

Building Breakthrough Business Models

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Your Tasks

- *10 minutes: Read the case*
- *5 minutes: Discuss in two and threes*
 - *Left half: Which revenue model?*
 - *Simple calling plan or pay-as-you-go?*
 - *Right half: Which operating model?*
 - *Subsidized handsets or no subsidy?*

MSI Cellular Investments: What happened?

From a Business Model Point of View

- *Five key elements in every business model*
 - *Revenue model*
 - *Gross margin model*
 - *Operating model*
 - *Working capital model*
 - *Investment model*

MSI's Revenue Model

- *Rhodes' view: Western calling plans are an antilog*
 - *Too much commitment to ask of people who had never had phones*
 - *Too much to expect them to know how much they'd use a mobile phone*
- *Eastern Europe: an analog*
 - *Prepaid scratch cards are the answer: pay as you go (with "beer money")*

MSI's Gross Margin Model

- *Gross margins would be high: moving electrons is cheap!*
- *But took great care to make everything user-friendly*
 - *Minimize the need for call centre help*
 - *Literacy was marginal in many SSA countries*

MSI's Operating Model

- *Eastern Europe: analog*
 - *GSM technology, no fancy billing system*
- *Western Europe: antilog*
 - *Free handsets burn cash*
- *His decision: no free handsets. Why?*
 - *Lower capital requirements to get started*
 - *Greater ability to grow the business over time*

MSI's Working Capital Model

- *The revenue side*

- *Customer buys a scratch card, day one*
- *Puts cash in the till before services are rendered.*
Negative A/R.

- *The expense side*

- *Main expenses are for infrastructure: towers, switches, etc.*
- *Vendors gave lengthy terms*

- *The result: negative working capital (business model nirvana!)*

MSI's Investment Model

- *Building mobile phone systems is not cheap*
 - *Governments to wine and dine*
 - *Licenses to win*
 - *Operating infrastructure to build*
- *Would investors play?*
 - *“I’m not going to Uganda without my hard hat. That’s where Idi Amin lives.”*

Three Unanswered Questions Remained: MSI's Leaps of Faith

- *The investor question*
 - *Would investors invest in SSA?*
- *The license question*
 - *How expensive would African licenses be?*
- *The beer money question*
 - *Would impoverished SSA consumers actually pay to buy and use mobile phones?*

Would Investors Come on Board...

- ***First, a rock-solid management team***

“We took the view that it was worth backing because you had an entrepreneur who understood the technology requirements. And it was a commendably honest operation and did not involve any underhand payments.”

Lord Cairn, CDC, an early investor

Second, and Equally Important: The Business Model

- *Once up and running, the favorable working capital model should help fund future growth*
 - *New customers mean more towers and switches, serving more communities*
 - *But each new customer generates cash flow from day one*

Did Everyone Agree?

“We were seen as slightly mad. Everyone knows you’ll never make money in Africa – they’re all crooks and incompetents.”

Lord Cairn, CDC

What About the License Question?

- *An answer from South Africa*

“Governments realized that because returns here are lower, the business model just doesn’t stack up if they charge big license fees.”

A new South African operator

Testing the Remaining Leap of Faith

- *Would customers in SSA spend beer money – and more – on mobile phones?*
 - *The Eastern European analog suggested they would*
 - *But Eastern Europe is not Africa, where poverty is daunting*
 - *Only one way to know for sure: launch the first system*

MSI's Rationale: More Talk, Less Walk

“In Africa, there is hardly any alternative to mobile telephony, apart from traveling, which can be dangerous. So even for those with lower incomes, mobile telephony can be a very effective solution.”

Marten Pieters, MSI Cellular

Guiding and Tracking the Journey: Build a Dashboard

- *Much like the one in your car*
- *Two key metrics, once investors were on board and licenses acquired*
 - *Acquisition cost per subscriber*
 - *ARPU: Average Revenue per User*
- *If these numbers pan out, there's a business in SSA*
- *If not, MSI dead in the water*

MSI Starts Rolling

• 1998

- Raised \$16 million in equity, plus \$15 million debt (the investor leap of faith answered)*
- Won licenses in Malawi, Zambia, Sierra Leone, and Congo-Brazzaville (the license leap of faith answered)*

• 1999

- Raised another \$35 million, plus \$22.5 million debt*
- Won licenses in Gabon, Chad, DRC, and Guinea*

2000: The Dashboard Speaks

- *Acquisition cost per subscriber:*
 - *A small fraction of Europe's figure*
 - *Mass advertising is cheap in SSA*
 - *Personal selling, too*
- *ARPU*
 - *Quickly reached \$300 per year (\$25/month), similar to Europe – but widely varied*
- *The “beer money” leap of faith? No longer a question!*

MSI Cellular: A Growth Machine

- **2001 and 2002**

- *Built out the systems, licensed new SSA countries at breakneck speed*

- **2003**

- *Turned profitable*

- **2004**

- *Renamed the business Celtel*

- **2005**

- *Sold Celtel for \$3.4 billion (8 short years!)*

Celtel: A Rare Case Where “Plan A” Has Worked

- *But let's face an uncomfortable fact. Most new ventures fail.*
- *Why? Most new businesses fail because the business model doesn't work!*
 - *Too little cash coming in...*
 - *Too much cash going out.*

My Assertion: Today's Start-up Process Is Seriously Flawed

- *Driven by business plans based on naïve and unfounded assumptions*
- *All in support of a “Plan A” that rarely works*
- *And it's not the entrepreneur's fault...*

In the Words of One Angel Investor

*“I’ve made more money on Plan
B than I ever made by sticking
to Plan A!”*

So, is there a solution to the flawed start-up process?

- *A rigorous solution, perhaps, for getting from your Plan A that probably won't work*
- *To a better Plan B, a better business model, based on*
 - *Real data*
 - *For a real product or service*
 - *From real customers*

The Conventional Business Planning Approach

- *Turn on Excel*
- *Make silly “assumptions” (SWAGs) lacking in real evidence*
- *Tweak the cells to create a “hockey stick” pro forma*
- *Voila, you’ll soon be rich!*

So, how can *you* develop a business model that really stacks up?

- ***Turn off Excel and consider the five building blocks of every business model***
 - *What's your revenue model?*
 - *Your gross margin model?*
 - *Your operating model?*
 - *Your working capital model?*
 - *And your investment model.*

A Process to Get You There

- *The story of Apple's transformation*

The Key Steps in Apple's Journey

- *Analogs*
- *Antilogs*
- *Leaps of faith*
- *Hypotheses to rigorously test the most crucial leaps of faith*

Steve Jobs on Analog and Antilog

“Picasso had a saying: he said good artists copy, great artists steal... and we have always been shameless about stealing great ideas.”

The First Building Block: Your Revenue Model

- *Plan A → Plan B → Plan C → Plan D*
- *The Momento Cero story...*

Another Building Block: Your Gross Margin Model

- *A Plan A that worked*
- *The eBay story*

The Third Building Block: Your Operating Model

- *The Ryanair story...*

An Often Overlooked Building Block: Your Working Capital Model

- *The Costco story...*

Lest We Forget: Your Investment Model

- *Two vastly different business models for VoIP telecom technology*
- *Skype vs. Vonage*

What Do All of these Examples Have in Common?

- *All (except eBay) built their eventual success not on Plan A, but on Plan B*
- *For each of them, their breakthrough was a business model whose strength was anchored in just one of the five business model elements*

On Which Elements Did Each Break Through?

- *Apple's and Google's revenue models*
- *eBay's gross margin model*
- *Ryanair's operating model*
- *Costco's working capital model*
- *Skype's investment model*
- *On which element can you break through to a better business model?*

Putting Process and Framework Together: The Business Model Grid

| Business Model Element | Analogs | Antilogs | Leaps of Faith | Hypotheses |
|------------------------|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|
| Revenue Model | <input checked="" type="checkbox"/> | | <input checked="" type="checkbox"/> | <input checked="" type="checkbox"/> |
| Gross Margin Model | <input checked="" type="checkbox"/> | <input checked="" type="checkbox"/> | | |
| Operating Model | <input checked="" type="checkbox"/> | | | |
| Working Capital Model | <input checked="" type="checkbox"/> | | <input checked="" type="checkbox"/> | <input checked="" type="checkbox"/> |
| Investment Model | <input checked="" type="checkbox"/> | | | |

Does this Work?

The Proof of the Pudding

- *Google*
- *Starbucks*
- *PayPal*
- *None stuck to their original business model*
- *All became household names by abandoning Plan A and getting to Plan B*

Lots More Examples, in Start-ups and More

- *China's Shanda: Revenue model*
- *Japan's Toyota: Gross margin model*
- *India's Oberoi Hotels: Operating model*
- *USA's Dow Jones: Working capital model*
- *Spain's Zara: Multi-dimensional model*
- *And many more, in visionary companies of all sizes and kinds*

A Closing Thought on *Why Plan A Seldom Works*

There's simply too much that you simply don't know

–Some things you know you don't know

–Others you don't know you don't know

A Tell-Tale Phrase in Too Many Business Plans

“We believe that...”

There Is a Solution

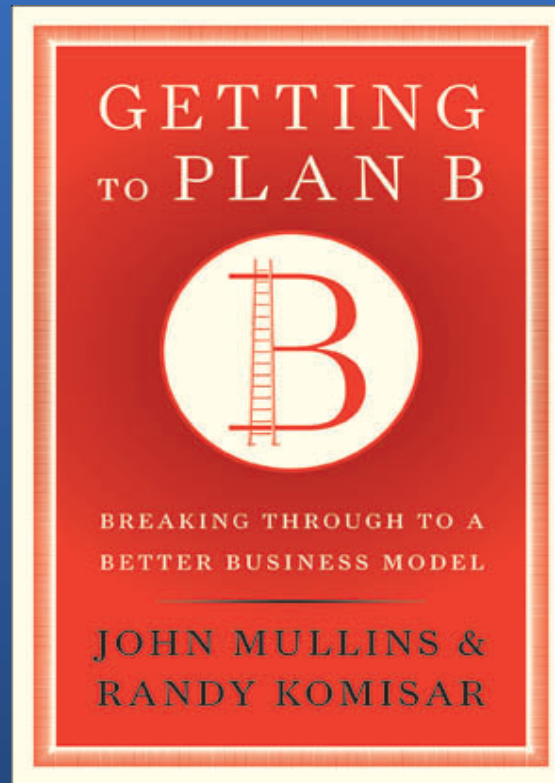
- *Stop working on your business plan for Plan A*
- *And get on with your business, your journey to a more vibrant Plan B*
 - *Find some analogs and antilogs*
 - *Identify your most crucial leaps of faith and some hypotheses to examine them*
 - *Build a dashboard to guide your journey*
 - *Get out there and learn*

But Don't Take it Just from Me

“What matters most is not the quality of the initial business plan, but instead the ability of the team to iterate successive business plans as a means to finding what works. The trick is to experiment quickly but intelligently, and with discipline.”

Dennis Whittle
Founder and CEO: GlobalGiving

For the Rest of the Story, in English now, en Español 2010



Questions?

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