

IS6640

Lecture 3

Business Model

Understanding Business Models

- Key Learning Objectives
 - Understand the concept of a business model
 - Learn how to analyze the three components of a business model – strategy, capabilities, and value – through a business model audit
 - Understand SWOT analysis
 - Understand the different ways that business models can evolve

Business Model Framework and Definition



Business Model Definition

A business model defines how an organization interacts with its environment to define a unique ***strategy***, attract the resources and build the ***capabilities*** required to execute the strategy, and create ***value*** for all stakeholders.

(c) Lynda Applegate 2009

Example: BYD (“Build Your Dreams”)

- A Chinese electronics and car manufacturer
 - Headquartered in Shenzhen
 - Founded in 1995 as a manufacturer of rechargeable batteries
- Five main product categories
 - **Automobile** -electric and fuel personal vehicles and electric buses
 - In 2013, BYD obtained the EU’s Whole Vehicle Type Approval and has right to sell electric buses without any restriction in EU countries.
 - Energy – Products range from Nickel-cadmium and rechargeable batteries to large-scale energy storage stations for power plants.
 - Lighting – mainly on LED technology and solar-powered lights.
 - Photovoltaic – Development of high-quality solar energy panels and parks.
 - Electronics and micro-electronics for mobile phones, such as connectors, digital cameras and LCD/LDM displays.

What is a Strategy?

- **What is a strategy?**

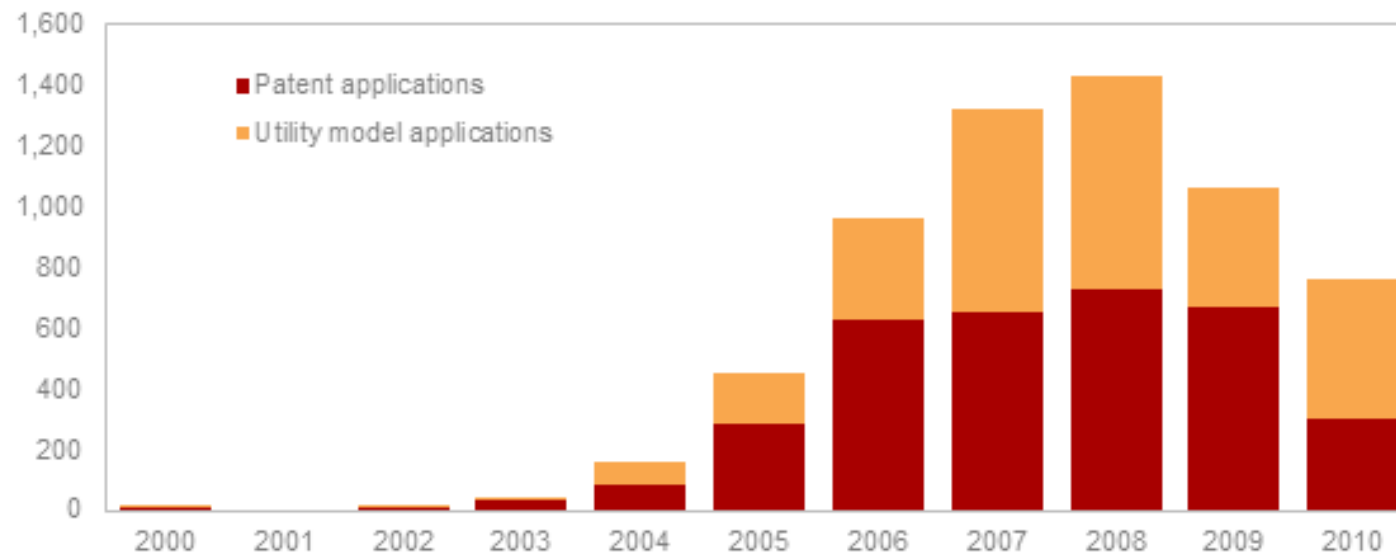
- “A unique positioning in the market”
- A series of choices that determine the **opportunities** you pursue and the **market potential** for those opportunities.
 - Revenue drivers of the business
 - Potential for growth over time

- **Sustainable advantage** occurs when barriers exist that make it difficult for competitors to imitate your actions or for customers to switch

Example: BYD

- Strategy
 - Leading the new energy revolution via innovative technologies

Applications for Patents and Utility Models
BYD Company Ltd.

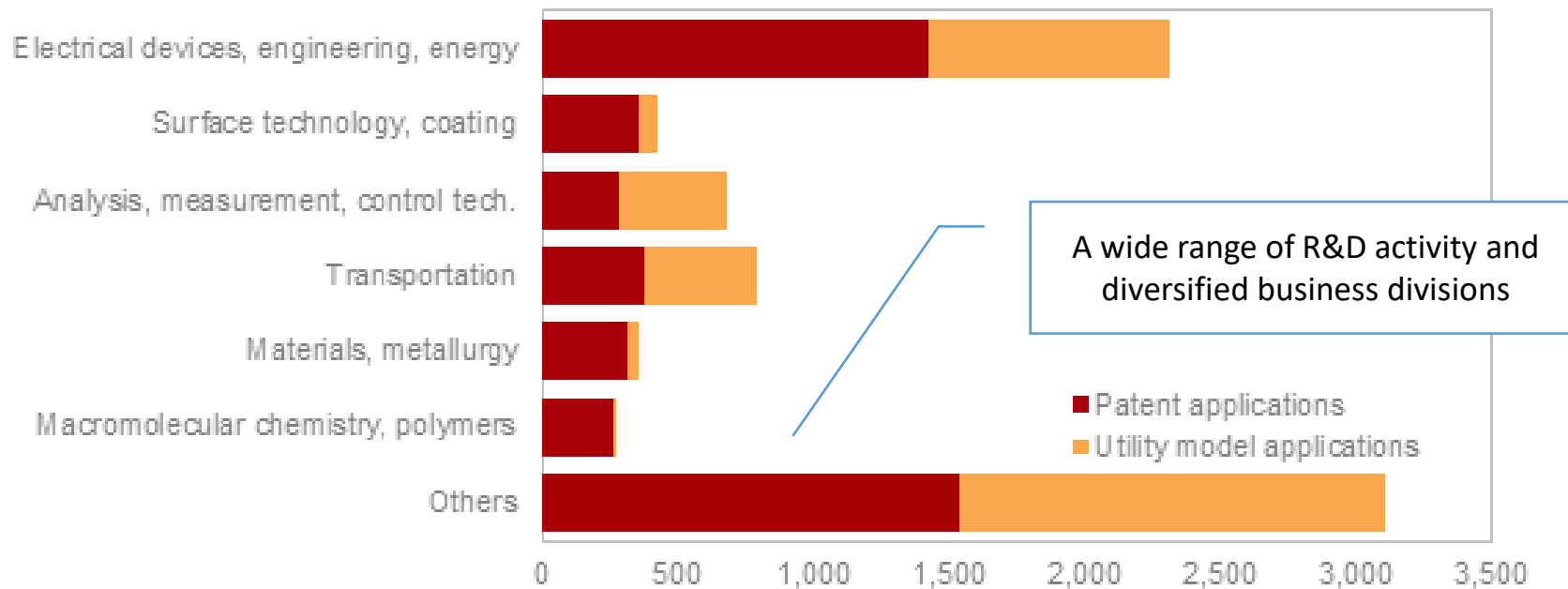


Source: Chinese Champions, www.chinese-champions.com, study conducted by the Technische Universität München and the Munich Innovation Group, computed with the EPO Worldwide Patent Statistical Database (PATSTAT) licensed by the OECD-EPO Task Force on Patent Statistics

Example: BYD

Technological Areas of Patent and Utility Model Applications

BYD Company Ltd.



Source: Chinese Champions, www.chinese-champions.com, study conducted by the Technische Universität München and the Munich Innovation Group, computed with the EPO Worldwide Patent Statistical Database (PATSTAT) licensed by the OECD-EPO Task Force on Patent Statistics

Example: BYD

- Strategy
 - Leading the new energy revolution via innovative technologies
- Sustainable advantages
 - A full range of technologies such as rechargeable battery, enriched IT technology, solar energy that can be fully utilized to their automobile.
 - BYD successfully developed the second generation of the dual mode technology and the bi-directional inverter technology that integrated solar energy into their hybrids cars.

Strategic Positioning

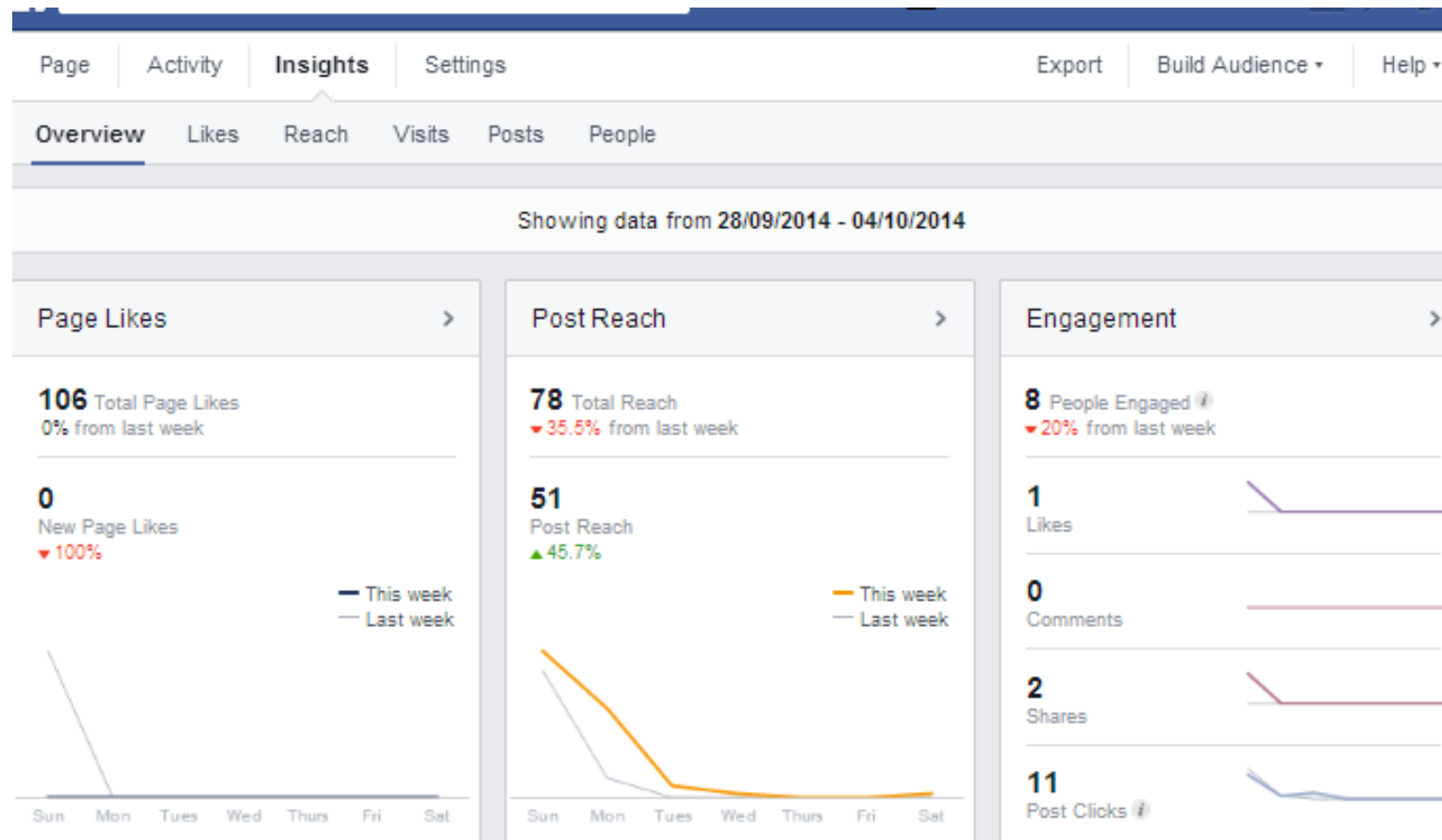
- **Market positioning**
 - What customers to serve and channels to reach those customers
- **Product positioning**
 - What products and services to offer, features and pricing
- **Business network positioning**
 - Roles to play and activities to perform within a network of suppliers, producers, distributors, and partners
- **Boundary positioning**
 - Markets, products, and businesses that will NOT be pursued

Strategy Audit

- **Market positioning:** What customers to serve and channels to reach those customers
- **Analyze customers**
 - Identify customer problems
 - How do the company's products and services can address these problems?
 - Channels to reach customers
 - Marketing research report, internal customer information, customer service centers, social media channels, etc.

New Channel to Reach Customers

- Online analytics tools – *trends revealed by the activity on your Page*



Example: BYD (Automobile)

- Marketing positioning
 - Customers' problems: fuel consumption; air pollution
 - “Low-carbon emission” cars
 - Target customers
 - Individual consumers (middle-high end)
 - Corporate consumers
 - Public buses

Strategy Audit

- **Product positioning:** What products and services to offer, features and pricing
- **Analyze competitors/substitutes:** what **alternatives** customers have for meeting their needs
 - Who are our competitors/substitutes?
 - How do they differentiate their offerings by feature and price?
 - What is the market share of key competitors/substitutes?
 - Any new entrants offering radically different business models or products/services?

Example: BYD (Automobile)

- Competitors & substitutes

- Tesla (electric vehicles) – battery has a much greater range
- Cars using gasoline (cheaper and more stable)
- Subway
 - Hong Kong: 1) an excellent public transport network; 2) cost of operating a vehicle is high

- Product positioning

- F3DM cars
 - The world's first dual mode electric car that can release the charging stations limitation
- Extra long-term warranty of “4 years or 100,000 km” covering all existing series of car models
- Re-developed classic car models S6 that met the C-NCAP five-star safety standards and ranked first among domestic branded SUVs

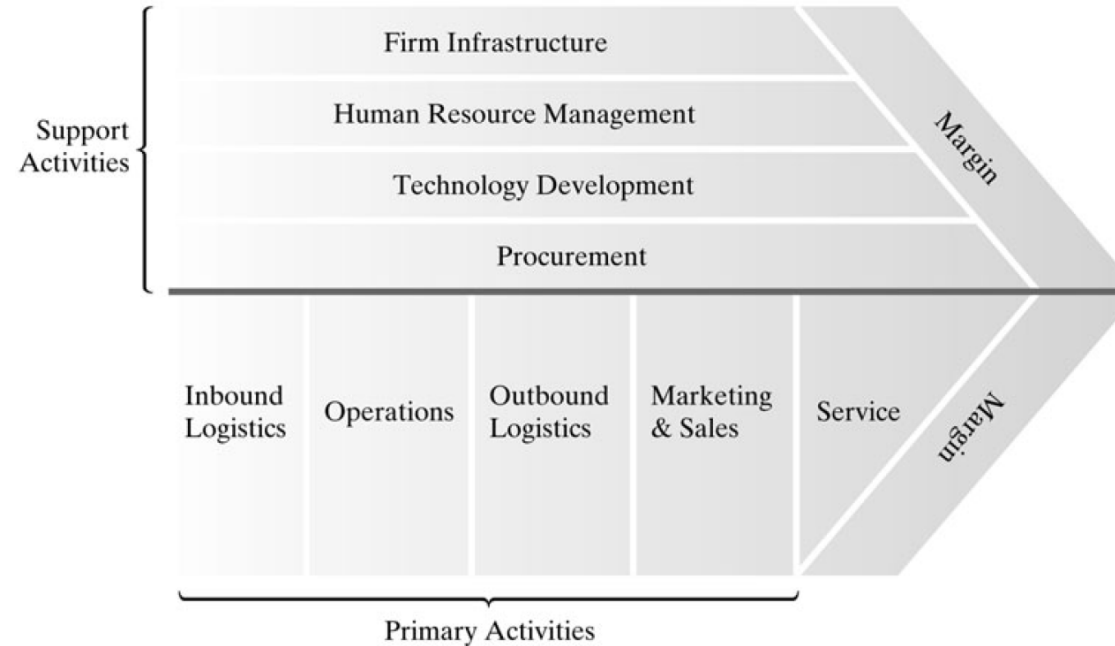
Strategy Audit

- **Business network positioning:** Roles to play and activities to perform within a network of suppliers, producers, distributors, and partners
- **Assess business network:** activities different players perform and their relationships in the supply chain / value networks
 - Who are the powerful players?
 - How is the network organized?



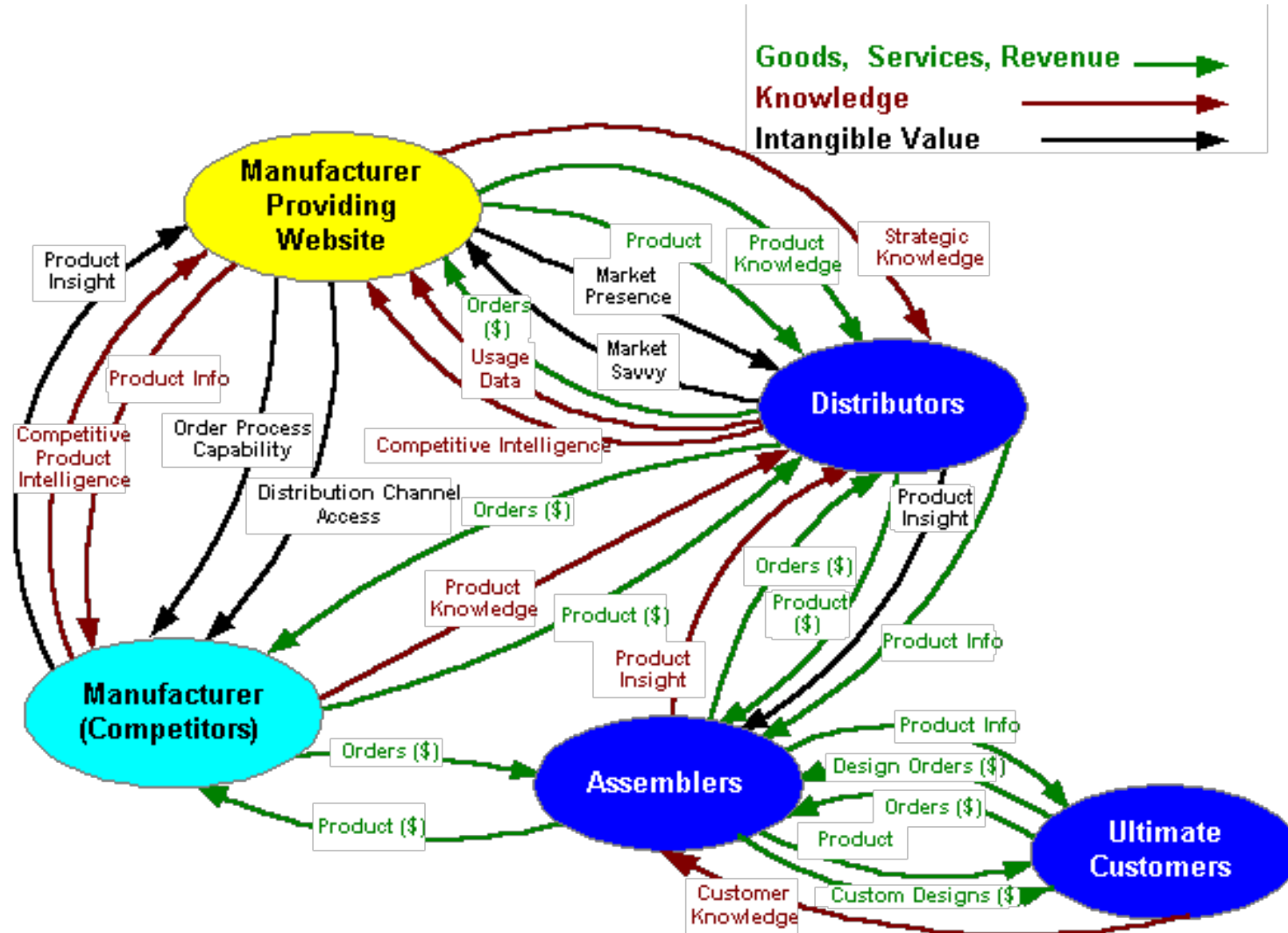
Business Networks – Value Chain

- The Value Chain



- Network of specialized roles
 - What activities should we keep inside the boundaries of the firm and which we should source from outside?
 - Locate activities internally when costs or risks involved in coordinating/ managing them are too high

Value Networks



Options for Designing Network Structure

- **Corporation**

- Locate all but the most routine activities inside a vertically integrated firm
- The majority of specialized units are located inside a **legally defined organization**.

- Selective sourcing partnership/**Alliance**

- Source selected **core** activities from trusted partners
- An agreement formed between **two or a small number** of firms to manage activities across organizational boundaries

- **Community**

- Network of specialized, independent firms that work together to perform, coordinate, and control value chain activities – often across a shared platform
- An **ecosystem** in which suppliers, distributors, and buyers work together to achieve shared goals.

Example: BYD (Automobile)

- Business network positioning
 - Suppliers
 - Essential parts of their cars are created in-house: Battery, electric motor, energy conversion system, etc.
 - Dealers
 - Long-term win-win partnership relationship

Strategy Audit

- **Boundary positioning**: markets, products, and businesses that will NOT be pursued
- **Business context**: “What business are we in?”
 - Industry and competitive dynamics
 - Demographic, economic, political, regulatory and societal factors
 - **Key trends** (e.g., technologies, globalization, new business models and regulatory changes)
 - **Opportunities** can be pursued and associated **risks**

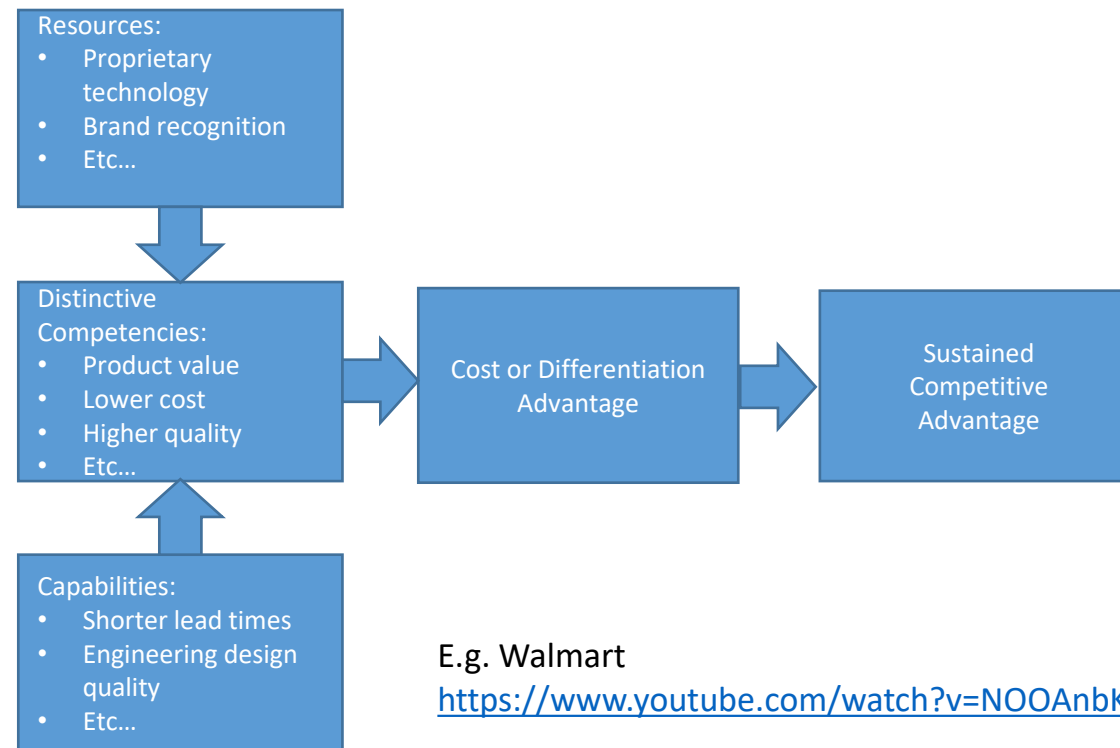
Example: BYD (Automobile)

- Boundary positioning
 - Automobile industry: highly competitive
 - Trends
 - “Low-carbon emission”
 - HK: “Green Transportation” 1) Tax deduction is provided for buying electric cars; 2) A \$300 million Pilot Green Transport Fund has been established to subsidize the non-profit-making organizations for providing services and encouraging them to use electric vehicles.
 - Technologies for rechargeable battery and new energy are improving

- Joel Ross and Michael Kami

“ Without a strategy the organization is like a ship without a rudder, going around in circles.”

Distinctive Competencies Lead to Value Creation



E.g. Walmart

<https://www.youtube.com/watch?v=NOOAnbK8bfo>

Capability Audit

- Capabilities refer to the resources needed to execute current strategy, which define the **cost model** of the organization
- Capability audit
 - **Process/infrastructure**
 - Key activities needed: core operation processes and support processes
 - Group activities into roles
 - Focus attention and resources; develop expertise
 - Coordinating mechanisms that enable the flow of goods and information
 - Infrastructure requirements
 - Facilities, equipment, technology

Example: BYD (Automobile)

- Process/infrastructure
 - 10 industrial parks across China in 2009 with nearly 15,000 Kilometer square
 - Setup trial operations in Spain, Hungary, Austria, Belgium, Netherlands and the United States
 - Develop green products such as solar farm, battery energy storage station, electric vehicle, etc.
 - Car division: leading the R&D of electric vehicles
 - Some of BYD's machines lack precision and produce components in varying quality

Capability Audit

- **People/partners:** expertise needed to carry out the required activities and processes
 - Identify expertise and skills needed
 - Job descriptions for key roles
 - Where to get the expertise and skills needed (within the firm or source from outside?)
 - Cost analysis of attracting talent
 - Develop recruiting, hiring, development, and performance appraisal systems

Capability Audit

- **Organization/culture:**
 - Group employees and partners into work units
 - Easier to accomplish goals and developing expertise
 - Clarify and formalize authority and accountability by role and unit
 - Reporting relationships
 - A flow of information on expectations and performance
 - Information coordination and collaboration mechanisms
 - Values and behaviors
 - Consensus between incentives, performance measurement and culture

Example: BYD (Automobile)

- Organization/culture
 - Core corporate culture of equality, factuality, passion and innovation
 - Loving the company as a family

Capability Audit

- **Leadership/governance**

- Key positions
 - Strengths and weaknesses of people filling those positions
- Succession plans for key positions
- Governance systems and structures to ensure strong operating and strategic controls and effective risk/culture management

Value Audit

- Business value delivered to all stakeholders
 - Identify internal and external stakeholders
 - Assess interests and expectations (market value expectation)
 - Develop the financial model and determine financing needs (economic value)
 - The DuPont Formula to deconstruct return on equity (ROE)

The diagram illustrates the DuPont Formula for Return on Equity (ROE). It consists of three light gray rectangular boxes at the top, each containing a component name: 'Profit Margin', 'Asset Efficiency', and 'Leverage'. Below these is a single light green rectangular box containing the mathematical formula. The formula is:
$$\text{ROE} = \frac{\text{NET INCOME}}{\text{REVENUE}} \times \frac{\text{REVENUE}}{\text{ASSETS}} \times \frac{\text{ASSETS}}{\text{SHAREHOLDERS' EQUITY}}$$

(c) Lynda Applegate 2009

Example: BYD (Automobile)

- Value

- 2002: BYD IPO listed in the Stock Exchange of Hong Kong Limited with HK\$10.95 per share. (HK\$28 as of 18/1/2015)
- 2012: BYD and China Development Bank signed a strategic cooperation agreement with RMB30 billion to provide credit support for BYD's solution aimed at promoting new energy vehicles.
- 2013: BYD Auto sold a total of 506,189 passenger cars in China, making it the tenth largest selling brand and the largest selling Chinese brand

Business Model Alignment

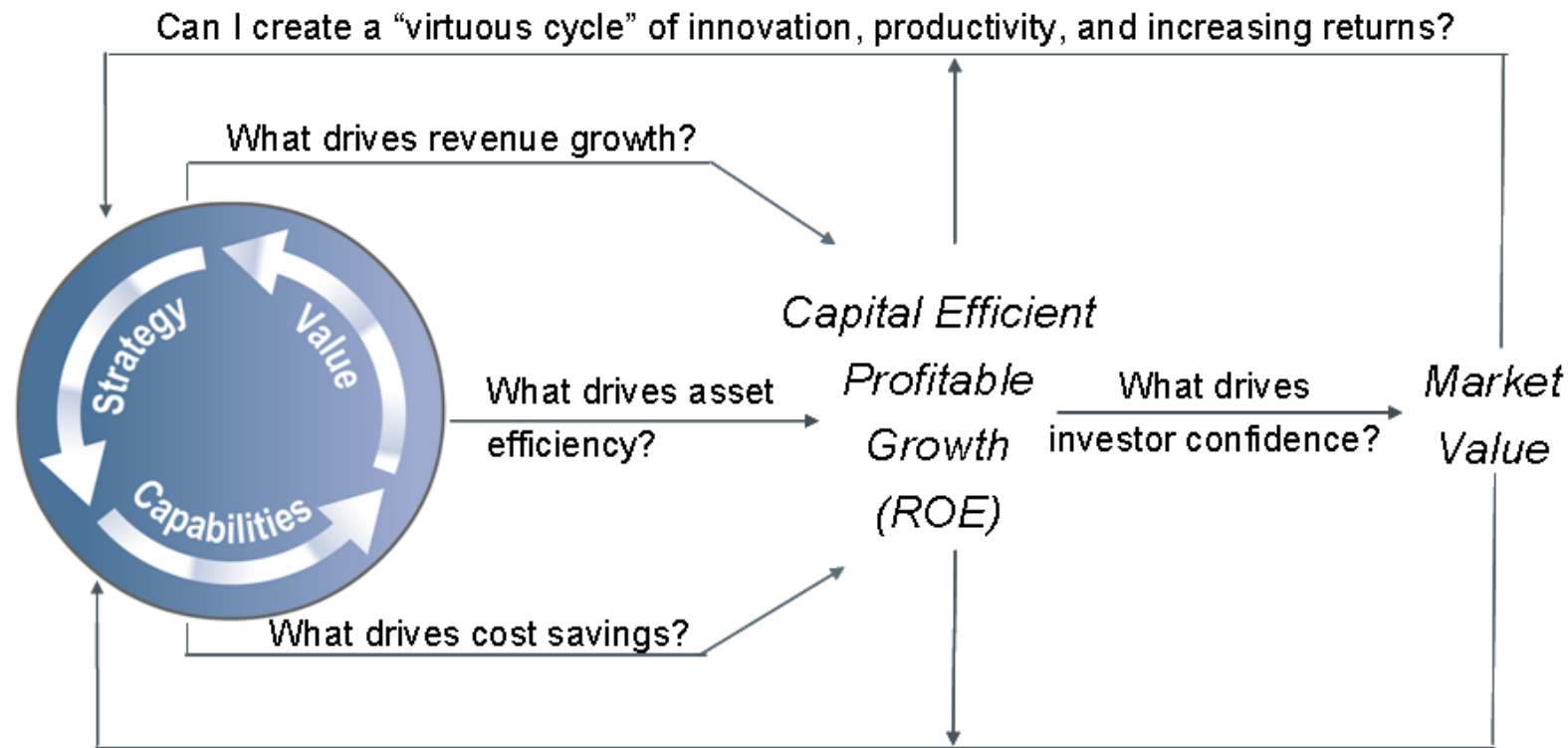
- **SWOT analysis:**
 - Strategy audit: opportunities, threats
 - Environment external to the organization
 - Capability audit: strengths, weaknesses
 - Internal to the firm
 - Prioritize S.W.O.T

SWOT Strategies

	Opportunities (external, positive)	Threats (external, negative)
Strengths (internal, positive)	Strength-Opportunity strategies Which of the company's strengths can be used to maximize the opportunities you identified?	Strength-Threats strategies How can you use the company's strengths to minimize the threats you identified?
Weaknesses (internal, negative)	Weakness-Opportunity strategies What action(s) can you take to minimize the company's weaknesses using the opportunities you identified?	Weakness-Threats strategies How can you minimize the company's weaknesses to avoid the threats you identified?

Analyzing Business Model Linkages

- **Drivers** of economic value and financial return are determined via business strategy audit and capability audit



Group Discussion

- Discuss within your project team
- Analyze the Business Model of a company of your choice
- What are the drivers of economic value for the firm?
 - Revenue growth? Cost savings? Asset Efficiency? Investor confidence?










The Business Model Canvas

Designed for:

Designed by:

Date:

Version:

<h3>Key Partners</h3>  <p>Who are our Key Partners? Who are our key suppliers? Which Key Resources are we acquiring from partners? Which Key Activities do partners perform?</p> <p>MOTIVATIONS FOR PARTNERSHIPS Optimization and economy Reduction of risk and uncertainty Acquisition of particular resources and activities</p>	<h3>Key Activities</h3>  <p>What Key Activities do our Value Propositions require? Our Distribution Channels? Customer Relationships? Revenue streams?</p> <p>CATEGORIES Production Problem Solving Platform/Network</p>	<h3>Value Propositions</h3>  <p>What value do we deliver to the customer? Which one of our customer's problems are we helping to solve? What bundles of products and services are we offering to each Customer Segment? Which customer needs are we satisfying?</p> <p>CHARACTERISTICS Newness Performance Customization "Getting the Job Done" Design Brand/Status Price Cost Reduction Risk Reduction Accessibility Convenience/Usability</p>	<h3>Customer Relationships</h3>  <p>What type of relationship does each of our Customer Segments expect us to establish and maintain with them? Which ones have we established? How are they integrated with the rest of our business model? How costly are they?</p> <p>EXAMPLES Personal assistance Dedicated Personal Assistance Self-Service Automated Services Communities Co-creation</p>	<h3>Customer Segments</h3>  <p>For whom are we creating value? Who are our most important customers?</p> <p>Mass Market Niche Market Segmented Diversified Multi-sided Platform</p>			
	<h3>Key Resources</h3>  <p>What Key Resources do our Value Propositions require? Our Distribution Channels? Customer Relationships? Revenue Streams?</p> <p>TYPES OF RESOURCES Physical Intellectual (brand patents, copyrights, data) Human Financial</p>		<h3>Channels</h3>  <p>Through which Channels do our Customer Segments want to be reached? How are we reaching them now? How are our Channels integrated? Which ones work best? Which ones are most cost-efficient? How are we integrating them with customer routines?</p> <p>CHANNEL PHASES 1. Awareness How do we raise awareness about our company's products and services? 2. Evaluation How do we help customers evaluate our organization's Value Proposition? 3. Purchase How do we allow customers to purchase specific products and services? 4. Delivery How do we deliver a Value Proposition to customers? 5. After sales How do we provide post-purchase customer support?</p>				
<h3>Cost Structure</h3>  <p>What are the most important costs inherent in our business model? Which Key Resources are most expensive? Which Key Activities are most expensive?</p> <p>IS YOUR BUSINESS MODEL Cost Driven (leanest cost structure, low price value proposition, maximum automation, extensive outsourcing) Value Driven (focused on value creation, premium value proposition)</p> <p>SAMPLE CHARACTERISTICS Fixed Costs (salaries, rents, utilities) Variable costs Economies of scale Economies of scope</p>			<h3>Revenue Streams</h3>  <p>For what value are our customers really willing to pay? For what do they currently pay? How are they currently paying? How would they prefer to pay? How much does each Revenue Stream contribute to overall revenues?</p> <table><tr><td>TYPES Asset sale Subscription Fees Lending/Renting/Leasing Licensing Brokerage fees Advertising</td><td>FIXED PRICING List Price Product feature dependent Customer segment dependent Volume dependent</td><td>DYNAMIC PRICING Negotiation (bargaining) Yield Management Real-time-Market</td></tr></table>		TYPES Asset sale Subscription Fees Lending/Renting/Leasing Licensing Brokerage fees Advertising	FIXED PRICING List Price Product feature dependent Customer segment dependent Volume dependent	DYNAMIC PRICING Negotiation (bargaining) Yield Management Real-time-Market
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DESIGNED BY: Business Model Foundry AG
The makers of Business Model Generation and Strategyzer

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Evolving Business Model

- **Enhance**
 - Incremental improvements to an existing strategy or capability
- **Expand**
 - Launch new product categories, enter new markets, or expand capabilities
- **Explore**
 - Launch new businesses and build new capabilities
- **Exit**
 - Exit a product or market or outsource a capability

Evolving the Amazon.com Business Model (1995-2000)

