



# Stanford eCorner

## Sketching Out a Business Model

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Video URL: <http://ecorner.stanford.edu/videos/2878/Sketching-Out-a-Business-Model>

Author and business model innovator Alexander Osterwalder sketches out a commodities business model with the help of Stanford students. The exercise examines the impact of customer segments, branding, logistics and value proposition on Nestle's Nespresso line of espresso machines and coffee capsules.



### Transcript

So, let's look at this visually, all the components of their business model. So, let's sketch it out. So, I didn't write any fancy value proposition here. I sketch to that with the strategy of machines and pods. So if you look at what they do within Nespresso machines, they sell them through retail, mainly to households about 85% of their market, little bit to businesses, they would have another sales force here. They sell the machine once and they don't even make it, they work with machine manufacturers because what they're interested in as you correctly pointed out are the pods. So, for the pods, they've a different strategy, they sell them directly through their own channels, started out with mail order and with call centers, then nespresso.com and now you find Nespresso stores all over the world, Champs-Elysees, Fifth Avenue, why do you think they set up stores, it's pretty expensive, you can sell everything through the Internet, why would they do that? Branding. Branding will develop a little bit. Prestige. Prestige, it's a very high-end brand, they ask you for a lot of money, six to eight times more for espresso and you can't establish that only through the Internet, so the similar strategy to Apple, right, building their own stores to create a high-end brand.

George Clooney is good, but not enough, okay, you need the stores. So, then you start buying the pods and then have recurring revenues with insanely high margins and all the money goes into their pockets. That's what makes them such a successful company. Now let's look at this side, what did you put up in key resources, what are some of the most important things in their key resources, what did you come up with? Patents. Patents, right? Patents is a key component of their business model. So, the entire business model is built on patents because otherwise anybody else could make pods and push the margins down. The interesting thing is, this year some of the patents are running out. So, it'll be interesting to see how Nespresso is going to evolve the business model because they need to change it, a business model is never finished, okay? What else do we have in the key resources, what else would be important here? Coffee! Yes. Straight forward, but they just want high-end coffee. What else? Give me another one.

What else would you put in key resources? Basically if you know, what you do here on the right hand side, you should be able to figure out what you need on the left hand side. Give me another key resource, anybody? What is missing? We have, patents, coffee... Access to an international company. Access to an international company, Nestle is pretty international, yeah, correct. What else? Transportation. Transportation, logistics - that would be more than key activities, absolutely. Capital. Capital, access to capital, maybe it's not so important here. Style. Okay, style, you might want to call it brand.

If you're in a consumer business you have no brand, you're dead, okay? And that's expensive to create. So if you want to go in that type of business, you better have this brand, okay? Then key activities, business to consumer distribution marketing production, interesting thing here this was the first time that Nestle sold to households. They were used to sending pallets to retailers. It's the first time they needed to build logistics that sends small boxes to households, okay? And if you know this here

on the left hand side, very quickly you can figure out the cost structure. So, on the right hand side, we have a little bit the front stage related to the customer, on the left hand side, we have the back stage that enables the front stage. Okay? See that duality? It's little bit like a mirror. So, why did I choose Nespresso talking at Stanford in the engineering school because there's something you can learn that's really, really important for you. When Nespresso started out, they were so close to going bankrupt. Why? It's exactly the same product, same technology because their business model didn't work, same product, same technology, their business model didn't work. This is how it look - I'll keep it simple, joint venture with machine manufacturers, so this is the similar piece to before, but they would sell it to offices, to companies through the sales force of the joint venture, through the sales force of the machine manufacturers.

Two things didn't work, offices were not interested, and the sales force, they didn't want to sell these small machines. Okay? So, that business model didn't work. Actually they invested a lot of money in this before they moved or pivoted it for use the Silicon Valley term to a new business model. Okay? The only reason why they did it is the board said we produced all these machines; our warehouses are full. We might as well try something else. So, they shifted to a new business model. They actually moved the inventor of this, who was the CEO, back to research where he came from and brought in a new CEO who came up with the business model that we saw. Okay? So, they experimented with that. But they could have done it in a less costly way; they would have experimented before building this business.