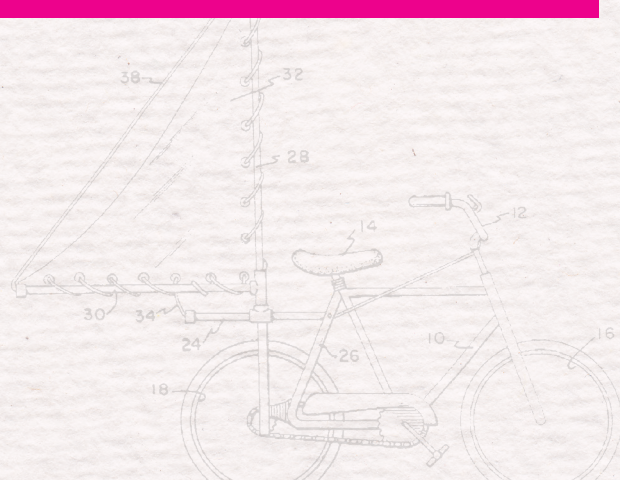
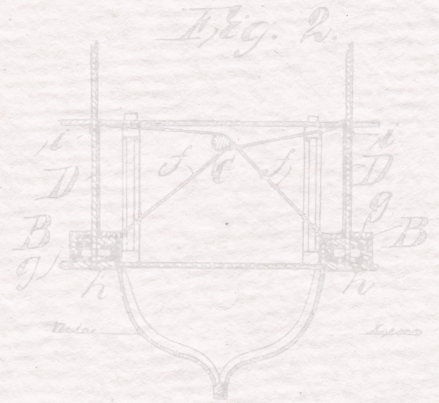
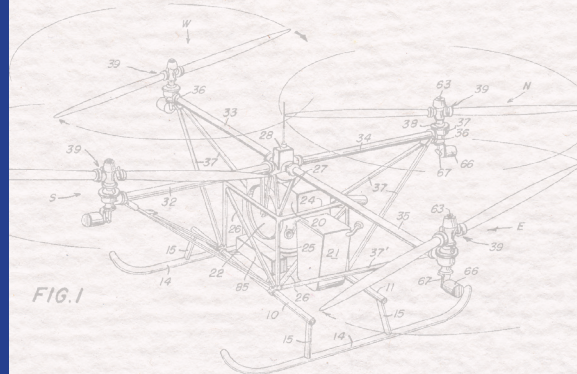
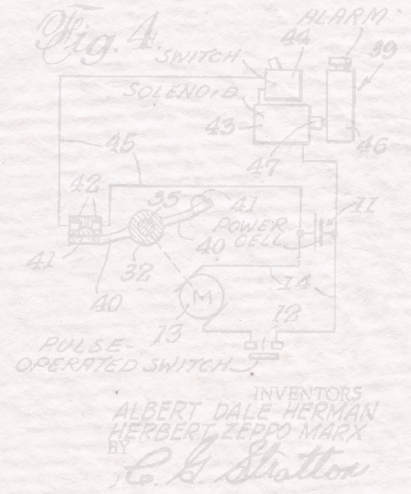
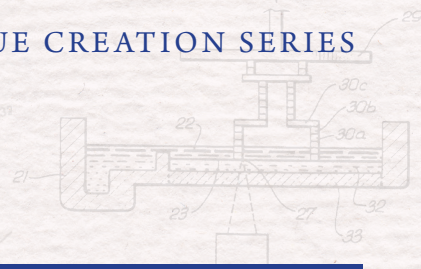


MAKING THE CASE

Value Proposition Analysis and Strategy

James M. Wilson III, PHD



TOOLS FOR BUSINESS VALUE CREATION SERIES

Making the Case

*Value Proposition Analysis
and Strategy*

James M. Wilson III, PhD

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I want to thank all of the students in my MBA classes at Bay Path University for providing the inspiration and many of the ideas for this text. Some students are “geniuses of misunderstanding” who can unearth any trace of ambiguity with a remarkable and surprising creativity. In an attempt to answer that challenge, my instruction and writing have become clearer.

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The US patents illustrated on the front cover (and their inventors) are, clockwise from top left: 20070011989A1, Sperry et al.; 4,575,330, C. Hull; 3,473,526, Z. Marx; 3,053,480, E. Vanderlip; 6,469, A. Lincoln; 2,415,012, R. James; 6,932,368, V. Zam; and D101,756, A. Einstein.

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Introduction

Diligence is the mother of good luck.

Benjamin Franklin

Businesses often begin with an insight into an opportunity. Imagine a phone that functions like a computer. How about a drink that combines vitamins and water? Could people use a website to rent out the rooms in their homes to travelers? You may recognize the companies that implemented these opportunities.

The start of the business idea is a *value hypothesis*.¹ A hypothesis is an assumption that requires empirical evidence in order to be proved true. Testing a hypothesis requires resources, and so new ventures must ask investors for money.

How can the investor know whether or not a value proposition is a good idea? For the prudent investor, the main factor in deciding whether to invest is the estimation of value: What is in it for the investor? What is the proposal's potential for generating profit? I asked students in my Innovative Growth Strategies class to review the television show *Shark Tank*, in which seasoned venture capitalists vet business ideas. After they had viewed more than ten episodes of the show, I asked my students what questions the “sharks” repeatedly asked. They produced the following list:

- **About value:** Does the entrepreneur have evidence that the product or service has a market? Is the value proposition unique and compelling? If

¹ Italicized words are defined in the glossary at the end of the book.

the business has already started, are there sales or evidence of potential sales, such as purchase orders?

- **About the business model:** Does the business proposal clearly explain how the business will make money? Will it do so through sales, royalties from licensing, franchising, or something else?
- **About growth:** Is the proposed target market growing?
- **About scalability:** Can resources be gathered to make the idea grow? Will it be easy or difficult to establish supply and distribution chains?
- **About appropriability:** Can the idea be protected? Is there intellectual property protection?
- **About expertise:** Do the people involved, the “agents” in the project, have the knowledge to compete in the market?
- **About commitment:** Have the agents invested any of their own money in the project? Do they really believe in the idea? Could the agents easily abandon the project without risk? How can they be held accountable?
- **About collateral:** Does the entrepreneur have collateral that could be liquidated to repay the debt if the project fails?
- **About return on investment:** How much investment is needed, and when will the investors get their money back?
- **About risk mitigation:** What are the potential risks, and what might go wrong? Does the project offer contingency plans in the event things do go wrong?

It is important to remember that these venture capitalists, aka “Sharks,” are looking at business ideas that are fairly well developed. If the entrepreneur’s ideas are not well developed, the investors’ risk increases. In order to offset this risk, the entrepreneur might be compelled to trade away more equity or reduce the amount of investment requested for existing equity, or to assume debt. The logic of the relationship among risk and return and investment is clearly on display in these television episodes.

Note that investors have many proposals to choose from; as the saying goes, “ideas are a dime a dozen.” When a business idea is presented, an investor compares that option with other potential investment options. Investors know that new ideas have a high failure rate and so they need to see a solid effort at due diligence in considering the opportunities and risks of an idea,

all persuasively presented. That presentation is called “making the case.”

Case analysis is a qualitative research method for investigating a particular area of interest. Whatever the area of interest, researchers use archival searches, interviews, focus groups, and surveys to gather data in order to better understand it. In this text we focus exclusively on how case analysis is used to vet a value proposition. Our guiding research questions are: How do we find and verify value, and is it worth bringing to market? The method developed in this book is a form of case analysis used by business researchers when considering *value propositions* for new ideas for start-ups or new corporate projects.

The text addresses the reasons for the high percentage of failures among new value propositions and links this failure to issues of cognitive bias, environmental uncertainty, and lack of a persuasive presentation of the proposed value. The biases derive from what psychologists call *System 1 thinking*. To overcome the biases and improve the chances of success, we offer a step-by-step method. This method of due diligence, we will learn, is a form of *System 2 thinking*. The method presented guides fact-gathering, evaluates findings, summarizes results, and estimates the risk for a value proposition. Examples of the method are provided throughout the text.

Case analysis can have many possible approaches that depend on the founding conditions of the idea. We consider three kinds of funding conditions that typify innovators: The Pure Entrepreneur, the Expert Entrepreneur, and the Intrapreneur.

Note that when we use the term “firm” in the text, we are referring to the resources and capabilities that are owned by, or are available to, these respective entrepreneurs to be used to launch a new idea. So, even if the business does not yet exist, the existing or needed resources and capabilities to start the firm can condition subsequent choices about innovation.

For the *Pure Entrepreneur*, the concerns are these: Is the idea feasible? Is it a “go” or a “no go”? For the *Expert Entrepreneur*, the concern is this: How can existing expertise be leveraged into a compelling value proposition? For the *Intrapreneur*, the concerns are these: Does this idea add to the firm’s existing strategy, or does the firm need to change its existing strategy by considering this new idea? These differences in priorities result

in analyzing and presenting cases differently for these different types of innovators.

I wrote this textbook for my students and my consulting clients, whose ideas represent many kinds of innovations. When they first develop a business idea, they need a direct and clear method to evaluate its viability. This three volume series, *Tools for Business Value Creation*, provides the entrepreneurially minded with the tools they need for the evaluation of business ideas. *Making the Case*, provides innovative methods for integrating archival research, quantitative modeling, and experimentation to develop the case for a value proposition. The methods and tools presented have been tested in classroom settings as well as in the real world.

Road Guide to the Chapters

Chapter 1, “The Challenge of Proposing Value,” discusses the reasons why so many value propositions fail to succeed in the market. The concepts of System 1 and System 2 thinking are presented, as well as concerns about environmental uncertainty. The chapter argues for use of a “method” in order to improve the chance of success in a venture.

Chapter 2, “An Overview of a Method for Making the Case,” presents an overview of a step-by-step method for analyzing a business value proposition, given the challenges of System 1 and System 2 thinking.

Chapter 3, “Transitioning from System 1 to System 1.5,” indicates how to harness the speed and intuition of System 1 and the methodical analysis of System 2 in a compromise method that we term System 1.5. System 1.5 allows for a quick and somewhat thorough assessment of an idea. Results from System 1.5 then allow for the future investment in System 2 thinking.

Chapter 4, “Finding and Considering Value,” describes research methods for exploring sources of value creation and enhancement. This chapter provides methods that may stimulate System 1 thinking.

The subsequent chapters address the methods of due diligence required by System 2 thinking.

Chapter 5, “Testing a Value Hypothesis,” provides advice and steps for conducting research to test the validity of a value hypothesis.

Chapter 6, “Methods for Archival Research,” explains ways to vet, organize, and cite research sources for archival research about the firm and its

environment, relying on historical secondary data.

Chapter 7, “Evaluating the Resources and Capabilities of the Firm,” addresses the challenges of researching a firm’s strength and weaknesses using archival data, as well as other approaches to developing an evaluation.

Chapter 8, “Evaluating the Boundary of the Firm,” discusses inter-firm relationships and how intellectual property is a key factor in such relationships.

Chapter 9, “Evaluating the Firm’s Environment,” examines Porter’s Five Forces for analyzing market structure, the PESTEL analysis for considering the broader environment, the product life cycle, and the innovation cycle. These frameworks provide a diagnosis of the environment, and that knowledge can help to refine a value proposition.

Chapter 10, “Connecting the Value Proposition to Strategy,” provides a range of potential strategic choices for the firm, given its resources and capabilities and the conditions of the environment.

Chapter 11, “Modeling Market Demand and Operational Costs,” demonstrates tools and formulas for linking marketing research to an estimation of sales, operating costs, and operating profit.

Chapter 12, “Financial Analysis of a Value Proposition,” shows how to calculate and interpret financial measures such as the net present value, internal rate of return, cost of capital, and hurdle rate. The chapter also describes how to estimate projections of start-up costs, which determines the initial investment for the venture. This estimate, in conjunction with the profit projections described in Chapter 11, can help you calculate whether a business idea is financially feasible.

Chapter 13, “Case Study: The Beastali Chef’s Knife,” puts all of the tools from the preceding chapters to work, in a detailed example.

Chapter 14, “Making the Case: Writing the Case,” describes how to write and present a persuasive and thorough case, using the sample case presented in Chapter 13.

Making the Case concludes with a comprehensive bibliography and a full glossary of business-related terms.

The three books of the *Tools for Business Value Creation* series provide a comprehensive tutorial for the entrepreneur:

Exploring Value: Research Methods for Entrepreneurs guides readers through the quantitative and qualitative research methods vital to entrepreneurship. Qualitative research methods include idea generation and selection, observation methods, interviews, focus groups, grounded theory, and knowledge creation. Quantitative research methods encompass surveys, quasi-experiments, and experiments.

What Counts: Data Analytics for Entrepreneurs explains quantitative and qualitative data collection methods and how such data are processed to produce discovery, diagnostic, predictive, and prescriptive analytics that help monitor and manage innovation, and all processes in the value chain for the entrepreneur.

Making the Case: Value Proposition Analysis and Strategy explains how to create a case study to evaluate the feasibility of a value proposition. Readers learn to investigate a business idea, using a step-by-step method for conducting “due diligence” to estimate market demand and financial viability.

These books provide the knowledge and tools an entrepreneur needs to research and prepare a business case. I wish you success in your venture.

All internet links are provided on a site associated with this text. Contact the author at info@vidya.press to request access.

About the Author

James M. Wilson III, PhD, is a serial entrepreneur, a consultant, and a professor of entrepreneurial thinking and innovative practices. He has lived the dream of starting a company in his apartment and having that firm sold to a Fortune 500 company.

He began working on big data in the 1990s and at one time owned the largest database on teacher education and work histories in the USA. He then started and grew a software company to deliver curriculum mapping for school systems. Another venture included sourcing manufacturing in China for small firms. His current interest is a social entrepreneurship partnership to promote the hand-loomed silks produced in Varanasi, India.

Dr. Wilson shares his business expertise with small firms on the verge of rapid growth. He has consulted with inventors and entrepreneurs in a wide range of fields, including viticulture, apparel manufacturing, healthcare, food service, forest management, website production, international outsourcing, and talent management. He shares a patent on software and services that detect pathogens in hospitals in order to prevent disease outbreaks.

His academic research emerges from his consulting work. Sample projects include explaining the reasons for the difference in success between Tokyo Disney and Disneyland Paris; studying the organizational requirements for rock-and-roll concert production; examining the human resource management of symphony orchestras; analyzing factors influencing motion picture box office revenues; and developing an ethnography of bazaar economics in India.

In addition, Dr. Wilson uses mathematical simulations to explore large-scale systems. His simulation of emergency medical services in Massachusetts was used in the conversation to privatize those services. He modeled a simulation of educator supply and demand in the northeastern United States. He also developed a simulation of competitive market evolution that explored the difference between intentional strategy and luck.

Dr. Wilson teaches research methods, innovative growth strategy, and entrepreneurial management strategies in Bay Path University's MBA program in Entrepreneurial Thinking and Innovative Practices. He was

the Assistant to the Provost, with the charge of promoting his university's transition to data-driven decision-making.

He earned his bachelor's degree in psychology and philosophy from Clark University and his MBA, an MS in resource economics, and a PhD in strategic management from the University of Massachusetts at Amherst. He is a graduate of the Exeter Humanities Institute and a Six Sigma Black Belt. He won his university's award for innovative thinking.

Dr. Wilson lives in Massachusetts, where he sidelines as a cheese and wine judge at the Big E, the annual "New England's Great State Fair."

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