) and since then, this has been a particularly effective entry strategy. The data available till 2011 indicates that 87% shampoos sold in India are through sachets.

Annexure 3 – Gillette's launch of 'Guard' shaving razor in India

An important case in point is Gillette's market penetration strategy for India. Gillette's early version of Vector did not receive a great response in 2002. It had a plastic push bar that slid down to unclog the razor, ostensibly recognising that Indian men have thicker, denser hair and shave less often. As a proof of concept, Gillette tested the feature on a focus group of Indians studying at MIT. But the crucial point they missed was that these gentlemen at MIT had running water at their convenience, while men in Indian villages had only limited water and the razor stayed clogged with hair as a result.

This failure made Gillette realise the need to not only know the customer but also embrace the peculiarities of his environment and customs. In 2010, when Gillette launched Guard, it was after three painstaking years and 3,000 hours spent observing more than 1,000 customers shaving and having innumerable group discussions with them. Gillette's product team understood how crores of men in villages shave with a basic bowl of water and often no mirror in the dark hours before sunrise. While in the developed world, millions are spent to provide the 'smoother' shave, the primary concern of rural Indian men was to not cut themselves.

Consequently, Guard for the Indian market had only a single blade and a hollow and textured handle for easy an easy grip. The Mach3 razor had 25 components, while Guard was a minimalistic design with only four components that minimised nicks. This enabled lowering of the prices, increasing its mass appeal.

The results followed. According to P&G, Guard grew faster than any other P&G brand in India and Gillette's market share grew to 50%.

Annexure 4 – Launch of Mia range by Tanishq

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In 2012, Tanishq, the jewellery brand from Tata, launched a promotion drive called 'My Expression' where participants were asked to submit an idea for Mia, the working women's genre. There were cash rewards for finalists and the winner got a chance to work with Tanishq' core designers.

Annexure 5 - Chotu Kool from Godrej

Godrej and Boyce's ChotuKool, the super-economical refrigerator was the result of a workshop between the senior management and Clayton M. Christensen, the Harvard University professor, famous for his thoughts on disruptive innovation.

The concept was defined based on workshops that involved village women and articulated their needs. ChotuKool weighed only 7.8 kgs and used high-end insulation to stay cool for several hours without electricity, a precious resource in rural India. Though small, it was capable to cool five to six bottles of water and could stock up to 4 kgs of vegetables. The workshop also considered the key element of portability and the refrigerator was designed so that it could be moved to service family gatherings. The success of ChotuKool has led Godrej and Boyce to expand distribution using rural community networks,

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