**Three steps to a sound business model**

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*Investors are paying more attention than ever to startups' business models. Here's how to make yours bulletproof.*

Portero, which operates an online market for luxury goods, secured $6.6 million in venture capital financing earlier this month. In the press release announcing the deal, one of the investors, LFE Capital Chief Executive Leslie Frécon, lauded Portero's business model as a "strong competitive advantage." That sort of comment may just sound like standard-issue boilerplate, and in many cases it can be. But it also points up an underlying truth that entrepreneurs need to understand: All successful ventures need a clear business model, and any qualified investor will want to see it before making an investment. The poor economic environment means even more emphasis will be placed on your business model.

But what is a business model? Investors and entrepreneurs throw this phrase around a lot, often without examining what it really means. On a basic level, a business model tells us how a business makes money. However, to get a deeper understanding—and to get investors excited—it's important to break up this concept into some key elements:

Customer Value Proposition: A strong customer value proposition means your product or service helps to solve a problem or provide a benefit. For example, Skype provides easy voice communication for free. That's tough to resist, even though the quality of the service is not up to that of a traditional telco. Athenahealth is another good example of a company that has a clear customer value proposition. Athena delivers a Web-based system to help physicians get higher reimbursements from insurance companies. It's a huge headache for doctors to keep track of the mind-numbing rules and regulations applying to reimbursements. Athena helps doctors save on administrative costs and improve revenues. Again, who could resist that?

While these companies have sophisticated offerings, their customer value propositions are downright simple. Unfortunately, the temptation for many companies is to mention as many benefits as possible, which often clouds the core message, not only for customers but also for employees. That makes it tough to get traction in the marketplace.

A foothold: Your customer value proposition, no matter how powerful, is worthless unless you get customer adoption. But it's often expensive to win customers, especially mainstream ones. One approach is to identify a niche customer segment of early adopters. These folks like experimenting with new things and can provide valuable feedback that improves your offering. This was the case with Facebook, which got its start at Harvard. Early adopters can also create lots of buzz, which is essentially cheap marketing.

Differentiation: In the 1990s, hundreds of companies entered the e-commerce space. But while many provided convenience and cost-effectiveness to customers, there was little differentiation. It was up to innovative companies such as Amazon.com to add unique functions setting them apart, such as user reviews, recommendations, wish lists, and speedy shipping. These all increased customer loyalty and made it difficult to switch to alternatives.

Pricing: Pricing can be another key way to build your customer value proposition. When Salesforce.com (CRM) launched in 1999, the company wanted to make it easier for customers to buy software. Until then, the typical strategy was to charge customers large up-front licensing payments on top of ongoing maintenance fees. Salesforce.com disrupted the industry by forgoing license fees and instead charging for the software as a service with a monthly subscription. That new business model helped turn Salesforce.com into a multibillion dollar company.

These characteristics form just a basic framework. Obviously, business models can take lots of work, and frequently evolve over time. However, in order to run a successful business, you need a clear understanding of your current business model. You certainly need it to impress investors, who are becoming more concerned about the viability of new ventures.

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