

# 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.

# Different Types of Revenue Models

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## 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

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

**Source:** Anderson, C. (2009). *Free: The future of a radical price*. New York, NY: Hyperion.



# 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.