Todd Zenger, MBC Online, Translating a Theory into a Business Model Part 1

Welcome. You have to this point composed a theory of value. In these two lectures, we want to talk about how you translate that theory into a business model. Again, the architecture where we've been, we began with this idea of you having a contrarian belief and converting that into a problem and a problem architecture and then into a theory with a causal structure. We've talked in a previous lecture about the importance of thinking about how one will test and provide you with reduced uncertainty about the validity of that theory on the experiments that you can run, where you can search for solutions to some problems, where you can find critical resources. We want to talk in these lectures about this last step in this business model creation, which is to actually orchestrate the composition of this business model. We'll talk about this in a little bit of detail. What's important to keep in mind is that in all industries, there are a variety of actors participating in those industries with a variety of different business models and those business models are evolving. People come up with innovative new business models. In particular, innovation in those business models is of course triggered by somebody seeing a new way to solve a problem or seeing a new problem that others have not seen, as we've talked about. In your object as an entrepreneur is to participate in this space. You may be able to call it an industry and in doing so create value. You're going to create that value not just in isolation, but you are going to create that value as you collaborate with a variety of other actors. With employees and with other suppliers, with those that are providing resources, with others that you might be collaborating with and cooperating with in other kinds of ways. Then position yourself through the composition of your business model in a way that allows you to not only create value, but to actually capture some of that value. It's this idea of a business model that enables you to both create and capture value that we want to talk through today. I want to anchor for a few minutes on a very familiar industry, I think to everyone, and that would be the music industry. I like the simple fact that in this industry, there are lots and lots of different business models that are being pursued by different types of actors, each of whom is interested in creating value and capturing some portion of it. Some of them may not be interested in value creation that's monetizable, or even their capacity to capture that value. They may be simply just wanting to create value. But many, many different actors are participating with different kinds of plays, different types of business models. You've got musicians out there and they're all performing in different ways with different instruments. You have vocalists and songwriters, you have people that are promoting concerts, you have the whole distribution function that occurs in a variety of different ways. You've got platforms participating this space as well. Lots and lots of actors composing a variety of different business models in an effort to create and capture values and in doing so collaborating with many, many other actors in an effort to do this. You could be a songwriter that's selling music to other artists, you could be a musician-composer, and you've created a band and you perform concerts and you sell performed music. You could be a conductor, you could be a producer, you could select and curate music and interpret music. You could be a vocal artist and actually completely outsource your songwriting, or you could do your own songwriting. You could be a promoter of music, a concert promoter. You could be a marketer of music. You could be a music distribution platform again. Lots of different business models are all competing in the same industry space. Entrepreneurs, again, are trying to find what's the new problem I can solve. How can I step into this space, create new value as one of these types of actors, and then compose a business model that's going to allow me to both create that value and capture it. My hope is that in walking through the value lab and really thinking deeply about this problem that you as an entrepreneur have targeted to solve, that this will enable you to compose a more effective business model. One that's going to position you to both create and capture value. Just to remind you why this problem formulation is particularly important is that it is the spark that should help you compose this business model. You think of Uber recognizing this problem of there's not a cab when you need it to be. It's really in servicing or addressing that problem. They compose this unique business model. Or Starbucks founders are perceiving the coffee's horrible and that the purchase experience for it is even worse and composing a solution and an entirely contrary and unique business model that addresses that particular problem. Or Walmart, Sam Walton recognizing the retail prices in small towns are particularly high and recognizing the problem that is triggering that which is this inability to efficiently supply those small towns. Recognizing that as the problem, building out a very novel contrarian business model to address that core problem. We've talked about Apple in the past as well. Again, triggered by observing a unique problem. Our hope is that you will be able to compose a business model that is uniquely configured to solving this particular problem that you've identified that is consistent with your theory about how to solve that problem. That theory ought to be the architecture around which you craft and build your business model. We have highlighted in several lectures the importance of uniqueness. Importance of uniqueness becomes particularly apparent as you think about building your business model. Uniqueness is considered the most important word in strategy. If you don't participate in this industry that you have scoped out or this space that you scoped out and solve a problem in a unique way, your capacity to create and capture value essentially disappears. It doesn't exist. Your capacity to create and capture value is a direct function of the uniqueness of the value that you contribute to creating. If you are easily replaced by a competitor or a supplier or some other actor in the space that you are trying to operate in, then your capacity to capture value is trivial. When you think about, back to this music industry, who's creating real value here, it's those actors that can play in this space. Build a business model that allows them to generate value that others are unable to generate. As a consequence of this, they are in a position, as we'll talk through, to capture that value that they create or at least a good portion of the value that they create. To eliminate this idea, let me simplify things a little bit. We've talked about a wide range of actors that might collaborate with you in building your business model. I want to simplify this a little bit and think about a customer or a set of customers. You're an entrepreneur trying to build a firm there in the middle and you have a supplier or a set of suppliers that are providing you with critical inputs. This is essentially your value chain and the way you create value, of course, is composing a product or service for which that customer has a high willingness to pay. They value highly that problem that you are solving for them through the product or service that you're introducing into the market. The total value that you're creating is the difference between this willingness to pay and what you might refer to as the supplier's opportunity cost. You're purchasing inputs and key services from these suppliers and they too are playing a little bit of a game with you and they are charging a price to you that reflects your willingness to pay them. The supplier opportunity cost would be you think of this as the walk-away prices. The price at which the supplier, if you are an extraordinarily shrewd negotiator, they would simply walk away. That difference is the total value that you are creating. That's not the value you actually get to capture or keep. The value that you are able to capture or keep is a function of the value that's captured by suppliers as they provide inputs to you. As you introduce value, they're trying to reach up and grab some of that value through their own pricing and negotiations with you. In addition, in order to induce that customer to buy your product, you are going to need to give away some of that value to customers and the value that you get to keep is the difference here. The game of strategy is not only to introduce value and maximize this total value that's created, but you're also trying to capture the maximum amount of value that you can capture as well. In order to do that, you need to be introducing a product or service that is unique. As soon as a competitor comes along and essentially replicates the product or service that you are providing your price slides down significantly as you compete for customers and your ability to capture value essentially becomes trivial. So you're now playing in a game much more like this, where the value you capture is slim to none. The key takeaway here is that as you think about building a business model, you need to think not only about what's the problem you're solving and therefore the value that you're creating. But you're also having to think about what is it that we can do here that is unique relative to our competitors. It may be that you are solving a unique problem, or it may be that you are solving a common problem but in a particularly unique and efficient way. Uniqueness here is central. As you start to build out the architecture of this business model, you need to keep in mind this central idea that uniqueness reigns supreme. Thanks for watching this video. The next segment we'll be talking about the details of how one builds out a business model.