GUIDE

How to build a lean business case

Validate and pitch business potential in an agile manner

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Introduction

About this guide

Innovation is the lifeblood of any company that wants to stay competitive. But innovation is also risky. You can only invest in so many ideas, so how do you know which ones are right to pursue?

In this guide learn the basics of the lean business case method, which you can use to create a light but comprehensive view of any potential business opportunity.

What is this guide?

Whether you work within a company, as an entrepreneur or elsewhere, this guide helps you evaluate business opportunities in a lean way. It helps business developers, product and portfolio managers and other innovators put together everything that is needed to understand whether their new idea is worth investing in.

Who exactly is the guide for?

Across six chapters, we describe how to build your lean business case. We start with why a business case needs to be built lean, walk you through the steps to make it lean, and eventually pitch it. The menu in the upper part of each page will help keep you on track.

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The lean business case

Your lean business case is a series of investment decisions, always ready to be stopped or pivoted, if the assumptions and market validation does not support the objectives and goals you set for the investment.

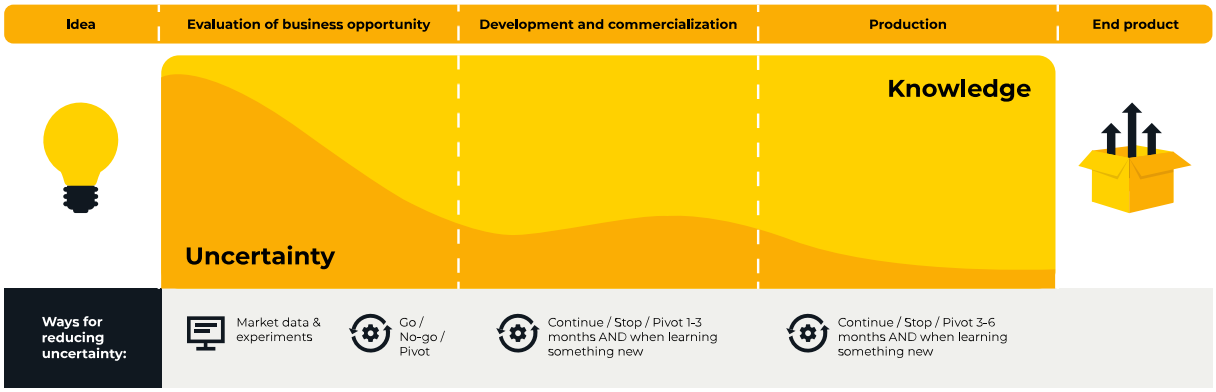
It is a holistic and well-communicated hypothesis of a market and business opportunity and investment proposal, and it is backed with facts.

It's also living (meaning that it is maintained) and visual document of various Go | No-go | Pivot decisions spanning from early idea to post-launch.

While business cases always require financial calculations of revenue, costs and KPIs, the other parts of the business model, describing your monetization logic, are equally important.

The three principles of building a lean business case:

- **Speed:** We want to learn – not fail – fast! Focus on the most important and uncertain issues first, the most potential "deal killers". By "fast" we mean days and weeks, not months! **Readability:** Everyone understands how your system is tested, and development is done with testability in mind.
- **Efficiency:** More is more – also with lean business cases. Tools, templates and examples support and speed up your work.
- **Data-driven, but visual storytelling:** The aim is to create good "conversation pictures" backed with data, where the relevant information is presented in a visual and easy-to-understand way.



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Iterating business potential with a lean business case

Business cases are not always necessary. But at a minimum, we recommend that you build one at least when there are more than usual uncertainties and risks, or when the investment's size is substantial (in relation to company size).

Developing the business case is an investment too. If the benefits are self-evident, save your money for something more valuable.

Building the lean business case is an iterative process, similar to the build-measure-learn loop in "Lean startup" by Eric Ries. With as-minimal-as-possible investments, you try to learn and achieve as-much-as-possible.

Similar to the "Lean startup" clock cycle, how fast you can iterate within your case is important.

You need discipline to pivot or stop (kill the case) in an early phase. Far too often business cases are being stubbornly developed, although the facts don't support them.

The 4 elements usually found in a lean business case:

- Initial business model(s) or earning/monetization logic
- Early solution draft based on a need/problem among targeted customer segments in a certain market
- Financial model including market potential, pricing model (based on our value), revenue estimates and costs of development and delivery
- Analysis and recommendations for next steps, including investments required

The lean business case might still need a business plan, which adds the "how" part to the business opportunity and investment rationale.

Don't start with the business plan. Concentrate first on your business case ("why", "to whom", "what" and "how much").

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Method

Building the business case is a journey, not just a task

In a waterfall-type business case, you would propose a three-year investment, based on predicted cumulative profits and an ROI that pleases management. But most parameters in this business case are, at best, nothing but educated guesses.

The lean business case splits the waterfall into a number of trickles - smaller business decisions. You have several control points. Thanks to more recent and detailed information, the uncertainties are fewer. You can decide on further investments – even reduce the original investment plan – and change direction. You can even bury the entire service before the launch if the goals are not met.

Uncertainty affects the decision cycle. The more uncertain you are, the more business tests and investment decisions you need. More information translates into fewer uncertainties, implementation can be started, and you can prolong the decision cycle.

Business cases need disciplined decision making:

- Instead of one, large, investment decision, you make a series of smaller decisions. You retain the ability to react to the environment, make changes and take corrective action.
- If necessary, you are prepared to cut funding and run the service down quickly.

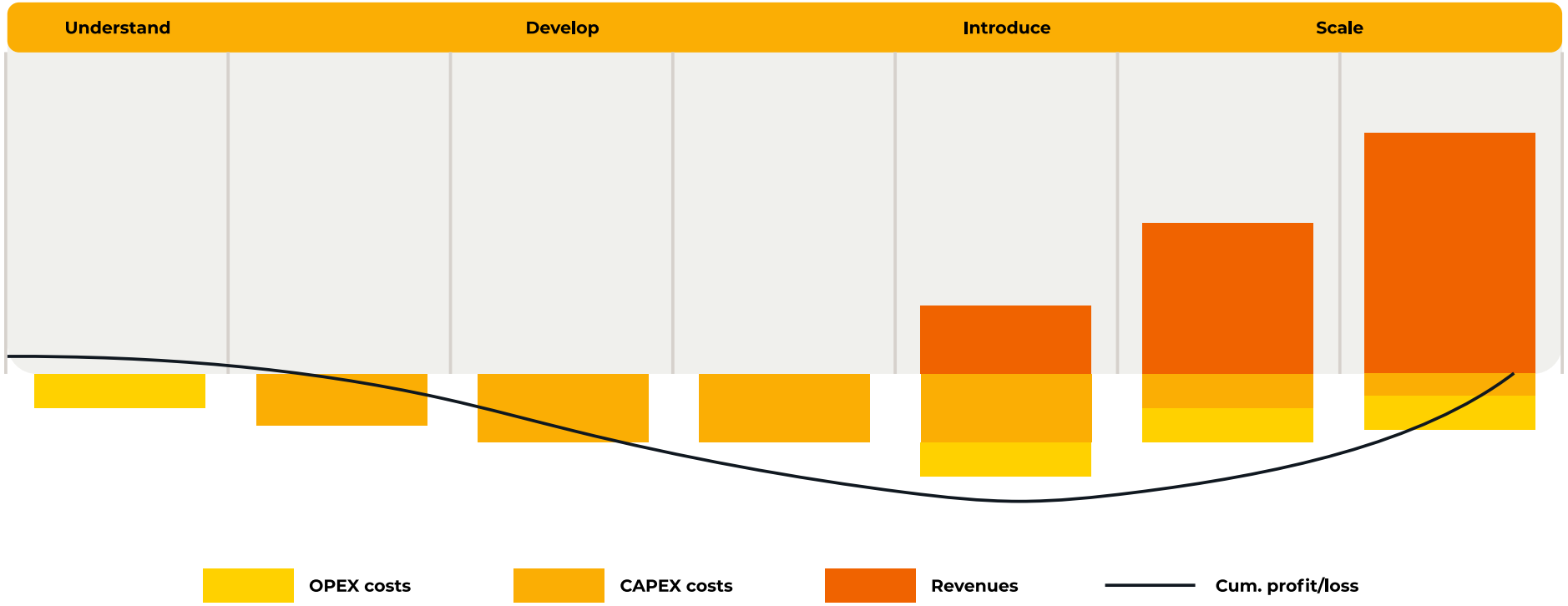
It is wiser to save money for another venture than to keep banging your head against the wall.

Don’t fall in love, have the courage to drop the case. Most business cases should be dropped eventually.

If the case is dropped, you should still collect learnings for future use.

Building the business case is a journey, not just a task

Each step of the journey requires Go / No-go / Pivot investment decisions.



Uncertainty, estimates and assumptions

The problem of estimating the future is always the uncertainty. And early on there is lots of uncertainty. To move forward (and sometimes backwards), you need to make assumptions and estimates – educated guesses. That's perfectly fine, but you still need to validate them "on the road".

You can never be "totally sure", with zero uncertainty. That's the nature of business - some risks always exist. The key is to understand these uncertainties and their possible impact when making decisions.

Fast learning is invaluable! Learning becomes expensive and slow when you aim for near 100% certainty. It's seldom a straight path from idea to crystal clear business case.

Avoid over-engineering the lean business case and remember that the truth is usually outside the office.

Keep this in mind when working with assumptions:

- It's important to keep track of and document all the assumptions you make for your lean business case
- Some assumptions are small, and some are huge, requiring much more care and consideration
- Some are more uncertain and can have much more impact
- Some are easily checked, some need more research, tests and work

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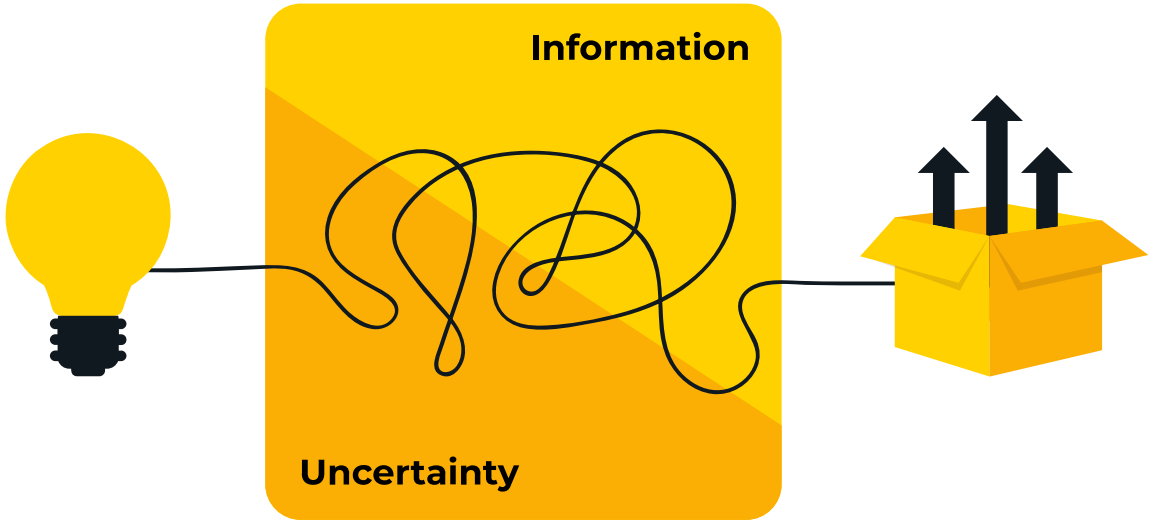
Uncertainty, estimates and assumptions



When documenting your assumptions:

- Write down facts and proofs as soon as you identify and validate them
- Start your validaton with assumptions that have the greatest uncertainty and highest impact
- Use different types of MVPs (=minimum viable products) as validation tools

You may need to run several MVPs, and make sure you run both business tests and product prototypes.

Make pivots and change your approach, if the tests don't validate your assumptions.

Keep track of your learning curve. Stop and re-think if there is no learning.

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Business model

The business model is at the core of your lean business case. The Business Model Canvas is a great tool for creating scenarios. And within each scenario, financial analysis not only helps you iterate along financial parameters, but also supports business model innovation. You can use lean canvas, too, as a scenario tool.

Each business model can have its own unique market potential, pricing and revenue model. The cost base and structure can also vary. Some of the revenues and costs are common for all scenarios, and some depend on the business model (typically channel-related costs or specific features required for the solution).

Exploring several business model scenarios is useful from the lifecycle perspective, too. You often can't implement the "final" business model right away - especially with a new offering.

You may need different models for the launch, growth and mature phases. And with lean business case tools, you can combine and aggregate different models.

Working with business models:

- The business model describes how you plan to monetize your opportunity
- When innovating with a business model, you have a lot more options to work with than just revenue streams and costs, which typically get too much "screen time"
- Using different business models for introduction, growth and mature phases gives you more flexibility to plan the business

Business models require validation and testing too, so plan business tests to validate the biggest uncertainties in your models.

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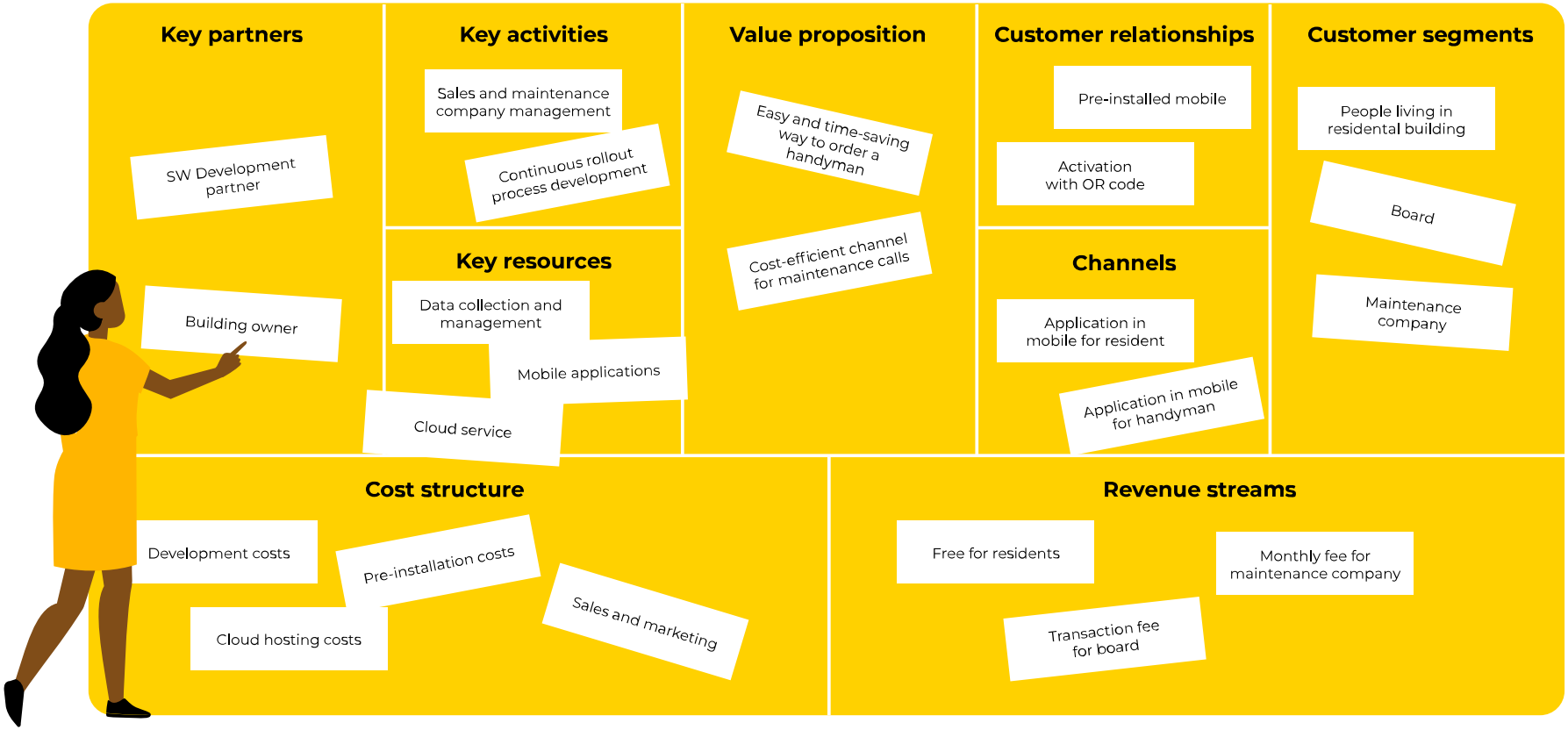
Business model



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Estimate

Estimating market potential

Market potential estimation is more art than science. It's hard and you have a wide margin of error. So many variables are involved – and most of them you have very little control over, or none at all.

Potential market size is usually not the real problem. There are almost always enough potential customers, but do you have access to them and how long will it take to build a sustainable customer base?

Start with realistic segmentation of the target customers. Find a few sub-segments which can be quantified with reliable data, and understand the main characteristics of these segments. For example, selling to big customers is totally different from selling to SMEs.

You can estimate the market size of each segment, using the TAM-SAM-SOM approach, which is a three-step approach to make a rough estimate of the available potential.

TAM = Total available market
Residential buildings, Finland: 86 000

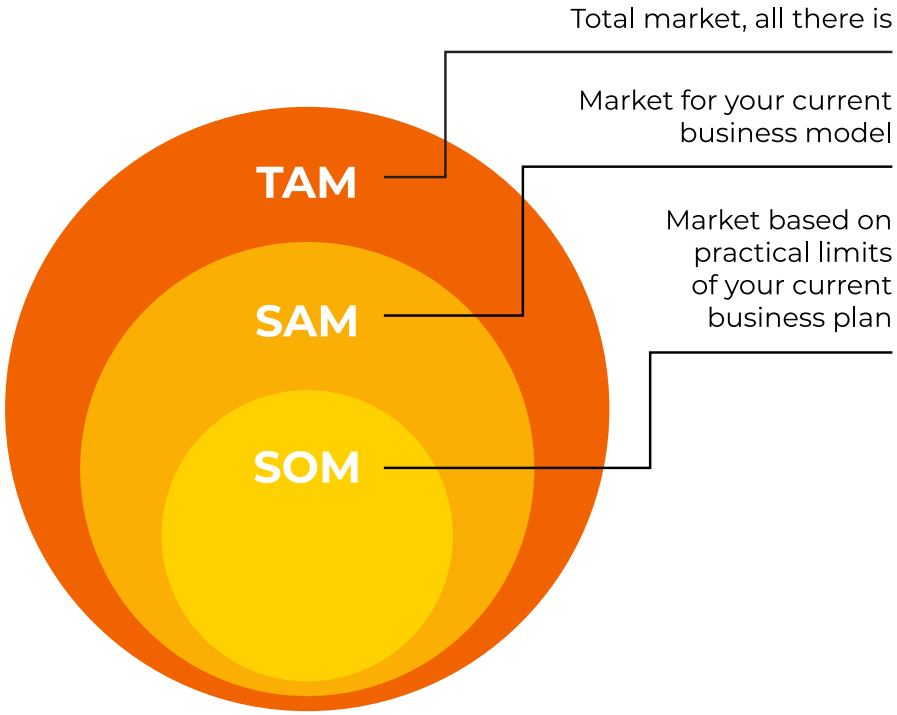
SAM = Serviceable available market, portion of TAM suitable for your business model
Residential buildings, Uusimaa: 42 000
Having 50+ apartments: 8 000

SOM = Serviceable obtainable market, share of SAM you plan to capture
25% share of 8 000 = 2 000

Avoid these pitfalls with estimation:

- The bigger the share of the customer segment or the faster the speed, you (usually) get (significantly) higher costs.
- People are typically hugely over-optimistic about the speed of things.

Estimating market potential



Estimating market size

1. Figure out an estimate for a customer segment SOM size for your offering, using verified data for TAM and SAM.

2. Within your lean business case planning horizon (e.g. 3-5 years), estimate how fast you could reach the SOM sized market. It's good practice to have at least an optimistic and pessimistic scenario, e.g. "in 3 years" and "in 5 years".

3. The SOM size and speed at which you aim to capture the market, have big impacts on both revenue and cost model.

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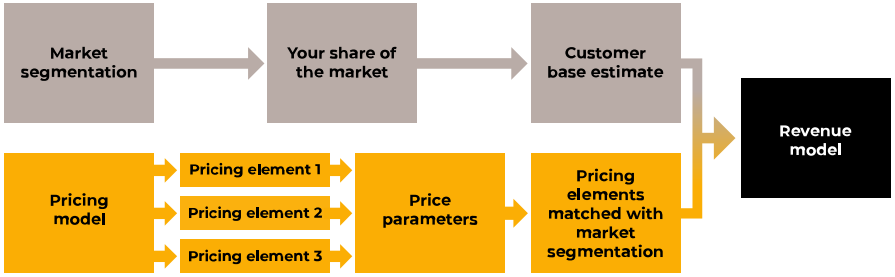
Revenue model

To make an educated revenue projection, you need a model for the customer base development and a pricing model for the offering, based on the revenue stream assumptions in your business model.

A lean business case encourages you to iterate with several revenue generation models. Also try different market segmentation approaches, different pricing models, and different pricing parameters. (But note that not all your customer segments need to have the same pricing model.)

We recommend you keep each pricing model simple enough and easy to understand. Don't try too many options in one model.



Pricing models you should at least consider:

- As-a-service, periodically recurring fee
- Transaction or volume-based fee
- Traditional one-time installation plus maintenance fee

You can also experiment with:

- Freemium, ad-based, in-app-purchase models, if you are in the mobile app domain.
- A revenue/profit sharing-based model, when a channel(s) is involved.
- Benefit-sharing fees, if your solution provides measurable cost savings. Measuring savings is usually quite complex if you don't have some benchmarking data.

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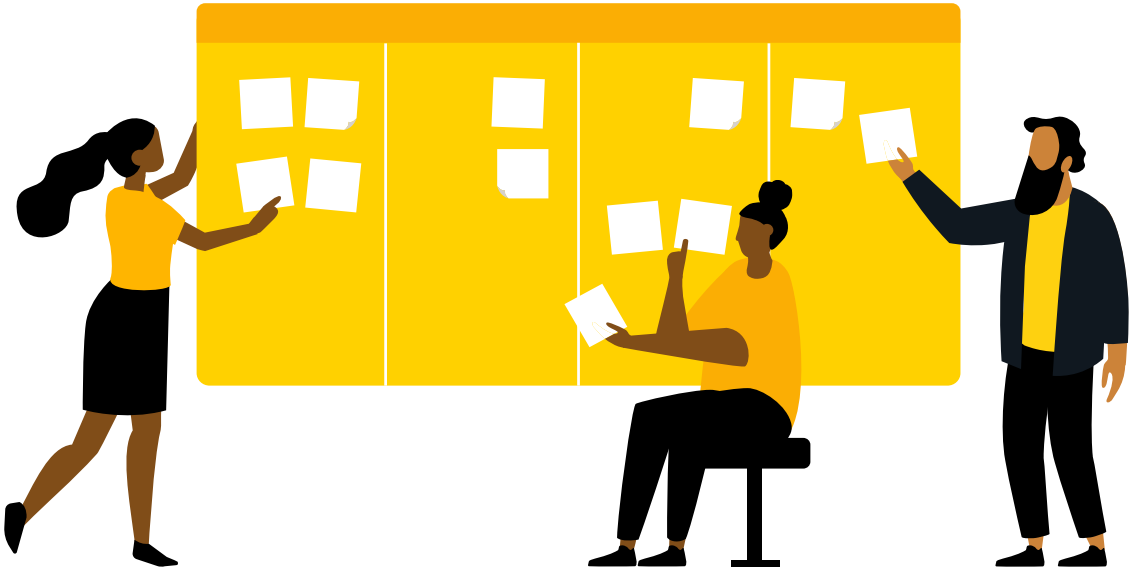
Revenue model



More challenging models:

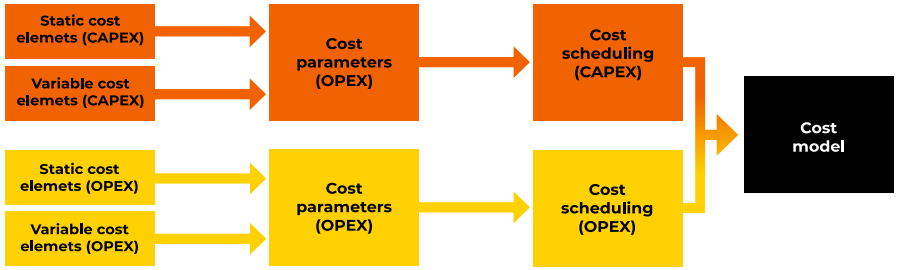
- Performance-based fees, but these are tricky to model, since the standard baseline for calculation is hard to set.
- Value-based pricing models, since they are a good test for your value proposition. In practice, value-based models are very hard to implement.

If you are considering a time and materials-based pricing model, think again! Your business case might need some serious re-planning.

Cost model

Costs are often calculated in extreme detail. This is overkill, since the revenue side is almost always an opportunistic guess, based on unverified and poorly tested data.
The “guesstimates” for revenues and costs should be kept in balance.

The cost analysis should also cover channel building, market entry, and sales and marketing costs, since these often quickly exceed actual development and solution maintenance costs. Channel building is usually costly and takes time. It’s also an upfront investment, with revenues from new channels coming later. Keep this in mind when considering the cash flow and funding needs for your business case.



Typical CAPEX costs:

- Own or sub-contracted development work, based on dedicated funding
- Investments in hardware and other (mostly physical) assets

Typical OPEX costs:

- Running costs and basic maintenance
- Exploration, MVPs, early planning and design work, (such as requirement gathering and management)
- All administration and support work
- All sales and marketing work

It is absolutely ok to define development costs as OPEX costs as well.

Major product development projects are usually considered as investment for the future and listed as CAPEX costs.

Analysis

Analyzing business cases with ROI and other KPIs

Eventually you need to calculate some form of payback or "goodness" indicator for the investments.

ROI is the key performance indicator, and is widely used in business case analysis.

$$\text{ROI} = \frac{\text{Gain from investment - Cost of investment}}{\text{Cost of investment}}$$

ROI is the efficiency of an investment: "how do the expected returns compare to the costs?". The scale of acceptable ROI varies by industry.

NVP is often used in the context of profit/loss calculations. The bigger the investment, and the longer your case's time horizon is, the more impact NPV has.

Other KPIs you might consider:

- Paypack period = The point in time when cumulative cash flow reaches zero, meaning "How long does it take for the investment to pay for itself?"
- ECV = Expected commercial value. ECV Combines NPV with probabilities of commercial and technical success, and remaining development costs.
- IRR = Internal rate of return. IRR is a derivative from NPV.

ROI and other KPIs are primarily tools to rank and compare different business cases. Even at best, you have made quite a few assumptions in each case, so the absolute values of KPIs should be treated with a healthy dose of scepticism.

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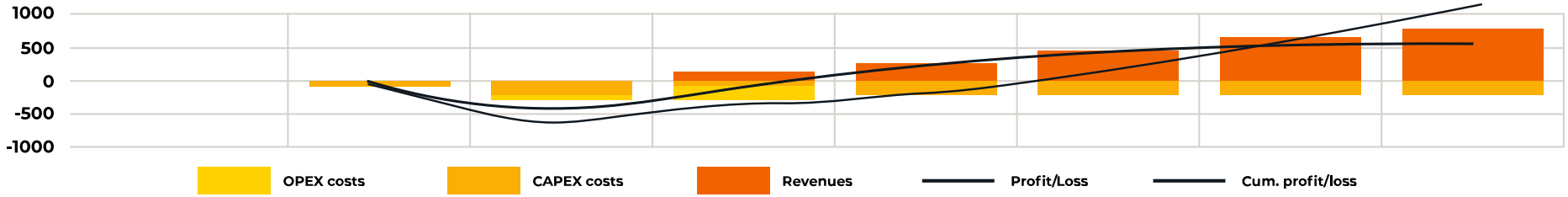
Analyzing business cases with ROI and other KPIs

Example Business Case

Transaction model	Understand	Develop	Introduce	Scale			
	MVP	YO	Y1	Y2	Y3	Y4	Y5
CAPEX	-30	-180	-30	-30	-20	-10	-10
OPEX	0	-73	-156	-166	-131	-153	-166
Cum. Costs	-30	-444	-469	-665	-816	-980	-156
Revenue	0	0	160	296	474	622	717
Profit/Loss	-30	-253	-80	100	323	458	541
Cum. Profit/Loss	-30	-526	-363	-263	60	518	1059
Cum. P/L NPV (3%)			-352	-255	58	503	1028
Profit margin %			-75%	34%	68%	74%	75%
ROI			-251%	-197%	-79%	73%	242%



Pitch

Pitching your lean business case

The business case is an internal sales pitch of an investment opportunity.

Investors, internal customers and stakeholders are usually the hardest sell, so good preparation and a compelling presentation is needed.

When presenting business cases, remember the audience: people running businesses, seeking revenues, profits and growth – and often also cost reductions or efficiency improvements in general.

Financials are always of interest, but before you even get there, stakeholders are usually concerned and curious about:

- Why should we do anything at all? (The “zero scenario”.)
- Why this approach? (Usually someone has a preferred solution.)
- Why now? (Timing is always tricky, why not now?)
- Is there something else that could be a better investment? (The alternative business case scenario.)

Stakeholders often ask these questions, so get your answers ready:

- Who are the first customers? Have you talked to them? What did they say?
- How reliable is your market potential estimate? How did you come up with these numbers?
- What are our competitors doing?
- When will you make money?
- How much?
- What is the investment needed for?
- What are the biggest risks? Business, technical, project, people etc.

Pitching your lean business case

You can build your 9 slide lean business case pitch deck based on this approach:

Business case summary
1-page overview

Business case hypothesis - Why should we do this?
What is the need / problem we are addressing? What is the value proposition for the customer? If we do this, what then?

Total opportunity value - What's in it for us and the customer
Value propositions

Market potential - Who are the customers and why now
How is the target market structured? Who are they? How much can we target? How can we teach them?

Solution - What is the approach and why now?
MVPs. development invrements

Analysis - What is the (est.) outcome of the hypothesis?
Financian calculations for improved understanding, development, introduction and scaling phases KPIs

Action - what do you recommend we should do?
What are the uncertainties and how to tackle them? Where to use the money and how much? How and when to proceed? What happens next?

Assumptions
What is assumed, but not yet verified? What is the impact of the assumptions?

Evidence and facts
What have we verified and learned? What facts support / do not support the hypothesis?

When presenting, here are 6 valuable tips:

1. Keep it compact and visual, tell a story
2. Use (enough) numbers
3. Have even more detailed numbers ready for additional questions and in-depth discussions
4. Talk about your own experiences and learnings about the subject
5. Use gathered evidence and facts as proof
6. Practice makes perfect!

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TAKE THE NEXT STEP

Whichever level product organization is at today, product management experts are available to help you to the next level and beyond.

Contact us

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