Using Failure to Develop a Successful Business

Ron Craig
Wilfrid Laurier University, Canada

INTRODUCTION

Can failure play an important role in developing a successful e-comm, dot-com, or Internet-based venture? This chapter shows that testing the firm's business model provides quick feedback concerning what works and what does not. Often the only way to test the assumptions of a business model is through implementation. Failure can (and should) be a learning experience, whereby a venture confirms or modifies components of its business model and moves forward. This article starts with a review of business model literature, considers a recent start-up, and concludes with lessons learned. References and a glossary of key terms follow.

DEVELOPING A SUSTAINABLE BUSINESS MODEL

There are three broad pillars upon which a new venture is built (Timmons & Spinelli, 2004). These are an attractive opportunity, a capable venture team, and sufficient resourcing. The opportunity must include a viable marketplace (customers, distribution channel, sales and service support, etc.). High-tech ventures usually start with a concept, which needs to be developed into an actual product/service. This requires significant time and effort, with risk that the market may reject the product/service, or a competitor may get there first. Secondly, a team is needed. This team must capably cover both technical and business sides of the venture, from conception to launch to successful market penetration. An ideal team has prior experience in successfully launching a venture. Without this experience, the likelihood of wrong decisions and the time required to determine appropriate action steps can increase. Finally, sufficient resources (including financing) are required to carry the venture through the development phase and into active marketing, to the point of positive cash flow. Venture capital sources will fund high growth potential ventures using successive rounds of financing.

These three pillars support the venture's specific business model. There has been considerable confusion about the terms business plan, business model, e-business model, Internet business model, and business strategy. Sometimes the terms are used interchangeably, and other times they are used in a broad or narrow sense. As Rayport (1999) states, "In the end an e-business is just another business." In this article, the business model answers the question, "What is our business and how do we make money?"

An excellent discussion of business models is provided by Chesbrough and Rosenbloom (2002). They identify six functions:

1. Articulates a customer value proposition
2. Identifies a market segment (*who* will use the technology for *what* purpose; specifies the revenue generation process)
3. Defines the venture's specific value chain structure
4. Estimates the cost structure and profit potential
5. Describes the venture's positioning within the value network linking suppliers and customers (includes identification of potential complementors and competitors)
6. Formulates the venture's competitive strategy

Magretta (2002) articulates a less detailed view of business models. She states, "A good business model begins with an insight into human motivations and ends in a rich stream of profits." To her, a business model contains a story (narrative) that explains how the enterprise will work. A financial model (pro forma P&L, etc.) supports this narrative and shows the numbers side. There are two tests to apply to any proposed business model:

- **Narrative Test:** Does the business model tell a logical story, explaining who the customers are, what they value, and how the venture will successfully provide them with that value?
- **Numbers Test:** Does the pro formal P&L make sense? Are the assumptions reasonable?

Others have suggested alternatives. Clarke (2004) succinctly states a business model answers the question, "Who pays what, to whom, and why?" Hoppe and Breitner (2004) apply business models to e-learning, distinguishing three interdependent submodels (market, activity, asset), which comprise the holistic model. Mahadevan

(2000) sees three streams: the value stream (value propositions for various stakeholders), revenue stream (plan for assuring revenue generation), and logistical stream (addressing various issues related to supply chain design). Weill and Vitale (2002) identify eight different 'atomic e-business models', each describing a different way of conducting business electronically and supported by various IT infrastructure capabilities. Singh (2002) defines a business model as a method of doing business, and provides a taxonomy of current and emerging e-commerce models (emphasizing technology and participants).

Porter (1996) provides several frameworks to guide firms in selecting their strategy and business model. His '5-forces' model, physical value chain network, and generic strategies are useful frameworks. Rayport and Sviokla's (1995) virtual value chain framework is particularly useful for firms using the Internet. Porter (2001), in response to the question of whether or not the Internet renders established rules of strategy obsolete (as some proposed), answers that it makes strategy more vital than ever. He concludes, "In our quest to see how the Internet is different, we have failed to see how the Internet is the same."

Several frameworks that segment evolution of a new firm provide a complementary approach to viewing venture creation and growth. Kaulio (2003) identifies four perspectives: (i) milestones and time-pacing, (ii) venture capital financing, (iii) growth stages, and (iv) market entry focus. Depending upon one's purpose, any (or all) of these frameworks can be useful. For purposes of this chapter, a growth stages model is considered: conception, start-up, growth, maturity; our emphasis here is on the first three stages, whereby the venture establishes itself and its business model.

Building upon this introduction, the following section tracks the recent history of an entrepreneurial team and their venture. Planned failure during execution of the business plan provided a means of refining their business model. Using a 'shotgun' approach to product development, the firm investigated four initial products, developing two and introducing them to a particular market. One product turned out to be much more financially attractive.

BACKGROUND OF THE BUSINESS

On August 31, 2000, Cisco Systems announced they had agreed to purchase PixStream Incorporated, a Canadian privately held provider of hardware and software solutions to distribute and manage digital video across all types of broadband networks. Founded in 1996, and situated in Waterloo, PixStream ranked 22nd on ProfitGuide's 2000 list of 'Hottest Start-Ups'. With 1999 revenues of $7.2 million Canadian, the firm experienced two-year growth of 812%, and was getting ready for an IPO. Cisco paid, in shares, the equivalent of $550 million Canadian.

Only eight months later, with Cisco in considerable financial difficulty, the new owner announced that PixStream would be shut down. This sudden reversal of fortune could have demotivated the PixStream team. Yet, having previously experienced the exhilaration of starting and successfully developing a high-growth business, the core group of managers and engineers considered their options and looked for new opportunities. From this, Sandvine was born. The team not only developed a plan for a new business and found venture funding, but also negotiated a phase-out contract with Cisco to assist current customer migration from the PixStream/Cisco product. This provided start-up money and time.

DESCRIPTION OF THE BUSINESS

Sandvine's history is chronicled in Table 1. Some four years after start-up, Sandvine's Web site describes their product as "award-winning network equipment (that) helps broadband service providers characterize what really happens on their networks, enabling policies that improve customer satisfaction, reduce operational costs and increase revenue per subscriber." Their target customers are broadband service providers, and their customer value proposition is to characterize, control, and secure broadband traffic, thereby increasing network profitability. Initially their product focused on managing the bandwidth consumed by peer-to-peer (P2P) file swapping, and then added the capability of managing worms, viruses, spam, and DOS attacks. Worldwide, these problems add up to hundreds of millions of dollars in extra costs for broadband providers and degradation of service for users. For the typical ISP customer, payback is 12 to 18 months.

MANAGING THE BUSINESS

Unlike most high-tech ventures, Sandvine did not start with a defined product concept. Hence, the company's start-up phase focused on identifying market opportunities and testing these. It took some two-and-a-half years to develop a viable product and become established as a leader in managing bandwidth activities. Based on the founding team's knowledge of video networking, and their previous experience at PixStream and Cisco, four potential product areas were investigated: (1) voiceover IP (VOIP) equipment, (2) enterprise storage area networks (SANs), (3) fibre to the home (FTTH) systems, and (4)