

Dot-Com Discretion

*A Five-Step Model for
Evaluating Internet Business
Models*

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It is certainly no secret that the commercial Internet revolution, which began in the 1990s, has been full of seemingly ordinary individuals attaining extraordinary success and wealth from their dot-com startups. While many of these success stories have evolved from highly technical concepts, others have grown and flourished from very simple ideas. Yahoo!, a search engine with \$60 Billion in market capitalization, began as a handful of Web pages containing hyperlinks to interesting sites on the Internet. Amazon.com, arguably the Internet's most successful retailer, started as a place for readers to find and order good books. While both of these companies have overcome tremendous hurdles in execution, they began in the mid 1990s as simple ideas generated by one or two individuals.

Today, Jerry Yang and Jeff Bezos, founders of Yahoo! and Amazon.com respectively, have achieved legendary status in the minds of most Internet entrepreneurs. Many aspire to the successful idea generation and execution that both have enjoyed. But perhaps more notably, many have used these two start-ups as benchmarks for conceiving and building the next "big idea."

Since the mid 1990s, though, the landscape for launching new Internet businesses has changed significantly. Perhaps the most crucial aspect of this change is the fact that many companies have already firmly entrenched themselves into different online industries, creating enormous competitive barriers to entry for new participants. Many would argue, for example, that launching a new search engine was a much more feasible idea in 1996 than it is today. A handful of competing firms have already established tremendous infrastructure toward making Internet search engines viable businesses. Quite

simply, they have a large head start over new entrants to this race. While it is certainly not impossible for another company to compete in this area, it would require tremendous economic resources well beyond the scope of many entrepreneurs' capabilities.

While many ideas today can be stifled because of deeply rooted competitors, there is still a wealth of entrepreneurial opportunity available. It is true that some of the most successful Internet companies started in 1995, but others are cropping up every day and will continue to do so as technology and consumers change and evolve.

With all of this in mind, how does an entrepreneur proceed in evaluating his or her idea? Is success ensured if someone has an idea that no one else is yet implementing? How does someone determine the likelihood of an idea catching on? How can competitive maneuvers be considered?

These are all questions that entrepreneurs instinctively ask themselves when evaluating a potential Internet endeavor. But with today's competitive climate, entrepreneurs must critically examine their potential enterprises using objective—not instinctive—criteria. At WebSolvers, a five criteria model is used to help businesses and entrepreneurs screen, process and refine their ideas. While these criteria are not wholly representative of what's needed to actually execute ideas, they have proven useful and conclusive in evaluating concept feasibility.

1. Identify a Clear Value Proposition.

Perhaps the most elementary step in evaluating an Internet idea is to identify a clearly defined value that the idea will add to the lives of its

customers. Yahoo! was very successful at the outset of its founding because it helped Web surfers organize the multitude of Web sites available to them on the Internet. Before Yahoo!, most Web surfers randomly surfed Internet addresses, primarily for the sake of novelty. But when users began to want a way to locate information on demand, Yahoo! was in a position to fulfill it. Yahoo! became useful to customers who wanted a way to locate unorganized information.

The first step in determining an idea's viability, then, is to examine its ingrained ability to deliver something of value to the customer. Business modeling experts call this the company's 'value proposition.' More often than not, customer value goes hand in hand with meeting the specific need(s) of a customer. When considering a value proposition, it is advisable to consider direct applications to meeting customer needs. If an idea provides compelling value to its potential customers, it has met the first of these five criteria.

2. Establish Factors of Market Differentiation.

Once an idea has been found to contain a strong value proposition, it must then be scrutinized for attributes which make it unique. It is no secret that 'being different' helps businesses establish themselves and build recognition. Analysts formally call this market differentiation.

Market differentiation comes in many different forms. Some businesses establish market differentiation through unique branding. Nike is an example of a traditional company that established market differentiation by making the word 'Nike,' the 'Swoosh' mark, and the slogan 'Just do it.' very recognizable symbols of product quality and consumer satisfaction.

Other businesses use patents to protect business practices or product composition. Amazon.com was able to patent and protect its convenient '1-Click Ordering' mechanism from competitors. It successfully defended its case in court when Barnesandnoble.com, a significant competitor, was found to be in legal infringement of Amazon.com's patent. Other businesses use price as a means of differentiation. Many argue that Internet consumers will migrate to online stores where prices are lowest.

Internet ideas which lack differing characteristics can quickly become commodities. When this happens, the company or product will lose its ability to attract or retain customers. If they can receive the same level of value from different sources (i.e., a host of competitors), differentiation has been eliminated. 'Being different' is more than a way to establish an identity. It's a crucial factor in building an online business and maintaining a competitive advantage.

3. Examine Potential for Growth and Scalability.

Now that an idea has been found to add value for customers and contain differentiating characteristics, the third criteria deals with the notion of growth. For any idea to be successful on a broad scale, it must possess certain attributes that position it for widespread adoption. Widespread adoption depends upon both the mass appeal and volume capability of an idea. In other words, the idea must be attractive to a wide audience and be in a position to support heavy demand.

Yahoo! has been successful in its ability to meet the individual needs of its customers. But a strong component in its economic success has been its ability to capture revenue associated with over one hundred

million customers. Several years ago, the company had only a handful of customers and a correspondingly low level of revenue. But along the way, the business was able to adequately scale to meet the demands of a tremendous number of customers. This has been complemented by over \$600 million in annual sales. A growth focus and capacity enabled Yahoo! to achieve success.

Very few companies will likely attract the number of users that Yahoo! has. Even so, any Internet idea must be evaluated for its ability to scale to a large volume of customers. This is not to say that a successful Internet company must support 100 million users. Quite the contrary. An Internet idea need only support a wide enough audience whereby the volume of use is sufficient to the point where correlative revenue is satisfactory to the company's growth objectives. One business with several hundred users might realize the same revenue as another business with several million users. This all depends on the economic model of the idea. The reality, however, is that any successful Internet business must be poised for use by multiple customers whose participation suggests significant revenue potential.

4. Evaluate Sustainability.

Once a business idea has been determined to contain value, differentiation, and growth potential, the next step is to examine the sustainability of the entire package. Many Internet start-ups fall prey to the proverbial "flash-in-the-pan" syndrome because the fundamentals of their operations fail to observe a long-term view.

Assuming that an Internet idea is able to attract a widespread audience, it must then be examined to see if the

initial attraction can be converted into a long-term commercial relationship. As with online and off-line businesses, the cost of attracting and acquiring new customers is more expensive than serving existing ones. An Internet company's success depends on its ability to draw revenue tomorrow from customers it acquired today. If a company fails to bridge the gap between gaining customers and retaining them, profitability will be an almost impossible objective.

When evaluating prospective sustainability, it is important to consider competitive implications. If an idea seems to be gaining widespread attention from customers, it is likely doing so from potential competitors as well. It is best practice to assume that would-be competitors will attempt to duplicate an attractive idea. Evite.com, a company specializing in helping consumers plan social events with other consumers, attracted enormous consumer attention when it launched its service in 1999. Weeks later, Yahoo! put a similar service in place which helped it retain its customers. Evite.com must now continue to differentiate if it plans to retain its initial users and attract new ones.

With this in mind, Internet entrepreneurs must fall back on compelling factors of differentiation to ensure that competitors are unable to undermine the initial adoption of a new idea. While it is extremely difficult to create a new idea with widespread appeal, it is perhaps even more difficult to sustain that appeal.

5. Determine the Likelihood of Profitability.

The final—and perhaps most crucial—criteria for evaluating a potential Internet business is its economic viability. Specifically, the

potential for short term and long term profitability must be examined. While most Internet businesses are founded upon dreams of widespread customer acquisition and market penetration, these must be carefully considered within the context of profitability.

If an idea can attract all the customers in the world but cannot recover its cost of customer acquisition, it has nothing. If a company can provide a compelling benefit to a customer but cannot generate a profit, it has nothing. Many Internet start-ups begin with unbridled optimism and expectations, and consequently, spend money lavishly toward building infrastructure and acquiring customers. But when exponential spending is met with incremental revenue growth, the results can be disastrous.

This is not at all a pessimistic prescription. It is simply a conservative one. Companies that fail to counter enormous expenses with enormous revenue will likely encounter economic insolvency. While some companies will certainly realize tremendous gains on these initial expenses, they are in the minority.

This, the last of 5 criteria that compose the WebSolvers model for evaluating and refining Internet business models, is certainly not the least in importance. However, the 5 criteria should be examined in succession. If an idea doesn't propose significant value for the customer (Criteria 1), the question of profitability (Criteria 5) is irrelevant. By successively examining each of these five criteria, an idea can be effectively evaluated for viability.

Jerry Yang and Jeff Bezos have achieved overwhelming success with their companies because of great ideas. The landscape for Internet start-ups is a much different place today than it was five years ago;

competition is fierce and barriers to entry are high. With all of this in mind, ideas should be evaluated stringently in terms of economic viability long before considerable investment of capital is made.

WebSolvers, Inc., located in Winter Park, Florida, is a proven leader in creative Web site development, Internet hosting, marketing and e-commerce. The company is dedicated to serving customers in a new age of Internet services and challenges its clients to integrate the Internet into their daily business activities. The firm's home on the Web is www.websolvers.com.