

Corporate Issuers

Business Models



Exam Focus

- Features of business models
 - Identify business models and features, including the value propositions of “who”, “what”, “where”, and “how much”
 - Identify and describe pricing and revenue models
- Value proposition and business model types
 - Distinguish between conventional and other business models, and define innovation and network effects

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Business Model Features

- **Business models** can be conventional versus new, or simple versus complex.
- Firms need to define a product or service, find their customers, and deliver the product or service, while also ensuring profitability.
- Four major components of a business model framework
 - “Who”—identify and characterize the customer base
 - “What” or “why”—define the firm’s product or service
 - “Where”—what channels to use to reach customers
 - “How much”—define a pricing strategy

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Pricing and Revenue Models

- **Pricing** establishes how much to charge customers for products or services.
- **Price discrimination** maximizes profit by setting different prices for different customers or identifiable groups of customers.
 - **Tiered pricing**
 - **Dynamic pricing**
 - **Value-based pricing**
 - **Auction pricing**

Customer Segmentation: **Example**

Cinemacity Corp. is a multiplex movie theatre that wants to maximize its profit. It identified four different customer groups which each have a different willingness or ability to pay for movie tickets (from cheapest to most expensive: early bird before 4pm, Tuesday movies, family tickets, and VIP experience).

- This is an example of *price discrimination*. Cinemacity can price the same or similar movie tickets differently by the four customer segments, volume purchased, time of day, and overall experience, on, based on perceived customer preferences to expand its addressable market.

Pricing for Multiple Products

Firms often sell multiple or complex products with different pricing schemes:

- **Bundling:** This is combining multiple products that customers often buy together. It is effective when marketing costs are high (e.g., furnishings with an apartment rental).
- **Razor, razorblade pricing:** This is selling low-priced equipment with high margin add-on/follow-up purchases (e.g., printer and ink/toner, razors and razorblades).
- **Add-on pricing:** This is selling optional services or add-ons with high margins after the initial purchase is made (e.g., video games after initial game console purchase).

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Other Pricing Models

Other pricing models

- **Penetration pricing**
- **Freemium pricing**
- **Hidden revenue**
- **Subscription model**
- **Leasing, licensing and franchising**

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Distinguishing Between Models: **Example**

It can be challenging to distinguish between the various business models. Here are a couple examples to help:

Verizon covers the initial cell phone subscription fee, and recovers costs over the life of the cell phone contract—This is an example of the razors (initial low cost to enter into contract) and razorblades (higher ongoing contract fees) model.

Google search is free for users, but revenue is generated through advertising—This is an example of the hidden revenue business model. The service (Google search engine) is free, but revenue is generated from significant corporate advertising on Google.

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Value Proposition

- A firm's **value proposition** refers to how customers will value the attributes of a product or service, leading them to purchase it.
- The **value chain** refers to how the firm executes its value proposition (i.e., how it creates value).
- By contrast, the **supply chain** refers to the processes involved in creating a product.

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Business Model Types

Conventional business models have existed for a while and make up most of the business models. They include natural resource producers, manufacturers, distributors, retailers, brokers, banks, service providers, and software.

Other business models

- Private label or **contract manufacturers**: Firms produce products to be marketed by others (e.g., Apple, Costco's Kirkland Signature™-branded products).
- **Value-added resellers**: Firms not only distribute a product, but also offer product installation, customization, service, and/or support.
- **Licensing arrangements**: Firms produce a product using someone else's brand name, in return for a royalty (e.g., DC Comics-branded T-shirts).

Innovation and Network Effects

- Business model innovation often occurs due to new entrants or new technologies (e.g., ultra-low-cost airlines like Ryanair or Spirit)
- **Digital technology** has especially led to new product development, including social media, streaming videos

Network effects: refer to increase in the value of a network as its user base grows; network effects often capitalize on both size and scope

- *"One-sided"*—one type of user (e.g., PayPal, Facebook)
- *"Two-sided"* or *"multi-sided"*—multiple users, like buyers and sellers (e.g., Airbnb, AliExpress, eBay)

Crowdsourcing models: products or services function through user contributions (e.g., Yelp, TikTok, Wikipedia, AnalystForum for CFA exams)

Business Model Innovation: **Example**

Bynta is a retail clothing firm that is a new entrant in the industry. Its biggest competitor is Ocean Hill, Inc., a well-established company that uses a conventional business model.

Bynta can use innovation to distinguish itself from Ocean Hill by using digital technology. This could enable it to

- lower the cost of communications and transactions;
- make outsourcing easier, allowing Bynta to better focus on design and marketing;
- improve customer segmentation and reach specific customer segments; and
- use network effects/crowdsourcing to enable collaborations.

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