BOB JONES: I was working in this consulting firm. I got bored. I wanted to go start a business, and I said it's not like I'm in my dorm room. It's not like I haven't done this before, so I need to be sensible about it this time. Because I've had start-ups that succeeded and start-ups that failed, and I like the successes more than I like the failures.

So I interviewed a bunch of people, scientists, marketing types, et cetera and came up with about 15 ideas and said that's too many. I need some filters. The first filter was I need to solve the right problem, because I'm good enough at operations that I'm going to hit the target. But it's embarrassing if you pick the wrong target.

So my definition of the right problem is that you would cheerfully pay for the solution and you will tell your friends. So I can lower your cholesterol with a nutritional intervention. It's not the right target, because you don't care. You'll forget to take it, your medication, most of the time, and you're never going to talk about it with your friends. And I can't afford to educate you, because I'm a start up.

If your back hurts, ooh, that's a whole different matter. Because if I can help you with something that makes your back stop hurting, you will cheerfully pay for it. You will tell your friends. And if furthermore I can set it up so that when you stop taking my stuff your back starts hurting, that's the right target.

Second filter, I have to be able solve the problem. So if I had an enzyme that metabolized gluten, I would be speaking to you today from my yacht. So that one's off the table. That killed all but about five of the ideas. The remaining filter was somebody besides me thinks this company is a cool idea and will buy it if I don't screw it up.

So the last thing I did was took the remaining ideas and called some senior execs that I was friendly with, had companies that could, well, one day buy the business-- Procter & Gamble, Johnson & Johnson, Pepsi, et cetera-- and said, I'm having some ideas. I'd like to hear your thoughts on them. I'm not selling anything.

Well, I knew you were up to something. What are you doing?

And when I would offer an idea, if I would hear crickets and-- OK, on to the next idea. That's how we arrived at sleep. There's somewhere between 50 and 70 million people in the US that have trouble sleeping, and they complain about it. And nobody has to tell them the benefits of a good night's sleep.

Everybody just feels better, and there are nutritional interventions that will solve the problem. And the companies I talked to said if you don't screw this up, we'd like to be first in line to talk to you in about two years.

So with that as background, I had several businesses in the past where we made nutrition bars and sold them through clinicians. So my business model was let's make a nutrition bar, and let's sell it through clinicians.

But I talked to a number of consumers and said, how do you feel about eating something at 10:00 or 10:30 at night that will have you asleep a half hour later? And most of them said I don't feel so good about that. I don't like the idea of eating something.

OK, what would you like? Well, you know those little 5 Hour Energy drink things? Make me one of those, except with the opposite effect. Oops, looks like I'm in the beverage business.

OK, well so maybe what I can do here is find the clinicians that you are seeing about the fact that you're having trouble sleeping, and I can do what I did before. My business model will be I will call on the clinicians.

The clinicians will say, this is fabulous. I will tell my patients. The patients will want to buy it. One day I will call Walgreens. We'll stock it there. We've done this before.

You may remember a little while ago I said I had a really bad five or six weeks where everybody told me no. I called doctors, nurses, physical therapists, dietitians. I went to assisted living facilities and retirement communities and talked to resident care directors. And without exception, I was told no.

People don't talk to their doctor about sleep. They talk to their doctor about their ear ache. If they do talk to their doctor about sleep, the doctor runs for cover, because he doesn't know how to solve the problem. And he's been trained that this is a symptom of something else. You are depressed and you need a therapist, or you have sleep apnea and you need one of those

Darth Vader devices that blows positive air pressure and it keeps you from having apnea.

So let's refer you to somebody else next. So nobody was willing to talk about our intervention.

This was the point-- at this point, we had made our minimum viable product, and we were offering free samples. And they didn't want it even if it was free, so clearly the business model was flawed. We weren't going to be able to get it into Walgreens or places like that if we couldn't find any customers. And the route I had chosen to get to the customers was not working.

Nevertheless, there were people who were calling us back and buying our minimum viable product. The one that looks bad tastes bad, and because the little manufacturer spilled a little solution on the threads and it dried into something like superglue, you need a vise grips to get the cap off. People were buying it anyway. Clearly we had something there, so it was time to address the business model of what is it we have, and to whom should we be marketing it, and how.

Along the way I ended up in a conversation with Whole Foods. Because when I was running a soy foods company I sold a lot of tofu to them, and I knew them. So I thought, oh, OK. We'll put this together. We'll sell it through Whole Foods.

But who is our customer? We did a lot of work, a lot of interviews, got told no some more and concluded that there are a number of niche markets here that we could work with. But the one where we were going to start was working moms, and not working moms who have infants or toddlers at home. They expect to be tired, and they want to be able to wake up if the baby's not sleeping through the night. So forget it.

But once their kids are preschool, kindergarten, or older, they've got the hardest job on earth. Most of them have husbands who don't shop, don't cook, don't pick up their socks, so they're hardworking. They're daytime professionals.

They're fussy about what they buy and what they bring in the house. They do shop at Whole Foods. It looks like the right market for us.

So in my conversation with Whole Foods, I was pretty direct with them and said, look, I can live a long and happy life and never put my products on your shelf. The moral of the point, I don't want to be on your shelf if it doesn't make sense. So really the purpose of this meeting in my view is to figure out will it ever make sense and if so, what's the trigger point.

And the answer to that was when we see enough reorders through Amazon to show that there's a there there, come back and see them. Keep them posted. They'll remain interested. We are after all friends, and it's a provocative idea.

So the revised business model now having gone through this postulate the idea, develop a minimum viable product, shake it down in the marketplace, identify the target is we're reaching working moms via mommy bloggers. We've identified 100 of them, some of whom have as many as 100,000 followers. There's also all manner of social media ways to reach working moms.

So working moms, we're reaching them. We're selling the product through our website which will be a minuscule percentage and through Amazon until such point as we have enough of a reorder stream to make a justifiable approach to Whole Foods and other retailers. Shortly after that, we hope to sell the business.

So Rich, that's sort of an impromptu summary of how our business model morphed and pivoted, and it's a work in process. So if you don't have anything else to do, wish us luck.

AUDIENCE: [INAUDIBLE].

BOB JONES: Thank you.

PROFESSOR: So the reason I wanted Bob to tell you about that is to reemphasize this is not just an academic exercise. He told you about how he succeeded before. He told you how he failed the first time. He did something different the second.

He took the second model into the third market, which turned out not to be the right thing for that market. And he's reinventing it. And it's been an interesting thing.

So what we say up here, we're not giving you a formula on how to do it. We're trying to get you to think about these kind of issues, and this is an example of an in-process thing. And it's been an interesting route. Bob, any other comments or people from the audience?

BOB JONES: It's practically a reality TV

RICH KIVEL: What were some of the learnings? It sounds like you modified the business model throughout.

There were learnings [INAUDIBLE] You integrated different approaches. What were some of the learnings that came out of that? What would you have done differently if you were relaunching it today?

PROFESSOR: Rich, is your mic on?

BOB JONES: OK. Rich's question, for those of you who may not have heard it from the back of the room, was what were some of my learnings so far? And if I were to relaunch the business today, what would I do differently?

And I think that most entrepreneurs are stubborn. I'm no exception to that. Well, you almost never tackle something that's going to be easy.

And I have a guy on my business advisory board who will give me 10 reasons why every idea I have will fail, and why every suggestion I make is dumb. And it's quite useful because eight of the 10 things he'll rattle off, I've thought about and addressed. And two of them I think, ooh, I'd better think about that.

But you have to be willing to walk through walls because it's hard. And most of you will fail. I did. You'll just need to decide that as a jockey, you need a different horse.

But I found something that worked. And I went out and proudly talked about it to the investment community. And then I tried it. And I tried it. And I tried it. And it didn't work.

So one of the things I would have done differently, were I to do it again, would have been to test the idea right from the get-go, rather than just assuming that because it had worked in the past, that this market and this group of people was like the last market and the last group of people.

PROFESSOR: That's great.

BOB JONES: Yes sir.

AUDIENCE: It seems like most of it is [INAUDIBLE]

BOB JONES: I don't really know how to do that. What I like is translating science, which is somewhere near to the leading edge, into something that consumers can buy. And I don't want to get metaphysical with you here. But I think there are some really fundamental things wrong with our health care system.

And we don't often enough provide consumers with stuff they can buy, which works, without a prescription. And I like being in that arena. And I like being able to understand what consumers want and translating some fairly serious science-- it's pretty sophisticated biochemistry in our little beverage for sleep-- into something that we can describe without going into all the science.

So I actually don't know. I don't really have any experience selling the one-off stuff. So with that as background, I'm going to duck your question. I don't know.

There was maybe one more. Yes, sir?

AUDIENCE: [INAUDIBLE]

BOB JONES: We had three ingredients in the product. And there were published papers on the action of each of the three. So sucrose gets metabolized here. Protein gets metabolized here. And gluconeogenesis runs through the liver, blah, blah, blah. And uncooked corn starch with its complex double bonds takes a far longer period of time to metabolize.

And we would show the papers to the clinicians. And they'd say, well this is a no-brainer. First of all it's just a food. So it won't hurt you. It costs $1.00. Might help. Go for it.

That was all the resistance we found. There were maybe 3% of the doctors out there that we called on who said, when you got a clinical trial on it, call us back. And we did in fact eventually do a clinical trial with the Joslin Diabetes Institute.

It did what it was supposed to do. But as an entrepreneur, I was unwilling to wait. Let's get in the market. My measure of whether or not it works is, do they reorder it?

PROFESSOR: Hey. Thank you, Bob. [APPLAUSE]

OK, so now segueing from what Bob told you about he's doing to find customers and everything, the question again is business models. And tonight we have Rich Kivel, who I've known for many years. Originally an internet IT technology entrepreneur, moved into the medical area and bio, and more recently into the financial technology area. So Rich Kivel-- his bio is on the website. And his topic is business models. Take it away, Rich.

RICH KIVEL: Thank you very much. Great. Can everybody hear me OK? All right. It's great to be back here. I've had the privilege of doing this class with Joe for-- he's invited me back for many years. I won't say how many, but many, many years. So it's also great to be here, being the 25th year of it.

Has anybody here actually attended this class before? All right. That's good. So I could tell some of the same jokes. And I will actually get laughs out of them. [INAUDIBLE]

So first of all, I want to start off because I love social media. And I'm going to include you in my social media life a little bit. So everybody here uses Twitter, yes? Or most of you?

That's our hashtag. So on the count of three, I want you guys all to cheer and yell in a congratulatory way for Joe celebrating the 25th year of this class, all right? One, two, three.

AUDIENCE: [CHEERING AND YELLING]

RICH KIVEL: You guys. I love it. Joe, that is live. That was outstanding.

So what I get to talk about today is actually kind of fun. It's business models. And unlike a lot of aspects of business, business models themselves, they change all the time. And as a matter of fact, they become an incredibly intricate and important part of how a business succeeds or fails, which is something new.

As I've worked around MIT for the past 15 or more years, so often the researchers, scientists, engineers that I speak with are so focused on their product, their technology, the intricacies of a particular design, that they actually don't think about the customer. And they don't think about how it's ever going to get to the market. They're more interested in can they actually get that new particular engineering-physics combined technology to do something they never did before.

Can they get that particular molecule to operate in a certain way? Or can they get that thin film polymer to elude a particular drug? And that's fantastic. But very often we forget about how do we actually impact the world with our technologies, whether it be internet technologies, applications, hardware, software, biotechnology.

So business models are really the foundation of that. And very often that's left to business students. And one of the wonderful things about MIT is that there's this great convergence, where business students actually have discussions with engineers and scientists and researchers and vice versa. And that doesn't happen everywhere. So we take it for granted here.

So I'm very privileged to come and talk to you about business models. My background, as Joe said is-- I started my career in technology, and then moved very much into bioscience, biotechnology, bioinformatics, diagnostics. I spent about the past 10 years doing that.

I took two years off, and was focused specifically on the financial services industries. So I worked for a very large fund in Westport, Connecticut. Now back in the Boston area. And now focused again more on not only funding and financing of early-stage development companies, but also in identifying great intellectual property and technology, all-around science and research.

So today's talk is going to be about business models. And I'm hoping to share some insights with you. Essentially this is how I think of these things. We start off with a whole bunch of disparate data points. We call that information. Hopefully we begin to connect those dots.

It's almost like a pointillist painting, where you have thousands of dots. And then slowly as they come together, they start to connect. And then ultimately out of that, you have wisdom. You have an image that is created out of that. What I hope to do today is provide you each of those three-- information, knowledge, and wisdom.

So let's start off with a simple foundation. And the foundation is to say this-- many definitions of a business model exist. The one that I like the most is simply this-- a method by which a firm uses its resources-- cash, technology, its people-- to offer its customers better value than its competitors, and make money doing so. It tells who pays how much, and how often do they pay.

For those of you that are looking to start companies, or even begin to work for companies, especially early-stage companies, the question that the board, the investors, the new employee coming in the door are going to ask is, what do you do? Who do you sell to? And how do you make money? It's pretty simple.

The how do you make money part is often the challenge for many start-ups. They have very cool technology. They think they know who's going to buy it. But they have no idea how they're going to get it in the hands of those individuals.

Are they going to create a website? Are they going to join-- sign on to the app store? Are they going to go retail? Are they going to use a distribution channel or partner? That's the big crux of it.

So that's the question you have to continue to think about is, how do we ultimately make money from what we are developing? So what's changed a lot in the way we operate in this world is the way that companies operate, the way that companies are formed and developed. And this chart is not really meant, in great detail, to be read.

But overall, what you have here is an example of how over time, you have points of history where, as industries developed, changed, they went away, what you had is different ways of communicating with the world, different ways of actually connecting with consumers. If you think about back in the days of merchants and mechanics and industrial businesses, the way they operated and communicated was much different. Retail stores existed, but in a very, very, very different way. They were family-run stores.

Most of the products and services we bought from were from a few large retailers like Sears, whether that be your washer and dryer or your tools or other things. As technology continued to mature, what you saw is the financial service industry becoming very, very sophisticated. And the financial service industry began to allow us to see business in a global way.

Out of that came complex advertising campaigns, global marketing and distribution mechanisms. And what you saw is entirely new ways to buy and reach the end user, the products. What really changed is, at this end of the world, where you had technology, was then introduced in such a way that distribution of goods-- ultimately the ability to connect an individual who wants a product or service to that product or service-- the barriers of distance, the barriers of manufacturing suddenly went away. The United States has probably done this better than almost any place in the world.

We can get something delivered tomorrow that we ordered this afternoon at 11:00 AM or 1 o'clock in the afternoon, whether it be a product or service, because of financial support and backing for those type of organizations, whether it be the manufacturers, the UPS, the FedEx, and others. The distribution channels have shrunk greatly. When I travel to different parts of the world, they find an amazing selection of products and services that we have in the United States. And when you go elsewhere, you notice how limited it is.

If you're living in parts of Europe, if you're living in parts of Africa, parts of Asia, if you're living in most of Russia-- the ability to actually order something today and see it arrives in the next month is very, very unlikely. And the more remote you are, the less likely it is it's ever going to reach you on time, or without being lost in some part of the distribution channel. So I encourage you to think about, as technology has changed and distribution channels have changed, it has impacted the way that we operate and build companies.

So at MIT, when we think about how do you bring a company from the idea to the market, or what is so often called the lab to the market, the way you think about that has to integrate the business model. So for those of you here that are scientists or researchers or engineers, as you're thinking about your new products, your service, or your technology, you have to continually test who is going to buy this. How am I going to get it to the consumer? How will this ultimately impact the people that I care about, the people that are going to benefit from my product or my service?

Just as Bob was sharing with us-- before-- some of the learnings he had as he was developing his new company, were those bumps in the road as they realized that various ideas they had about, hey, we'll give it away for free. Or perhaps we'll go through this particular distribution channel. Those things did not work.

You learn from those. You incorporate. You speak to more consumers. You speak to more investors that are expert in the space. And you modify your approach.

So as all of you think about building companies, products, and technology, think about how are you getting it to the consumer. I think the mistake that a lot of people have is they think that as they read *The Wall Street Journal* or Bloomberg or MSNBC is, they hear about the stories of these companies, and the stratospheric growth of these companies. But they think success is this linear process, when it's really not.

Success is really messy. It's noisy. There's lots of bumps, lots of failures and challenges, whether it be because of market acceptance, technology failures, or it happens just simply because the market was not ready for what you were doing. The goal is for you to figure out throughout those bumps and those curves how to identify opportunity, and also how to modify your products and services.

So that brings us to business models in general. There's lots of different ways to think about a business model. Complexity was famous for years. I remember when I was in graduate school, they would talk about business models, sales and marketing and distribution. And it was mind boggling.

If they pass it out on an 8 1/2 x 11 sheet, you would need a magnifying glass to figure out what was happening because the distribution channels were not as sophisticated. The technology was not as sophisticated. So you had complex models. And within these complex models, there were lots of points of failure, lots of points where your reseller or your OEM channel-- your original equipment manufacturer-- or your distributor was failing, lots of points where the manufacturing was not succeeding or the retail environment was struggling.

So what's happened is you've seen simplification of business models-- these ideas that become simplified in such a way where you say to yourself, I'm building this, and I want it to be in the hands of these people, whether that be a consumer, a doctor, a lawyer, if it happens to be a large corporation. What's the easiest way to get there? And leveraging technology, leveraging all of those things that are out there, including the good advice of experienced people, will help simplify this.

An example might be Zipcar, a company we're all very familiar with. This is a relatively simple business model. It almost seems so simple that you'd be amazed if you presented this to an investor and said, this is our model. This is it.

And we're going to build basically a company worth-- a publicly traded company-- I don't even know what the market cap is at right now. Fantastic, successful organization, operating globally in many cities around the world. They kept it very simple, very organized business model.

How many people here use Dropbox? You get 2/3 of the group here that use Dropbox. When's the last time you saw a Dropbox advertisement on TV? It doesn't exist.

20 years ago, if you were looking to build a company, you'd have to have an advertising budget. You'd have to think about how we're going to wind up getting this into the hands of the right people. Who are the right people? Are we going to sell to businesses? Are we going to sell to individuals?

What's Dropbox's business model? How come you guys know so much about Dropbox?

AUDIENCE: [INAUDIBLE]

RICH KIVEL: How was that? Word of mouth.

Other people told you. It's viral. So somebody tells you about this incredible thing called

Dropbox. You can sign up for free. You can get a certain amount of megabits of space for free.

And all of a sudden, you start uploading photos. Or you're sharing PowerPoint presentations and documents. And your friend signs on. And then all of a sudden, you tell three other friends. And they sign on.

And then all of a sudden, when that is shown as viable, before you know it, they've got an entire model here that is making them a fortune, because they now have businesses and large-- what they call Pro subscribers, large users-- paying large dollars in order to access that data. It's fantastic. Does that look like a complicated business model? No, not really.

Here's another example of simplicity rules. We have the luxury of leveraging technology. And we also have different types of mechanisms in order for us to educate consumers. Viral marketing is certainly one of those we'll talk about today.

So simply put, your business model is not your business. Please remember that. The business model and business model innovation is critical in developing a quality business, attacking new markets and driving profitability. Just as Bob had shared earlier, the ability to modify change and dwarf your business model is critical because just one small change can make all of the difference.

And we're going to talk about some companies that made small changes. And it's made all of the difference in their success. So I'll do the academic part of this presentation to give you components of the business model. Then we're going to talk about some good examples. And then I'm going to leave plenty of time for Q&A, and end on time, as I promised Joe.

So from a business model perspective, there's lots of components. There's aspects of a business model that should exist. Overall, they're pretty simple.

What is the value proposition? What are the market segments that you're targeting? What is the value chain? And what is the structure of that value chain? Who's involved in it?

What is your position within that value network? Are you at the early, early stage from a standpoint of manufacturing? Are you at the end stage from a standpoint of actually delivering the product or service to the consumer or are you somewhere in the middle?

How do you generate revenue? And how do you generate margins? And those are two very different things.

There are companies out there we all know that generate tremendous amounts of revenue. And their margins are very tiny-- 1%, half a percent or less. But they make it up because the revenue is so extreme.

You have other companies out there that have exceptionally high margins, tremendously high margins, not very large revenues. Think about luxury goods resellers. Take a look at the average consumer that goes out and buys a luxury bag or a nice suit or an expensive watch.

Well I can go buy a watch from Movado. Or I can go buy a watch from Swatch. These are beautiful watches. They're made by large manufacturing groups. They're going through a very, very sophisticated distribution channel.

And they're made in the tens of thousands. Those watches are sold anywhere between $39.00, $49.00 up to probably $1,000.00. And they're sold in the thousands through retailers that you see in the mall, through retailers that are online, and also through big-box sellers like Walmart or Costco or others. You think, wow, that's interesting. Someone like Swatch and also Movado, which is much higher end, they both sell through similar distribution channels.

They do tremendous volume. So they have very, very high revenues. But their margins are incredibly small. The goal is saturate the market. Get as many people to buy as possible.

Take a look at other types of products that are similar that are called watches. Very often they're then called timepieces, where you have watches that are handmade, where they're made in a very, very subtle way, where it's a lot of on-hand or craftsman work and craftsman design, very low on the manufacturing side. It might take months to make a particular watch, if not longer.

And the watches sell for tens of thousands or hundreds of thousands of dollars. You think about IWC, Patek Philippe. Many of these watches will sell for $100,000.00 or $50,000.00 for a watch. Totally different business model. Their margins are very large. But their overall revenues are relatively small because they don't sell a lot of pieces.

Think about Mercedes-Benz. And think about Ford. If you base success on the total number of vehicles sold, Ford kills them year in and year out. If you base it on margins, slightly different story.

Ford has some products that are incredibly high margins, like their SUVs. They have other products, like their low-end cars that are very low margins. But they're looking to get adoption within a particular marketplace.

Mercedes, much different story. Very high margins on virtually every vehicle they sell. Much lower volume.

So all of these things have to be taken into consideration. You cannot choose your business model because it seemed like it made sense, because you saw a competitor doing it. You have to figure out where are you within that particular value network. The competitive strategy plays into that, and what stage of development is the company.

So I'm going to flip through a couple of these slides. And we'll dive into some examples. And I'm hoping you guys have lots of questions at that point.

So the value proposition, which is really number one here, is really a description of the customer problem, the solution that addresses that problem, and the value of the solution from the customer's perspective. The customer's perspective is very important here.

If I am buying, let's say an Apple product, which I see a lot of here, well there's a lot of things there that I as a consumer might be attracted to. I love the design of it, the size of it, the feel of it, the way it operates. If, for example, you're buying a desktop computer, and you chose to pick out a Dell, or you chose to pick out another type of manufacturer, not like Apple-- maybe you're buying it for entirely different reasons than that Apple user.

So think about what is it that the customer perceives as value. Is the customer looking for low cost or are they looking for speed? Are they looking for something? You need to make sure that your value proposition offers that.

From a market segmentation perspective, it's choosing your audience. And we could talk about this entirely throughout this class. But I'm going to keep it short. You have to know who that ultimate end user is. Who is that person that's going to write that check, recognizing that different market segments have different needs.

If you're selling, we'll use the example I did a moment ago-- if you're selling to that high-end watch buyer, who's buying essentially a timepiece that's going to be passed down for generations, that's a different type of buyer, a different type of a marketing approach than if you're selling a Swatch watch, which borders on a disposable watch. If it lasts five years, it's fantastic. By then, you probably have bought three or four more watches. Same thing for computers and cars and many other things.

Additionally value change structure and position in the value network are critical to this. And they're part of that initial slide I shared. So what is the firm's position in the value chain? What are the activities within the value chain? And how the firm will capture part of the value that it creates within that chain, because where you fit within that chain and how much of it you own is really, really important to know. If you're Netflix think about where are you in the value chain.

AUDIENCE: Describe the value chain.

RICH KIVEL: Excellent. So you asked if I could describe the value chain. So think about the entire cycle. And I'll use Netflix as an example, because I mentioned it. So what does Netflix do, essentially?

AUDIENCE: They're distribution.

RICH KIVEL: They're distribution. To who?

AUDIENCE: End user.

RICH KIVEL: The end user. They are at the far end, whichever end you want to call the far end. They're at the far end of the cycle. There's not much after that. They're distributing a movie, something entertaining, to us.

If you think about that entire value chain or that entire cycle, it goes all the way back, way, way, way back to somebody, maybe a year ago or 20 years ago that had an idea for a picture, an idea for a movie or a film, who then as they moved through that value chain, maybe they found a screenwriter. They ultimately, perhaps, found a studio.

That studio ultimately made a decision whether they were going to fund it or not, just like a venture capitalist. Movies are just like starting companies-- idea, all the way through to the business plan to the funding. That venture capitalist, or in the case of a movie, it's the studio that says, we love it. We want it. The story's outstanding.

We want to buy the story. We're going to put this much against it. They then build the team. So they find who's going to be the lead. Who's going to be the second? Who's going to be the third? Who's going to the action character? Who's going to be the romantic? Where is it going to be filmed?

All of these aspects are just like a business. They've got to find the CEO, the CFO, the CTO. They have to figure out where are we going to locate the company. Where's the best place for it to be? And then at that point, they start working on it, and toiling away, and filming it. And filming could take weeks, months, or even years.

Then ultimately, it's distributed. Now it might be distributed directly into theaters. Or if it doesn't get great reviews in the early, early days of distribution, it might actually go directly to DVD. And that's when Netflix jumps in. So if you think about it, that's a long cycle. And I probably skipped 30 parts.

So where do you fit within the distribution channel is absolutely critical for you to understand how you think about that, and where you actually capitalize and make money. Netflix also had the big challenge where they were facing a major competitor at that time when they first came to market. Does anybody even remember who that competitor was?

AUDIENCE: Blockbuster.

RICH KIVEL: Blockbuster got their butt kicked by Netflix. What happened? What happened was two major things. Number one, technology changed.

DVDs came out. VCRs were going away. So videotapes made perfect sense when you went into Blockbuster. It was big, bulky, didn't even think about shipping it, easy to break. It gets crushed, doesn't work so well, tape gets pulled out, whatever.

Blockbuster had a great model. They were at the end of the cycle to us, the consumer. They put little stores everywhere. And they made it easy.

But all of a sudden, the DVD world came out, where you were able to get super high-definition quality picture motion pictures on a DVD that is as flat as an envelope. Netflix said, hey, why are we building stores for these things? People already know the movie they want. Or they could use this new technology called the internet, and figure out what movie they want, which is mailed to them.

The other big challenge that Blockbuster had was the whole process of limited supply, and demand on that supply. So they penalized you if you don't return the video on time because they were losing revenue. If you didn't get it put in that little tiny box by 7:00 AM or 10:00 AM the next morning, you got charged a fee. Why? Because somebody else wanted their one of three copies of that movie. They couldn't have an unlimited supply.

Whereas the ability to reproduce and print DVDs-- virtually unlimited. Everybody in this room could order a DVD today of a hot movie that just came out. It could be at your house tomorrow. There's no distribution issue. The ability to reproduce that DVD, drop it in an envelope, and mail it to you is effortless, completely automated.

So what you have here is this convergence, where there was an opportunity. There was technological change, whether it be DVDs or internet or a combination of both, that allowed Netflix to completely crush Blockbuster. And then Netflix changed themselves, didn't they? They recognized that our ability to capture more bandwidth, the ability for us to actually download a movie was increasing in many parts of the United States, not everywhere, not everywhere.

But as our ability, especially in large cities, increased to download movies-- now all of a sudden, it changed to we don't even have to ship it to you anymore. All you have to do is download it. It streams to you. And then they created a whole series of other distribution channels. Now you can get Netflix on your Roku. You can get Netflix in all of these other areas.

So if you think about it, when the guy that started Netflix started off, it was a very simple model. People like movies. They're willing to pay for them so they can watch them at home.

DVDs are the new thing. And we've developed a complex shipping method and mechanism and a model of warehousing DVDs that we can get it to people overnight. And they can keep it for a day, a week. We don't really care, because we're going to keep shipping more.

It was so simple. The business model could not have been easier. But what they did is they continued to change and morph their business model as the technology changed. And they continue to stay far ahead of the curve. What is the latest thing that Netflix is now doing?

AUDIENCE: Producing movies.

RICH KIVEL: They're producing movies. How crazy is that? But can you imagine if you were the CEO of Netflix and you said to the VCs when you went in to talk to them a decade ago, well here's the thing. I got a business idea. What we're going to do is, we're going to basically kick Blockbuster's ass.

We're going to distribute these things on DVDs. And then we're going to start to do downloadable. And then, by the way, we're going to become a movie production studio.

Their head would explode. And they would just say, listen you have no idea what you're doing. And you don't understand how complex the market is.

That's why earlier I said, simplicity. When you launch your business, keep it simple. Show that that model is easy to understand. And then from there you continue to expand.

Who would have thought Netflix is now producing some of the best shows out there? *Orange Is the New Black* is one of the top shows out there, produced by Netflix. What are some of the other ones?

AUDIENCE: House of Cards.

RICH KIVEL: House of Cards. So you think about-- that's mind boggling. What is the difference between Netflix and Blockbuster? Leadership, the ability to change, the ability to see around the next curve, and actually change the business model of the company in order to adapt.

So I'll finish up this area of revenue generation and margins. We talked a little about that earlier. Competitive strategy-- how will the company attempt to develop and sustain a competitor advantage? And I've shared a little bit about that. Netflix is a great example.

And then one other component of this is where are you on the field? Understanding where your business is. And the Netflix example is one that is pretty clear. When you're over in this area here where you're pilot testing, and you're in the gestational area, or you're doing the roll out, or you're in slow growth, that may not be the time to take on two or three new business models or enter a different part of the distribution channel.

But as you start to get the terminal velocity, that's the time when you start to really look back and say, hey, now let's take a look at our market in a different way. We've got the velocity, whether it be the funding, the adoption within the marketplace. And then at that point, based on the maturity, you can start to think of expanding. So where are you on the field? It's always important to know that.

A lot of companies-- Blockbuster is clearly one of them-- that took their eye off the ball, and they just focused on what they were doing. And what they did is just stuff that we look at now.

We go, gosh, that was so naive. You thought maybe eliminating the late fees is going to solve your problem. You thought reducing price-- you thought more stores is going to-- you look at that now.

You say, wow, that's the best that management team could come up with. They were not stepping back and saying, where are we on the field, guys? What's happening in the entire space that we're playing in? And where do we play?

A great example is Google. This is a snapshot of the Google website launched September 4, 1998. Isn't that awesome? Has it changed very much?

Think about it. How cool is that? That is elegant. How simple. Look at that.

What is it up there? Index contains 25 million pages, soon to be much bigger. How many trillions of pages does Google have currently indexed? Think about that.

But what's also important think about is this-- Google could have state just like this. They could have stayed a simple what?

AUDIENCE: Search engine.

RICH KIVEL: That's it. Search engine. It could have been a great search engine. They could have been a better search engine than anyone.

That was what they were promoting. We will find you what you're looking for faster, better. We prioritize. We have complex algorithms. We have a whole bunch of smart people, probably from MIT, that are helping you find that weird shit you're looking for.

Seriously. You're looking for-- you need a pink doily that will be eight inches that is under a lamp for your grandmother's house. Or you're looking for a new hand-held device for something else. They're going to find it for you.

I'm looking to book a trip to Paris. They're going to help prioritize it, best hotels Paris luxury. Put those in, boom. Boolean search, we all remember. Put in all the complex-- the word plus this are in quotes.

They have better algorithms than Yahoo. They have better algorithms than AltaVista, better algorithms than NaviSite. The list goes on. They could have stopped there, and just continued to be the best search engine in the world.

And you know what? They're still killing everybody in search, killing them. People that like Bing or others probably disagree. But I think they kill it.

But what did they do as a business? Or I should say, what didn't they do since 1998 as a business? Look at what Google is today. Give me a few ideas, one word from a bunch of you. Just what is Google today besides search?

AUDIENCE: Brand.

RICH KIVEL: It's a brand. What?

AUDIENCE: Maps.

RICH KIVEL: Google Maps. Most of us live on Google Maps. What else?

AUDIENCE: Mobile.

RICH KIVEL: Mobile. Think about Google is the mobile app in so many ways. What else?

AUDIENCE: Browser. Email.

RICH KIVEL: I missed that.

AUDIENCE: Email. Browser.

RICH KIVEL: Email. Browser.

AUDIENCE: [INAUDIBLE]

RICH KIVEL: Yep. What I haven't heard, maybe somebody did say is Google is data. What Google is, is Google is data. They have figured out ways to capture, store, analyze everything we do. Google knows more about us than our families do. And because of that, they're able to impact the world.

Do you realize that Google Health, as an example, actually provides data, completely anonymous data, to groups like the CDC? If there is an increase in the number of people in the Northeast, specifically Maine, New Hampshire, Vermont that are in the increase in searches around a particular series of symptoms at a particular time of year, that data is actually given to groups like the CDC to help think about positioning cures, positioning vaccines, and positioning hospitals and support. Think about how powerful that is.

If there is all of a sudden, thousands of searches, because a bunch of moms in New Hampshire, Vermont, and Maine start Googling high temperature, all of these symptoms that might be relevant, or regular cough or these types of rashes, and that's regularly Googled, all of a sudden Google has a data set where they can see trends before anyone else can see them. They know everything that's happening on a very, very global scale, both micro and macro. And it really helps make the world better.

Now people will get scared and say, you know it's about privacy and all these other things. And I absolutely believe that. But there is good that can be created. This is a data company that is changing the world.

They know more about you because of what you search, how long you hover over a particular part of a website, what you do on a regular basis, the time of day that you do it, the type of things that you like, whether it be the type of music, the type of concerts, the type of places you vacation, the type of hotels that you shop. All of those things are very powerful. So Google is a data company, different than what their original business model was, or at least appeared to be. And part of it is because of this. This is--

AUDIENCE: [INAUDIBLE] accidental business model? Bt they weren't going to make any money. [INAUDIBLE] stumbling on [? ad words. ?]

RICH KIVEL: I think so, yeah.

AUDIENCE: --earned them the money to do all this stuff. [INAUDIBLE]

RICH KIVEL: I think you're right. I think it may have been accidental. It might have been the genius of Eric Schmidt, when he was put in there by the venture capitalists. It might have been a lot of very smart board people. It might have been a lot of factors.

But they harnessed that opportunity that everyone else had. Any of the other search groups could have done this. No matter how good the Google algorithms are, they're not that much different, I'm sure, than some of the best search out there. Are they much different than Bing? Are they much different than the other ones?

I don't know. Are those companies going to ever become as important on a global basis as Google? Think about Google Maps is great.

What about Google Earth? How many people here have not used Google Earth? Will both of you stand up? Everybody's used Google Earth. It's the coolest thing.

If I'm booking a hotel, and I'm booking a hotel in the north of Spain-- we go every year on vacation-- if I'm booking a hotel and I've never stayed at a hotel before, I will look at it on Google Earth because I don't believe the website that says across the street from the beach. It might mean across the street from the beach. And by the way, the street is also referred to as an eight-lane highway.

I'm not going to be super happy with that when I show up for vacation. So I'll Google Earth it. I'll see where it is. And I'll be able to see what's happening. It's incredibly powerful, these little things.

And they know I'm searching that. So it goes back to the data piece. And a lot of it is driven around this-- the fact that the change in price of storage has dropped so dramatically has transformed every bit of technology, whether it be the ability for Netflix to download movies or store them, the ability for you to get on an airplane right now, and while you're on that airplane, instead of watching one terribly chosen movie coming out of a ceiling projector, you have a seat in front of you that has a screen in it.

And you can pick from 30 movies. That's just storage. That plane has enough storage that we can pick from 30 different movies at each seat. If you're on JetBlue, you can actually watch streaming TV as well.

So because of this, everything's changed. The rules of the game have changed. So the question always is, what business model, and why? And if you think about each of these different businesses on the surface, if you didn't know any better, you would think they were in the same business.

Apple sells computers. So does Dell. Bentley sells cars. So does Cadillac. Vertu sells cell phones. And so does Nokia. But their distribution channel and models are dramatically different.

So I'm going to give you a few examples of what I consider really innovative business models. Some of these companies we touched upon already today I'll touch upon a few of them again. And we can go into any more detail you want or ask questions.

But I think Amazon is probably one of the greatest companies out there. Jeff Bezos is an absolute genius. Might be why he's worth over $20 billion. He has figured out a company that he started, based on the concept of selling books online and harnessing what was called user groups or essentially peer-to-peer communication in order to provide reviews. That was the initial concept.

We're going to sell books online. And we're going to harness the power of the internet, where people provide feedback about the books they purchased. Were they happy with it? Was it good? Was it-- et cetera.

We take all this for granted now, because since then we can pick movies that way. We can pick restaurants that way. We can pick hotels that way. That user experience is there.

But Amazon has gone far bigger than that. So I look at the Amazon business model. I say basically it's a business model of leveraging assets. That's the business model. How many of you have been following what Amazon's doing lately?

A couple of big announcements at Amazon in the past 30 days, the *60 Minutes* special. How cool is that? If anything, it could just be a project of Bezos. But think about just the idea of the drone concept of delivering packages in a way that actually reaches the consumer, essentially the goal being the same day that they order.

So they've got this drone concept that is going to allow these robotic drones to provide people packages. Now we all know there's lots of red tape there. You've got-- you've got the approval of the FAA. You've got all these other governmental issues.

But the fact that they are thinking that far out of the box-- think about this. I'm going to use that example from before. Imagine if Jeff Bezos walked into his investors and said, yo dude. I need some money because I got this idea.

We're going to sell books online. And people are going to tell us whether they like the books or not, which will then enforce whether we sell more books or not, whether we carry that author anymore. And then soon, we're going to have drones delivering stuff.

It's crazy. What can't you buy on Amazon right now? It's amazing. I can buy tools on Amazon. I can buy anything on Amazon.

The drones is one thing. The latest one that came out this week was fantastic. What was the other release that they were talking about this week regarding Amazon? I'm sorry. Say it louder.

AUDIENCE: [INAUDIBLE]

RICH KIVEL: Exactly. Did you hear the new word that came out for this? This is definitely going to be one of those things that's in the 2014 anticipatory-- so it's anticipatory consumer something or other. I don't even remember what it is. I just heard it this week. I loved it.

This is going to be one of those things that next-- at the end of this year, it'll be the new word that falls in to the dictionary. The concept that they know so much about us that they can actually begin to anticipate what we might buy, very similar to how Google is a data company-- they can anticipate what we're going to click on next-- Google can pretty much tell so much about you, just on what you're clicking on next, and the speed at which you do it, and how long you spend on a website.

Amazon does exactly the same thing. We all go on to Amazon now. And it will say, other people that purchased that product also bought these eight. Or here is your last purchases. Here's some recommendations for you. It's gotten so good that it's so much-- I don't even understand why people do junk male anymore.

It blows my mind. I get stuff in junk mail for clearly not my demographic, stuff that might be perfect if I was a 17-year-old girl or an 88-year-old guy. I'm like, why are they advertising that to me? It's amazing.

It's even when it just shows up, it's in my mail. I'm talking about inbox. So this stuff comes in. You think, what a wacky way to make money.

Amazon's got it down. They recommend things that make sense to me because they take a look. I've been an Amazon member for years. They can say, listen these are the kind of books this guy's ordered. This is the kind of music he's ordered. This is the kind of other stuff. Hey, we have some recommendations. They're not recommending to me silly things that just don't make sense.

So now Amazon going to this next approach, which is absolutely-- it's so MIT-ish, I loved it. It is algorithmically driven. It is anticipatory shopping, that anticipatory experience, where they actually believe that they're going to reach a point where they have such familiarity with you, that they have an idea what you are likely to buy next, based on prior purchasing habits, based on the time of day, the time of year, you name it, that what they're envisioning is that they will actually begin to ship those things to the closest warehouse to you, and deliver to them to you that day or the following day.

It's mind boggling. All-around data. Amazon's incredible. They're leveraging assets.

Apple-- we could talk about them for years. Has anybody here seen the Steve Jobs movie? I just watched that, coming back from California last week. That thing-- what a fantastic movie. And Ashton Kutcher did a fantastic job as Steve Jobs. But the genius of this guy really spoke about why Apple succeeded. And it was a great story about how he started, and got kicked out, and came back.

But it's really providing convenient solutions. Apple is about quality design. And stuff better work the first time.

When you plug it in, it better sync. When you go to the app store, it better be there. It better download. If it doesn't-- it's incredible how good they are. It's all about convenience. That is a totally different model than virtually every other computer company out there.

Dell's a great company, has a different model. We're going to build it custom. You tell us what you want in it. We're going to modify it any which way you wish. And we're going to ship it to you.

It's not the Apple model. Who would have thought years ago-- many of you may not even remember, but years ago there was no such thing as Apple stores. How do you buy an Apple computer? Well you bought it primarily online. There were very few distributors of Apple computers.

Apple started off selling to large school systems and others. And now the Apple Store is as common in cities in the United States and towns as a Starbucks. What a different model that is-- totally mind boggling.

When most people were moving away from retail box stores-- those expensive locations-- and moving to everything being internet, Apple said no, no, no. We want to be closer to the consumer. We want the experience to be superb. We want them to be part of this experience. They've then opened stores. And they're making tremendous money doing that.

Who knows Etsy? These guys are cool, aren't they? What a neat idea. Doing good on a global basis, something that could never been done years ago-- a business model where they basically figured out ways to harness the power of creativity, the power of different parts of the world, people living in small villages building beautiful things that would never be seen outside of probably a 500-mile radius of their village, if that, are now part of this very special network where they can build things.

And you can go online. And you can purchase them. And a very small piece is kept by Etsy. And most of it goes back to the artist, to the individual. It's phenomenal, the thought that somebody sitting in Peru or Uganda, or somebody sitting in a far part of Russia that builds beautiful things is actually selling them to people sitting in Japan or in Paris or in Boston. It's absolutely incredible.

Other innovative models Zara is probably my favorite. Everybody here knows Zara at this point. I love Spain. And I love Zara. They're an absolutely mind boggling story.

Who thought one company could innovate an industry that has been stagnant and without innovation as the fashion industry? The fashion industry has operated the same way for about 100 years. They have models. They have designers. They have magazines.

The only innovation, the only innovation that's actually hit the fashion industry is they sell some stuff online. They outsource manufacturing. They've been doing that for 75 years. They have expensive high-paid designers. And they basically have a distribution channel through retail. It's been exactly the same way.

The challenge is that many people who want high fashion can't afford high fashion. These guys came in and revolutionized the market. And their business model was harnessed and built around time-to-market. That is the business model. They put people at every fashion show that's important.

They're in New York, Paris, Milan, everywhere. And those people are there taking sketches, taking digital photos, and those things they believe the Zara consumer would want. Those things are imaged, sent back instantly to the factory. 50% of all Zara products are made in Spain.

They're sent back. They're built. And they're sent to the stores. Virtually none of the products you find in the Zara last in the store more than four weeks.

And they will not continue to replenish them. They've created this concept of scarcity, this concept that what you're buying is high fashion and it's in a limited supply.

That is fantastic, compared to you go to Macy's. And there's 800 of the same sweaters. And there's 8,000 of the same men's shirts. And if I go to a different Macy's, it's exactly the same.

There's no sense of scarcity there. Very low design, very high volume. However, if I walk into the Armani shop on Newbury Street or the Fendi shop, and look at the bags, there's a sense of scarcity-- high price, limited resource. This is this year's bag. This year's jacket.

Zara basically turned it on its head and said, no, no, no no. We're going to have scarcity and volume and price. And they nailed it on all of those. You don't ever see the Zara stuff of at Marshalls and T.J. Maxx, do you? Because they don't have excess inventory.

The reason you can walk into Marshalls and T.J. Maxx and pick up Burberry and Cartier and all these other brands is because Bloomingdale's and Macy's and all of them overstocked on them. The season changed. They don't know what to do with the stuff. So they slash price 60% off, 70% off, 80% off, then boom, it's off to Marshalls.

And those companies have created an entirely different business model of getting high-quality goods to consumers. Zara said, no, no, no. We're not playing that game. Let me ask you this. When's the last time you saw a Zara advertisement on TV? It doesn't exist.

When's the last time you saw a Macy's one-day sale on TV? Once a day. Entirely different business model, same industry. Zara is amazing.

I want to finish off these with Gillette who's absolutely just fantastic. Gillette, right here in Massachusetts. You see them on your way to the airport. This is the company that created the concept-- they created the first ever disposable razor, which is a fantastic concept, back in the '20s.

They then decided that they were going to stay at the cutting edge of technology. Gillette has over 1,000 patents just around the Mach3 razor. They have thousands of patents within their entire portfolio. And they will not start creating a new razor until almost a patent life has expired on the existing razors on the market. They do not want to compete against themselves.

They've created this mechanism. It's absolutely mind boggling. We get the Mach3 razor as a [? base ?]. It comes off the assembly line in the United States.

If you go to other countries, especially developing countries, they're getting the razor that was hot here five years ago because they realize that they can sell it for a third of the price in large quantities. Those countries can't afford the Mach3. But they can afford the one that was five years ago, eight years ago. And they're buying them by the millions.

And in addition to that, they created that concept of the razor-blade concept. It's essentially, you've got the razor. All you have to do is just keep buying the blades and buying the blades. And they can charge whatever they want for the blades. Or you have to start fresh with Schick or somebody else.

So it's a fantastic concept of high quality, patents there in order to maintain their position within the marketplace, and also customer stickiness. We gave them this pretty razor. It's beautiful. It's got metal on it. It's got nice colors.

They're just going to keep buying the blades, buying the blades, and buying the blades. So it's a fantastic series of different business models within one.

Other ones we're all familiar with are great groups like Kickstarter, PayPal are really leveraging the whole P2P revolution. It's absolutely amazing what you see. Craig's List is a fantastic example of that. Their website is about as sexy as the Google page. There's really nothing attractive about it. But it's an incredibly successful business.

We talked about Dell. They built their entire success around the just-in-time concept. We're going to build a computer exactly the way you want it. In addition to that, you've got the one day, one deal business model. We're all familiar with our inboxes full of Living Social and Groupon and all these other groups.

In addition to that, you've got other groups like Priceline, which I think is a phenomenal model, and really unique advertising too. They've taken an approach, unlike a lot of these groups here who you never see on TV. Priceline has taken the approach of using somebody like Shatner or other people that basically get them excited about-- you set your price, you're in control.

And some of us love that. Some people love Priceline. I have friends that use Priceline all of the time. Some of us just jump on. And we just go to expedia.com. And we book our hotel.

Or we go to the new one, Hotel Tonight, which is my favorite app, especially when I'm going to different cities. You jump onto Hotel Tonight, entirely different model. They only list hotels after 12:00 in the afternoon. They cut these special deals with the hotels for that night.

So you wind up staying at fantastic places because they knew at 11:55 they had availability. They released the rooms to Hotel Tonight. Hotel Tonight kills hotels.com, another one, that day.

It might not be the way to book a seven-day vacation. But if you're looking for two nights in New York City, it's phenomenal. It's all on your app, not on the website. You can't even do it on the website.

Uber's another fantastic example of that. Instant gratification, car-service quality, not a taxi cab, all web-based, all app-based.

So to summarize, value proposition, market segment and value chain are really understandings that you have to have in this area of developing a business model. Where do you sit in the network? Exactly where are you on the field? And revenue generation and margins-- those are two different things. You have to think about what's important to you.

Are you going to be a high-margin business, low volume? Are you going to be a high-revenue business and low margin? Or are you going to try to do what Apple does, which is a combination of both? Where do you fit within the competitive landscape? And of course, the stage of development of your company is critical. Where are you within that particular growth cycle?

And always remember that success consists from going from failure to failure without a loss of enthusiasm. And I'll close there. Thank you all. [APPLAUSE]