BUSINESS MODEL PERFORMANCE

ANDREAS BIRNIK, PARTNER

INTRODUCTION

This deck presents the findings of an empirical study of business model performance among the S&P 1,500.

The researchers first divided the S&P 1,500 into four business models:

Asset Builders	Service Providers	Technology Creators	Network Orchestrators

- And then analyzed financial performance across numerous dimensions to reach the conclusion that Network Orchestrators outperform followed by Technology Creators.

- This study sheds light on why many venture capital investors are cautious to invest in Asset Builders (substantial fixed assets, working capital, risk of unsold inventory and risk of product recalls) and Service Providers (extensive payroll costs).

- Gross margins are substantially higher, and the cost of scaling is lower, for Network Orchestrators and Technology Creators. This leads to favorable valuations over Asset Builders and Service Providers.

SHIFTING FOCUS FROM INDUSTRY TO BUSINESS MODEL

BUSINESS MODELS

Why Are We Still Classifying Companies by Industry?

by Barry Libert, Megan Beck, and Yoram (Jerry) Wind

AUGUST 18, 2016

SAVE SHARE 3 COMMENT TEXT SIZE PRINT $8.95 BUY COPIES

For more than 60 years, investors, analysts, business leaders, and even governments, have classified companies based on industries. First there were Standard Industry Classification codes, which were introduced in 1937, then the North American Industry Classification System, and now we have Standard and Poor's Global Industry Classification Standard (GICS). Even though these systems are updated regularly, we can no longer rely on standards and measures that were developed in a different age to reflect today's realities – especially when we're evaluating tech firms.

"For more than 60 years, investors, analysts, business leaders, and even governments, have classified companies based on industries… If leaders want to take their companies into the next decade, they need to start looking beyond their vertical industry designation and best practices. They should be focusing on business models and thinking about pivoting to a more valuable one.

Our research has shown that companies that build and manage digital platforms, particularly those that invite a broad network of participants to share in value creation (such as how we all add content to Facebook's platform or that anyone can sell goods on Amazon's), achieve faster growth, lower marginal cost, higher profits, and higher market valuations."

Source: Libert, Beck & Wind, Harvard Business Review, 2016

FOUR BUSINESS MODEL ARCHETYPES

01 Asset Builders

Companies that build, develop, and lease physical assets to make, market, distribute, and sell physical things.

02 Service Providers

Companies that hire employees who provide services to customers or produce billable hours for which they charge.

03 Technology Creators

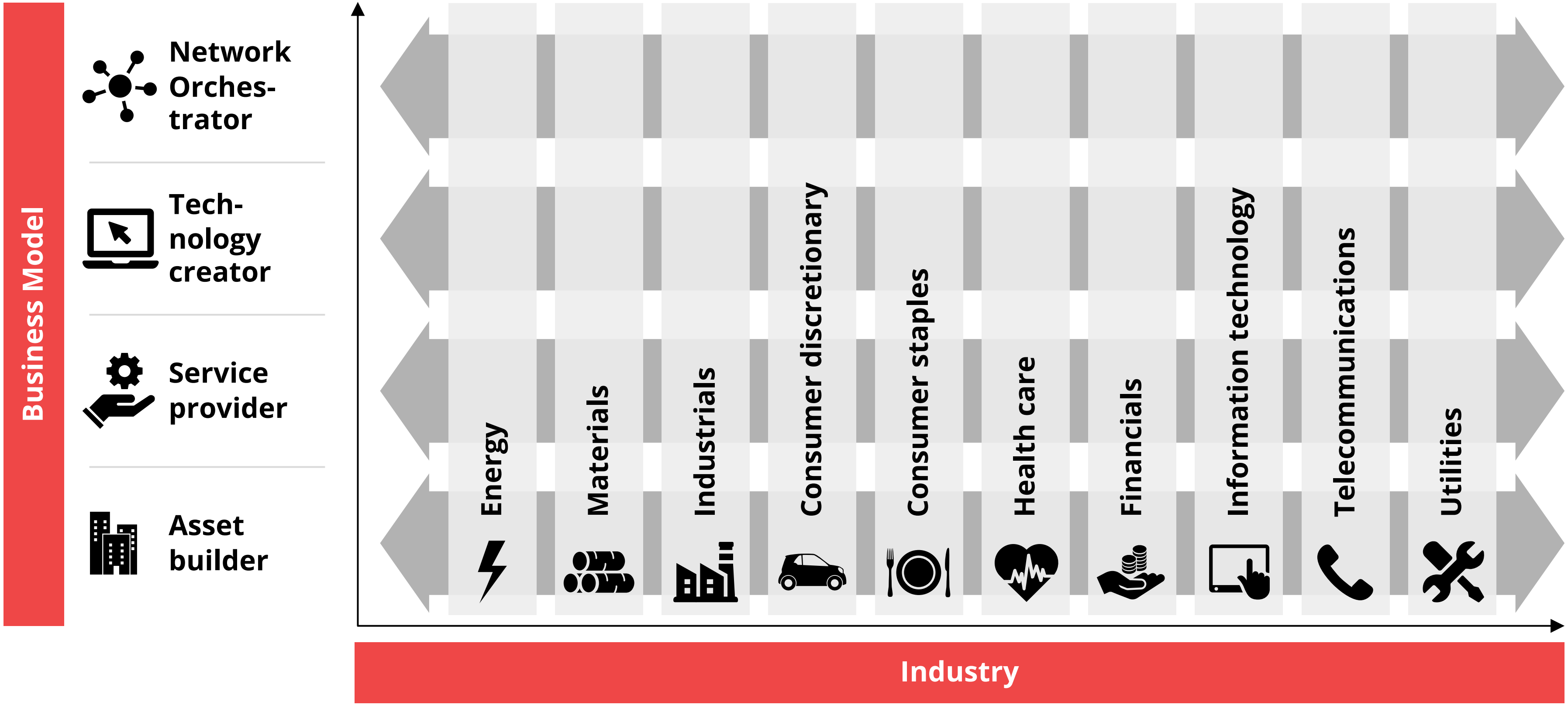
Companies that develop and sell intellectual property such as software, analytics, pharmaceuticals, and biotechnology. Low marginal cost to create product copies.

04 Network Orchestrator

Companies that create a network of peers in which the participants interact and share in the value creation. They may sell products or services, build relationships, share advice, give reviews, collaborate, co-create and more.

Source: Libert, Wind & Beck , Harvard Business Review, 2014

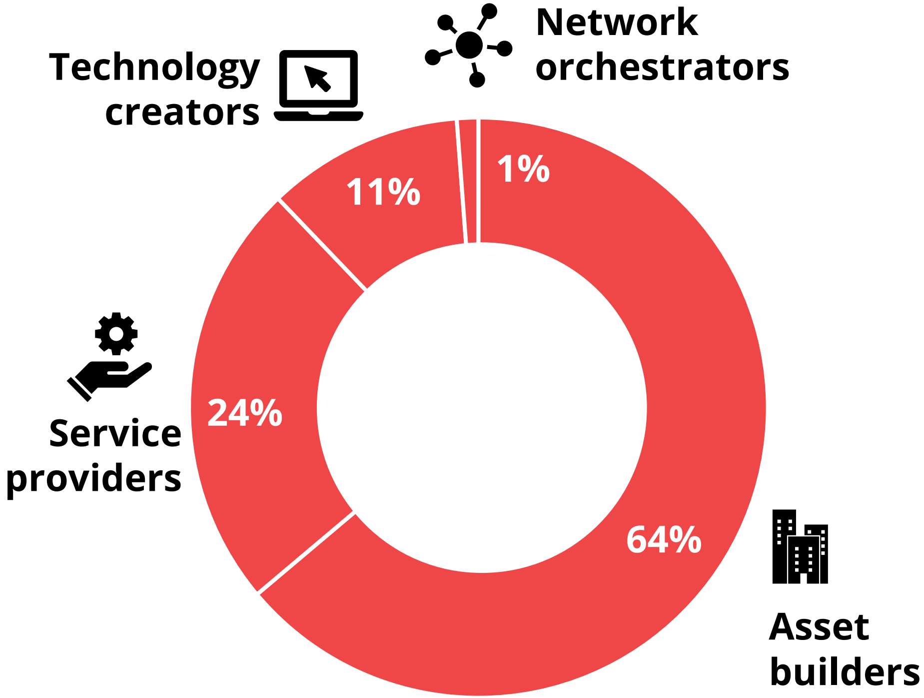
BUSINESS MODELS SPAN ALL INDUSTRIES



Source: Libert, Beck, Wind, 2014

CLASSIFYING S&P 1,500 INTO THE FOUR BUSINESS MODELS

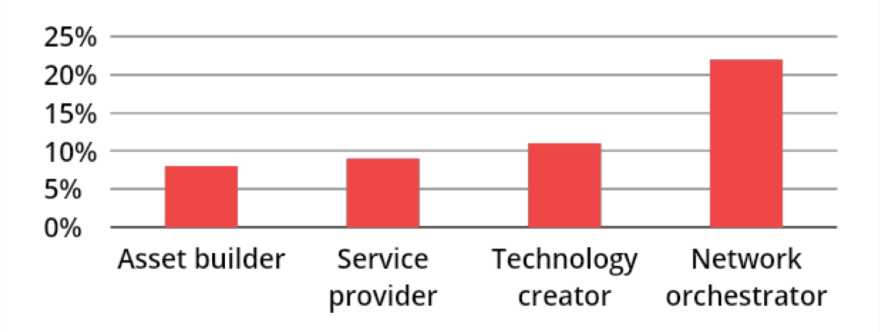
Companies on the S&P 1500 Index	1,519
Companies excluded for insufficient data	-76
Companies excluded for REIT status	-92
Companies analyzed	1,351



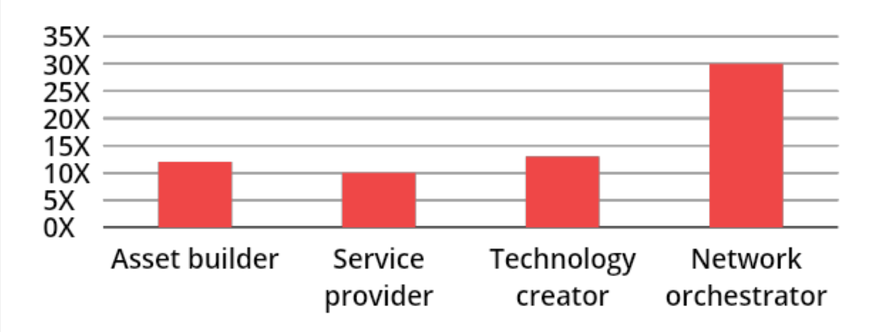
Source: Libert, Beck, Wind, 2014

NETWORK ORCHESTRATORS OUTPERFORM FOLLOWED BY TECHNOLOGY CREATORS

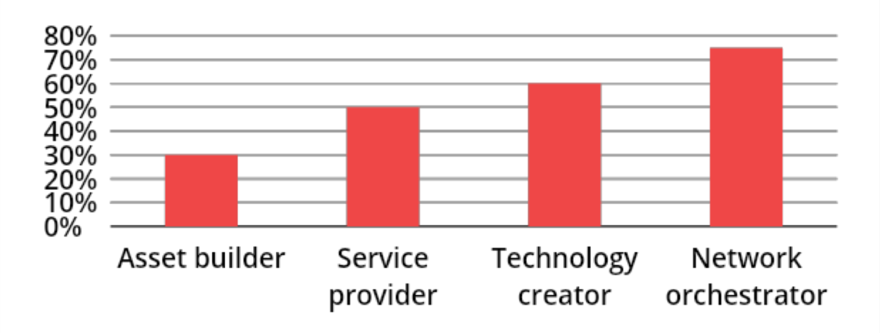
Sales growth (year over year)



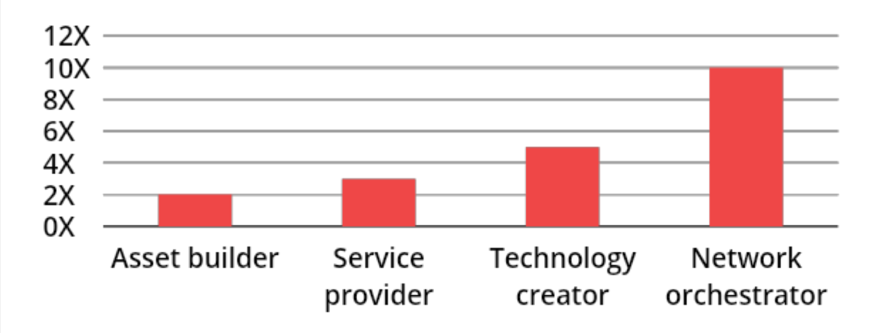
Return on assets



Gross profit margin

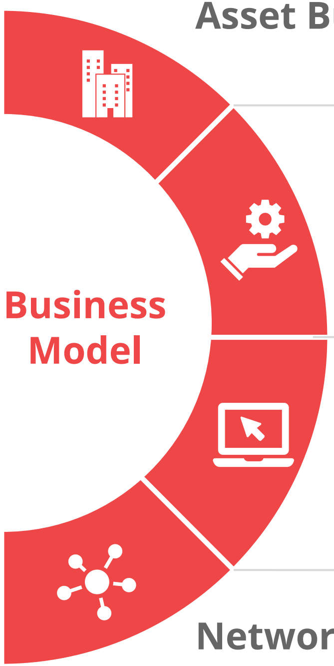


Multiplier (price/revenue)



Source: Libert, Beck, Wind, 2014

BUSINESS MODELS SCALE DIFFERENTLY



Asset Builder

- Additional input materials, plants, production time (i.e. asset heavy scaling)

Service Provider

- Additional people to recruit, train and deploy (i.e. manpower heavy scaling)

Technology Creator

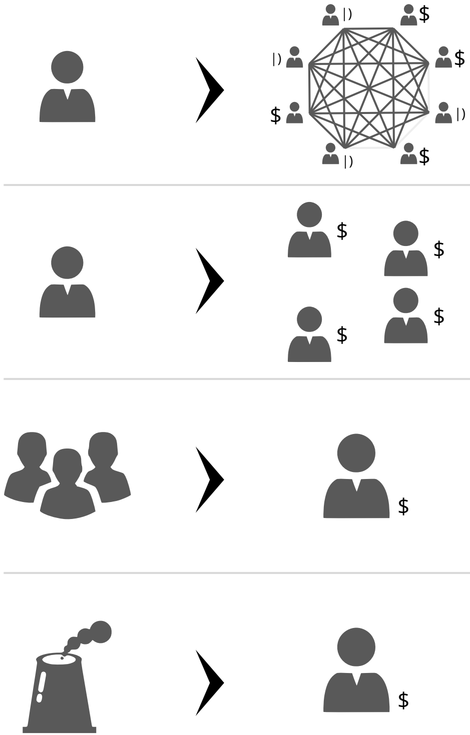
- Resources to manufacture pharmaceuticals or duplicate software(i.e. low marginal production cost beyond R&D of first product)

Network Orchestrator

- Least expensive to scale as the network contributes products and content

Source: Libert, Beck, Wind, 2014

COST OF SCALING DIFFERS BY BUSINESS MODEL



Network Orchestrator	Many make, many sell	Low scaling cost
Technology Creator	Make one, sell many	
Service Provider	Hire one, sell one	
Asset Builder	Make one, sell one	High scaling cost

Source: Libert, Beck, Wind, 2014

VALUE SHIFT

S&P 500 - 1975

83%

of market cap accounted for by ***tangible*** assets

S&P 500 - 2015

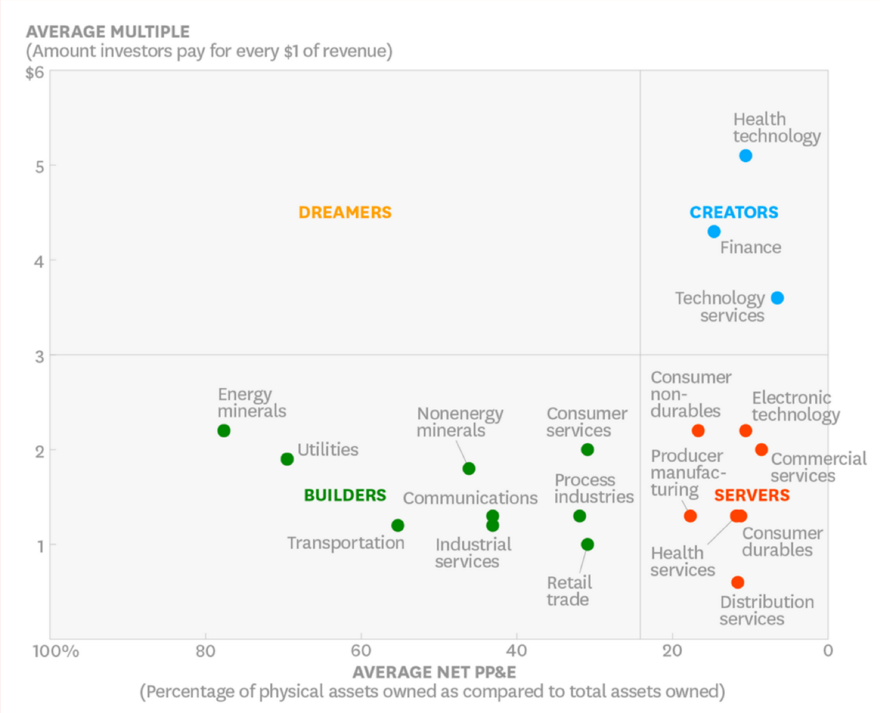
85%

of market cap accounted for by ***intangible*** assets

The value of intangible assets do not diminish with use – they often appreciate with use

Source: Libert, Beck, Wind, 2014

RELATED FRAMEWORK: **HIGHEST VALUED COMPANIES HAVE FEW FIXED ASSETS AND RELATIVELY FEW EMPLOYEES**



BUILDERS include industries such as utilities, energy, transportation, and retail. These industries are asset-heavy, with PP&E making up more than 30% of total assets. They are also value-light, with multiples topping out around two.

SERVERS are asset-light industries. Although these industries have lower PP&E on average, they are still using non-scalable assets, namely human beings, to provide services. This scaling limitation seems to have an effect on enterprise value, and their multiples also fail to rise much higher than two.

CREATORS is where the most value is being created these days. The health technology and technology services industries are creating highly scalable, and highly desirable, intangible assets. Thus, they have low PPE but high multiples. You'll notice that the finance industry is included in this group as well. But its location on the chart is due mostly to the inclusion of real estate investment trusts (REITs), which pay out high dividends to investors.

DREAMERS is an empty category. There are no industries with a high proportion of physical assets *and* a high revenue multiple.

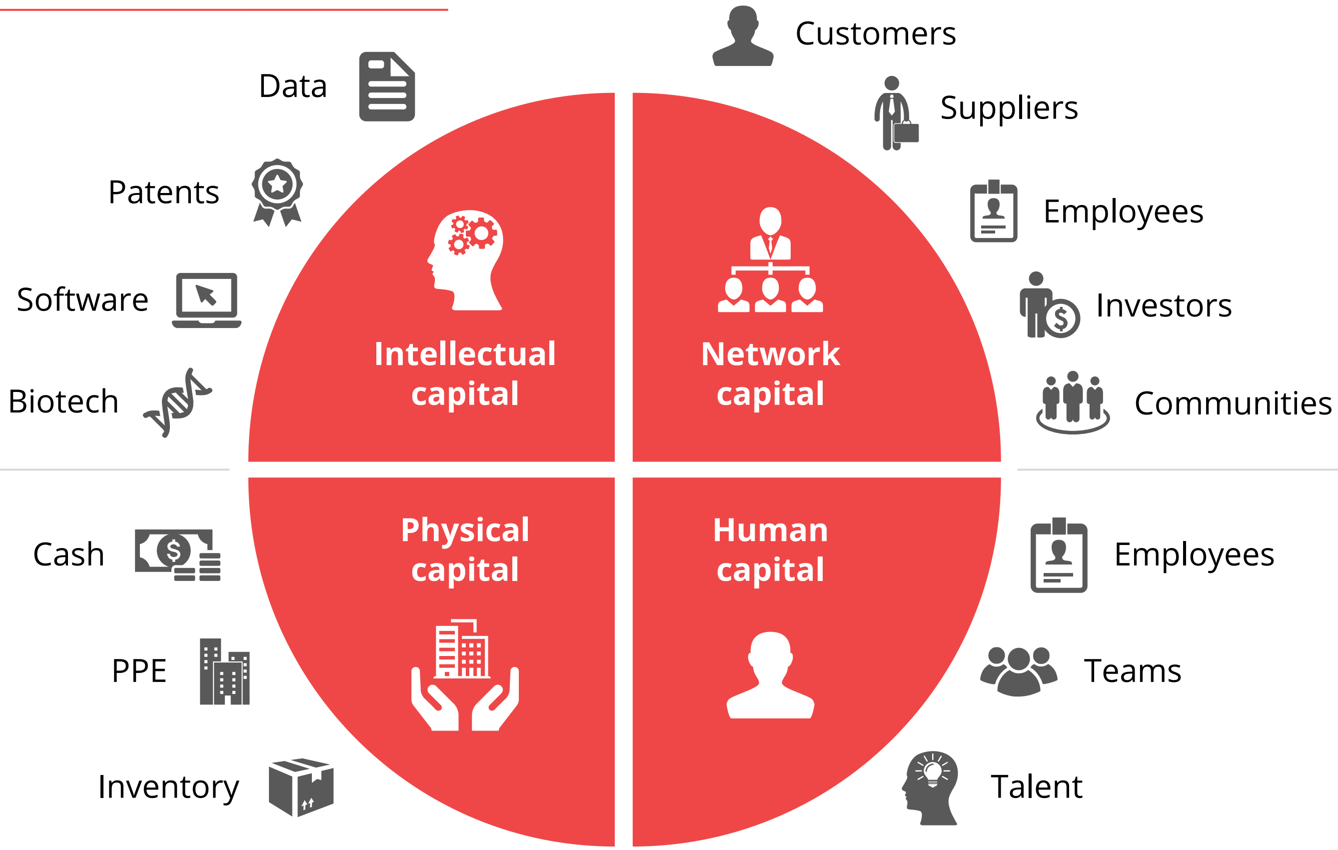
Source: Libert, Beck & Wind, Harvard Business Review, 2016

ACTIVITIES, KPIS AND ASSETS

	Which of the following activities is most important for the competitive success of your organization?	What KPIs are the most important for leaders to track in your firm?	Values to consider your values, it's helpful to start by reflecting on how you think about the four types of assets
Asset Builders	Efficient manufacturing, distribution, and operations	Inventory turnover, production efficiency	Physical assets such as factories, stores, products, and inventory
Service Providers	Hiring the right talent and keeping utilization up	Hours billed, employee utilization	Human assets such as skilled workers and customers
Technology Creators	Protecting IP and developing new technologies	R&D output, creation of new IP (patents, software, biotech)	Intellectual capital assets such as R&D, patents, and software
Network Orchestra-tors	Creating customer interactions and tapping in to the crowd	Visitors, users, subscriptions, and transactions	Network assets such as relationships and platforms

Source: Libert, Beck, Wind, 2014

THE ASSET INVENTORY



Source: Libert, Beck, Wind, 2014

LEGACY VERSUS NETWORK COMPANIES

Legacy organization

- Focuses internally
- Grows slowly
- Uses its own capabilities
- Sells its own products and services
- Has high marginal costs
- Has low profit margins
- Has a low multiplier

Firm-centric

Network organization

- Focuses externally
- Grows quickly
- Uses the capabilities of its network
- Lets others make and sell products
- Has near-zero marginal costs
- Has high profit margins
- Has a high multiplier

Network-centric

Source: Libert, Beck, Wind, 2014

TRADITIONAL VERSUS NETWORK MINDSET

Traditional Mindset

- What value can my firm provide to customers?
- How can I sell more products to customers?
- How can I optimize my company to operate at full capacity?

Network Mindset

- What value can my customers, partners, employees, advisors, alumni offer to the network?
- How can I engage my customers and partners to co-create products and services and how can I turn them into powerful advocates?
- How can I gradually expand and maximize the potential of my networks?

Source: Libert, Beck, Wind, 2014

NETWORK ORCHESTRATORS FULLY LEVERAGE DIGITAL TECHNOLOGIES

Benefits Provided

Digital Technologies		Benefits Provided
	Mobile technology	Convenience – interact whenever
	Social media	Access – global access through search
	Cloud technology	Integration – link with other services
	Big data analytics (AI/ML)	Scalability – inexpensive scaling
	Internet of things	Analytics – search, index, mine data

Source: Libert, Beck, Wind, 2014

TRACKING

Tracking The Network

- Size of the network
- Level of network activity
- Value created by the network
- Network sentiment
- Network loyalty
- Network growth rate

Tracking The Platform

- Ease of use
- Uptime versus downtime
- Number of interactions
- Number of active users

Tracking The Team

- Team morale
- On-time and on-budget projects
- Direct interactions with the network

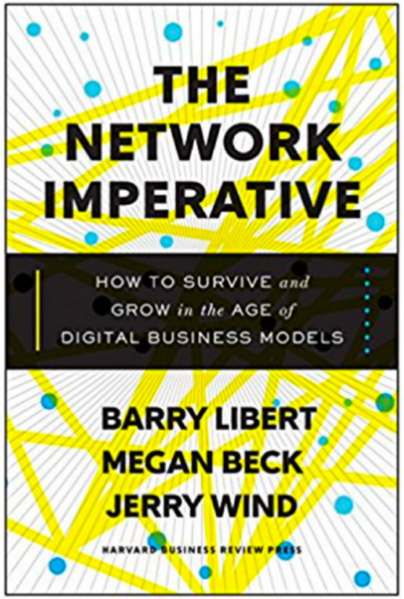
Source: Libert, Beck, Wind, 2014

DOMINANT LOGIC

	Which of the following descriptions best describes your organization?	Where does the bulk of your allocated capital go?	What does top talent usually do at your firm?	What risks are of greatest concern of your organization?
Asset Builders	Manufacturer, distributor, or retailer	Property, plant, and equipment (PPE)	Plant, production, and operations	Damage to PPE, loss of inventory
Service Providers	Professional services, care provider, or consultancy	Payroll for employees who provide services to customers	Client or customer services	Loss of key employees
Technology Creators	Developer or creator of technology, biotechnology, or pharmaceuticals	Research and development for software, patents, and other IP	Research and development	Inability to protect your IP (pirated software, generic drugs, etc.)
Network Orchestra-tors	Platform provider, facilitator, or connector	Building and evangelizing a network or platform	Digital development (cloud, big data analytics, social, and mobile)	Loss or declining loyalty of customers

Source: Libert, Beck, Wind, 2014

FURTHER READING



BUSINESS MODELS

Investors Today Prefer Companies with Fewer Physical Assets

by Barry Libert, Megan Beck, and Yoram (Jerry) Wind

SEPTEMBER 29, 2016

SAVE SHARE COMMENT TEXT SIZE PRINT $8.95 BUY COPIES

Having physical stuff just isn't as great as it used to be.

At home, we're Marie Kondo-ing our way to minimalism, buying experiences rather than things, and using services – Netflix, Spotify, Uber – rather than owning assets such as movies, music, and cars. The companies that provide those services and enable us to share what we have (insights, relationships, assets) with others not only are valued more highly by investors but also are relatively asset-light themselves. Amazon has only a handful of brick-and-mortar stores, Uber doesn't manage a fleet of cars, and Ebay doesn't manage a supply chain.

https://hbr.org/2016/09/investors-today-prefer-companies-with-fewer-physical-assets

INNOVATION

What Airbnb, Uber, and Alibaba Have in Common

by Barry Libert, Yoram (Jerry) Wind, and Megan Beck

NOVEMBER 20, 2014

SAVE SHARE COMMENT TEXT SIZE PRINT $8.95 BUY COPIES

When Facebook acquired the messaging service WhatsApp for $19 billion in the spring of 2014, the question on everyone's mind was, *does the service really merit a valuation of almost 20 times projected revenues?*

WhatApp's valuation may be extreme, but huge gaps between revenues and valuation are increasingly common. Cloud-based sharing service Dropbox received venture capital funding at a valuation of $10 billion, or 40 times revenues. Airbnb.com raised funding at a valuation of $10 billion, which would make it worth nearly 20 times its revenues – and worth more than Hyatt Hotels or Wyndham Worldwide. Taxi-replacement service Uber is currently raising funding and is expected to see a valuation of $30 billion, estimated to be more than 15 times revenues. Most recently, Alibaba's IPO raised funds at a value approximately 10 times revenues.

These companies represent a new trend in the types of business that investors prefer. Leaders of more traditional companies are left wondering why these upstarts merit such high valuations. Are they more profitable? Do they see faster growth? Do they have higher return on assets and lower marginal costs?

Our answer is yes – to all of the above.

https://hbr.org/2014/11/what-airbnb-uber-and-alibaba-have-in-common

BUSINESS MODELS

Why Are We Still Classifying Companies by Industry?

by Barry Libert, Megan Beck, and Yoram (Jerry) Wind

AUGUST 18, 2016

SAVE SHARE COMMENT TEXT SIZE PRINT $8.95 BUY COPIES

For more than 60 years, investors, analysts, business leaders, and even governments, have classified companies based on industries. First there were Standard Industry Classification codes, which were introduced in 1937, then the North American Industry Classification System, and now we have Standard and Poor's Global Industry Classification Standard (GICS). Even though these systems are updated regularly, we can no longer rely on standards and measures that were developed in a different age to reflect today's realities – especially when we're evaluating tech firms.

https://hbr.org/2016/08/why-are-we-still-classifying-companies-by-industry

CONTACTS

For further information, please contact:

Andreas Birnik
Partner, Antler
andreas@antler.co