Chapter 9: Creating Revenue Models
What is a Revenue Model?

- Revenue: Income gained from sales.
- A revenue model identifies how the company will earn and generate profits.
  - As an entrepreneur, this will give you a better chance of attracting investment.
Different Types of Revenue Models

• Some companies operate on one primary revenue model while others use a combination of models.
  – Each type determines different ways in which revenue is generated.
Different Types of Revenue Models

Unit Sales Revenue Model

- Measures the amount of revenue generated by the number of items sold.
- Retail businesses: Rely on the unit sales model by selling directly to consumers.
  - Includes physical goods and intangibles like digital products.
  - The razor and razor-blade model.
Different Types of Revenue Models

Advertising Revenue Model

- Amount of revenue gained through advertising products and services.
  - Has evolved from its traditional format to encompass the digital world.
  - It depends on developing a niche.
  - Another form is called promoted content.
Different Types of Revenue Models

Data Revenue Model

• It is used when they generate revenue by selling high-quality, exclusive, valuable information to other parties.

• Data brokers: Collect third-party information with people with whom they have no relationship.
  – Facebook, Google, and Amazon collect data directly from users.
Different Types of Revenue Models

Intermediation Revenue Model

• Describes the different methods by which third parties can generate money.
• Brokers: People who organize transactions between buyers and sellers.
  – Various entrepreneurial ventures have emerged to put a new creative spin on the role of the middleman.
Licensing Revenue Model

- Gives permission to other parties to use protected intellectual property.
- Licensing frequently takes place in the technology industry.
  - Many people design iPhone apps and then license them to Apple.
Different Types of Revenue Models

Franchising Revenue Model

• Describes how the owner of an existing business sells the rights to another party to trade under the name of that business.

• The franchisor helps the franchisee by providing support in:
  – Marketing.
  – Operations.
  – Financing.
Different Types of Revenue Models

Subscription Revenue Model
• Involves charging customers to gain continuous access to a product or service.
  – Traditionally applied to magazines and newspapers.
  – Growing number of startup companies also use the subscription revenue model.
Different Types of Revenue Models

Professional Revenue Model

• Provides professional services on a time and materials contract.

• Consultants, lawyers, and accountants often charge by the hour for their services.
Different Types of Revenue Models

Utility and Usage Revenue Model

• Charges customers fees on the basis of how often goods or services are used.

• Mobile phone carriers use this model:
  – Charge users a fee for the number of minutes used on calls.
Different Types of Revenue Models

Freemium Revenue Model

• Involves mixing free basic services with premium or upgraded services.
  – Businesses create at least two versions or tiers of products or services.
  – The company gives away the low-end version of the service for free.
Generating Revenue from “Free”

Offers a product or service for zero cost.

– Skype is an example of a freemium model that provides the functionality.
– It earns its revenue by charging for Skypeout.

Direct Cross-Subsidies

• Pricing a product or service above its market value.

– Cell phone companies lose money by giving away the phone handsets for free, but then cover the loss by charging monthly service fees.
Generating Revenue from “Free”

Multiparty Markets

• It is a free model that involves giving a product or service to one party for free.
  – It is the ad-supported free content model so common on the Internet.
  – The challenge is to prevent costly overuse.
  – It is often a viable option for web-based companies.
Generating Revenue from “Free”

Ideas for Multiparty Markets

<table>
<thead>
<tr>
<th>IDEA</th>
<th>EXAMPLE</th>
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<tbody>
<tr>
<td>Give away scientific articles, charge authors to publish them</td>
<td>Public Library of Science</td>
</tr>
<tr>
<td>Give away document readers, sell document writers</td>
<td>Adobe</td>
</tr>
<tr>
<td>Give away listings, sell premium search</td>
<td>Match.com</td>
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<tr>
<td>Sell listings, give away search</td>
<td>Craigslist New York Housing</td>
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<tr>
<td>Give away travel services, get a cut of rental car and hotel reservations</td>
<td>Travelocity</td>
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<tr>
<td>Give away house listings, sell mortgages</td>
<td>Zillow</td>
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<tr>
<td>Give away content, sell stuff</td>
<td>Slashdot/ThinkGeek</td>
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<tr>
<td>Give away résumé listings, charge for power search</td>
<td>LinkedIn</td>
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Revenue and Cost Drivers

- Revenue models influence who your customers are and how you reach them.
  - Important to have an understanding of what is driving both your revenue and your cost.
Revenue and Cost Drivers

Revenue Drivers

• More factors than just buying or selling need to be taken into consideration.
  – The first key revenue driver is customers.
  – The second key driver is frequency.
  – The third driver is selling process.
  – The fourth driver is price.
  – Testing hypotheses is the best way.
Revenue and Cost Drivers

Cost Drivers

• Two different types of costs should be taken into consideration:
  – COGS and operating expenses.
• COGS occur when a sale takes place.
• Operating expenses are the costs of running your business.
Revenue and Cost Driver

Income Statement

• Report that measures the financial performance of your business.
  – Subtracts the COGS and expenses from the total revenue.
  – The pro forma income statement is a projection of what the company could do.
  – Reflects depreciation and amortization of your company’s assets.
Revenue and Cost Drivers

Income Statement

- Operating profit: Amount left over from revenue.
- Interest expense: Good indicator of the company’s debt.
- Net income: What is left after all costs, expenses, and taxes have been paid.
- Comparing income statements: Helps set goals and strategies.
Pricing Strategy

• Startup entrepreneurs struggle with how much to charge for products or services.
  – The key to sustaining a new business is to create consistent revenue streams.

• Competition and planning the pricing strategy.
Pricing Strategies

Pricing Products and Services

• No right way to determine pricing strategy.
  – Prices will adjust as per demand.
  – Positioning and brand of product or service will affect how much it sells for.

• Think of 3 to 5 words to describe your business.
  – Carry the theme through your packaging, website, etc.
Pricing Strategies

Different Types of Pricing Strategies

• There are many different pricing strategies:
  – Competition-led pricing: Copy the prices of other businesses.
  – Customer-led pricing: Ask customers.
  – A loss leader: Offering a product or service at a below-cost price.
  – Introductory offer: Encourage people to try your new product by offering it for free.
Pricing Strategies

Different Types of Pricing Strategies

• There are many different pricing strategies (Contd.):
  – Skimming: For new products or services.
  – Psychological pricing: Encourage customers to buy based on their belief.
  – Fair pricing: Both businesses and customers believe that the pricing is reasonable.
  – Bundled pricing: Packaging a set of goods or services together.
Calculating Prices

• Calculate prices that will help you decide which one is best for your business.
  – The key to pricing is to ensure you make a profit.

• Breakeven analysis can also help set price.

• The formula is:
  – Breakeven units = Fixed costs / (sales price per unit – variable cost per unit).
Calculating Prices

Cost-Led Pricing

• Involves calculating all the costs involved in manufacturing or delivering the product or service.

Target-Return Pricing

• Involves setting your price based on the amount of investment.
Calculating Prices

Value-Based Pricing

• Involves pricing your product based on how it benefits the customer.
  – The buyers have a major influence over pricing strategy.