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HELPING BUSINESSES UNDERSTAND AND IMPROVE THEIR BUSINESS MODEL

THREE THINGS HIGH BQ COMPANIES HAVE IN COMMON

High IQ individuals enjoy higher income and longer life expectancies than average IQ people. The same holds true for companies with a high Business Quotient ™ Score. A high BQ almost always results in better profitability and longevity of a business. But that's the end result. How do great companies achieve a high BQ score?

This report will discuss the three most important factors to attaining a high BQ: tapping unserved or underserved markets, generating better margins than the competition, and creating leveragable intellectual property.

Tap unserved or underserved markets

In this flat, competitive world, many markets are over-crowded, over-competitive, and loaded with me-too offerings. Name a business with a terrific model which has a me-too product? You can't. The best offerings serve unserved or underserved markets. They do this where there is no competition or by creating a highly differentiated offering that effectively has no competition.

Walmart used this strategy early in its history by serving only smaller markets with populations under 20,000 people. These markets were underserved by Kmart, Sears, and other discount stores. Walmart developed a highly profitable business model serving this segment.

Starbucks enjoys the highest margins in the coffee business as well as a whopping 50% market share as a result of differentiation to a degree that puts them in a segment with little competition.

High BQ companies start with a strategy that distances them from the competition via minimal competition or significant differentiation. From there, the second factor – excellent margins – are much easier to attain.

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To find an unserved or underserved market, consider:

- Serve customers others thought unprofitable. Vistaprint is thriving in a difficult printing sector catering to micro business customers that most competitors thought were too small to service. Vistaprint is enjoying excellent profitability from these castaway customers.
- Who are the overshot customers? Harvard professor Clayton Christensen lays out an excellent process for disruptive innovation in his book ***the innovator's Dilemma.*** Part of the disruptive innovation process is finding customers who are "overshot" by entrenched competitors chasing better and better customers with higher and higher margins. Jitterbug cell phones for seniors offer big buttons and no frills for seniors just looking for a phone instead of a handheld computer phone. Ole hearing aids are "the hearing aid for people who don't want one. Their device has minimal features but does the trick for users who need an occasional hearing aid but don't want one full time.
- Adjacent markets offer potentially underserved customers. CVS and Walgreens are adding quick service health care for a handful of basic services. In the past, patients had to visit their doctor for these basic services such as throat cultures, flu shots, and ear infections. Now patients have more convenient access to doctor-type services.
- Substitution for an existing offering can offer opportunities. Southwest airlines did not originally compete with other airlines; it competed with driving from Dallas to San Antonio or taking the bus. Cell phones are competing with watches and cameras. Fast food competes with grocery stores. Hulu competes with cable television.
- Geographic isolation offers opportunities too. As grocery stores like Kroger struggle to compete with Walmart in large markets, they can offer a better shopping experience to customers in rural settings. Internet companies have leveraged their ability to ship anywhere as a way to serve geographically isolated customers.
- New products offerings can attract previously underserved customers Look at the thousands of iPhone applications that offer everything from fast food dietary information to decibel meters, to boredom fighters like Angry Birds.

Generate better margins than the competition

Great businesses create better margins than their competition. Margin powers the entire business. All meaningful components of your business are paid for with a sufficient dollar volume of margin:

- Marketing/Branding/Sales
- Paying quality staff
- Rent/Equipment/Facilities
- R & D, Business Development
- Fair return on your equity

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Margin is oxygen for a business. Without adequate margin, all functions in your business will be short of breath. It is virtually impossible to have a great business model without superior margins. Businesses with great model use their superior margins to distance themselves from competition.

McDonalds uses its economies of scale to generate excellent margins. This excess margin is plowed back into marketing to create a “moat” that fends off competition and further enhances margins. Proctor and Gamble uses a similar tactic to ensure premium margins for products like Tide, Scope, Crest, and Gillette. P&G spends in excess of ten percent of sales propping up the value of their brands to continue their high margin.

Interestingly, P&G has had to increase marketing spending as a percentage of sales in recent years to combat better and better quality generics from Costco, Walmart, and Kroger. P&G could have simply lowered sales prices to combat these generics, but they didn’t. Instead they doubled down on advertising to emphasize the value of their brands in order to keep margins high.

Google **vs.** Yahoo!

The search engine war between Google and Yahoo provides a great example of this dynamic. The bulk of Google’s revenue and profit comes from pay-per-click advertising as does Yahoo’s. However, Google can command much more money for the exact same search term. A competitive search term might cost $10 per click on Google and only $2 per click on Yahoo.

This superior margin allows Google to spend more heavily everything - from improving the core products to investing in new, high-potential products like the Android operating system, and Google Goggles. With lower margins, Yahoo is always handicapped vs. Google.

Creating leveragable intellectual property

Intellectual property doesn’t have to be a patent or trademark. Any valuable process, ideas, business practices, trademarks, copyrights, patents, or other intangible assets qualify as intellectual property. Many successful business models have relied on valuable intellectual property.

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Colonel Sander's secret recipe is not patented but it is highly valued intellectual property. You can buy all of seven herbs and spices at your favorite supermarket. However, the mix of them is a highly guarded secret

Lubricant WD40 has enjoyed a profitable 60 year history without the protection of a patent. For decades, competitors have tried to copy the product with no success.

Creating a powerful brand like Coca-Cola qualifies as intellectual property. Coke is the world's most valuable brand at $77.8 billion. Just look at the brand value of some of the world's other top brands (according to Interbrand).

#10 Toyota **$30.3 billion brand value**

#9 Samsung **$32.9 billion brand value**

#8 Intel **$39.4 billion brand value**

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#7 McDonald's **$40.1 billion brand value**

#6 GE **$43.7 billion brand value**

#5 Microsoft **$57.9 billion brand value**

#4 Google **$69.7 billion brand value**

#3 IBM **$75.5 billion brand value**

#2 Apple **$76.6 billion brand value**

A business process can become valuable intellectual property as well. If you know how to do something better, faster, or cheaper than your completion, this knowledge can convert into competitive advantage. If so, then it is valuable intellectual property.

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	Love him or hate him, the Rich Jerk created an automated internet-only marketing system selling get-rich-quick eBooks for $50 a pop and made millions. The combination of marketing message and marketing system served as leveragable intellectual property for the Rich Jerk.
	Rolls Royce outsources the manufacture of many components of its aircraft engines to lower-cost providers. However, Rolls Royce has perfected a fan blade material which no competitor can match. All engine blades are manufactured by Rolls to protect the “secret sauce” then paired with lesser cost outsource materials. The end result is competitive from a cost perspective but proprietary enough to command a premium price.
Walmart	In the 1980s and 1990s, Walmart created a super-efficient distribution system leveraging technology ahead of its competitors. This intricate system was so finely-tuned that a truck full of paper towels could pull up to the receiving dock at a distribution center and the product would be directly routed to outgoing trucks. The merchandise never touched a shelf.
	Gillette holds many patents on razors including the newest multi-bladed versions. The protection of their intellectual property does not stop there. Security at Gillette manufacturing facilities rivals military security. Gillette protects the process to make razors as importantly as their patents. As an aside, the famed “razor and blades” model credited to King Gillette was borrowed from another company. Before inventing the safety razor, Gillette was a traveling salesman. This work led him to William Painter, the inventor of the disposable Crown Cork bottle cap. Painter convinced Gillette that a successful invention was one that was purchased over and over again by satisfied customer. Gillette borrowed this business model for razors and blades.
	Of course, patented products can offer some of the best margins. The original Xerox copier was the most profitable industrial invention ever. In fact, the product was so profitable; Xerox changed its business model to a rental only model. Large customers like General Motors were making so many copies at five cents a piece that the machines had a two month payback. Xerox was savvy enough to realize you should not sell a device this profitable.

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Another area of opportunity to create intellectual property is under the umbrella of soft systems. Creating proprietary internal software, using a recruitment process that yields better talent, or a successful training process can all create competitive advantage.

Multi-modal carrier CSX created a proprietary software system to manage the loading and unloading of trucks at its massive terminals. This software offers CSX a competitive advantage of the completion by more efficiently utilizing trucks, drivers and other resources.

Technology provider Guilford Group uses a counter-intuitive approach to hiring. Most of their competitors have a specific technological need (java, .net, Oracle) and hire a “plug and play” developer who can immediately fill the technical need. However, these experienced developers are in high demand and therefore can demand top pay. Instead of jumping into the shark tank to compete for experienced developers, Guilford created a system that allows talented but inexperienced college graduates to contribute. By investing in training, workflow systems, and having patience, Guilford Group is able to pluck top talent from universities that can grow into outstanding development assets.

The Walt Disney Company’s training system is legendary. Disney’s training philosophy and process are so valuable that other Fortune 500 companies pay The Disney Institute around $7000 per person to attend the five-day course. Other successful companies pay Disney this sum because the training system is a valued asset in the everyday operations of Disney. Their training process results in better recruits, better run parks, and happier customers.