

# CRAFTING YOUR BUSINESS MODEL

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# Business Models

- What is a business model?
  - “A business model is a **framework for making money**. It is the set of **activities** which a firm performs, how it performs them, and when it performs them so as to offer its customers benefits they want and to earn a profit.”
  - A business model is a **summation of the core business decisions and trade-offs** employed by a company to earn a profit

# Business Models

- What is a business model?
- The phrase *business model* is “a term of art.”
  - One of those things many people feel they can recognize when they see it (especially a particularly clever or terrible one) but can't quite define

# Business Models

- Lots of people have tried to define the business model
- How people define the term really depends on how they're using it
  - “All it really means is how you plan to make money” (Michael Lewis)
- **The business model for Microsoft**, for instance, was to sell software for 120 bucks a pop that cost fifty cents to manufacture
- **The business model of most Internet companies** was to attract huge crowds of people to a Web site, and then sell others the chance to advertise products to the crowds

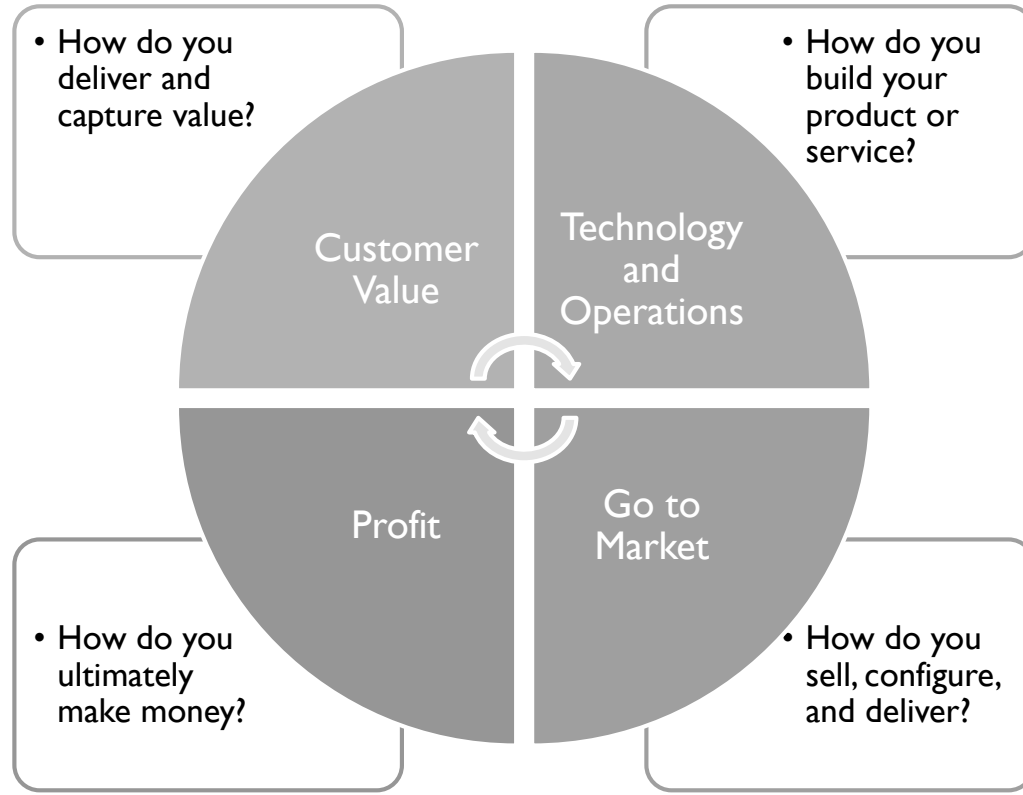
# Business Models

## Peter Drucker:

- “assumptions about what a company gets paid for”; specifically...
  - what a business will and won’t do
  - **identifying customers and competitors, their values and behavior**
  - about technology and its adoption
  - about a company’s **strengths and weaknesses**

# Business Models

- Essentially answers the questions:
  - Who is the customer?
  - What does the customer value?
  - How do we make money in this business?
  - What is the underlying economic logic that explains how we can deliver value to customers at an appropriate cost?



# Business Models

**Alex Osterwalder** - creator of the “[business model canvas](#)”

- “a business model is really a set of assumptions or hypotheses” which you need to lay out about...
  - resources and activities
  - value proposition
  - customer relationships
  - channels
  - customer segments
  - cost structures
  - revenue streams



# Business Models

## *Business models need to evolve*

Example: IBM

- Tech giant realized some assumptions were no longer true
- Assumptions changed as IBM made the shift from tabulating machine company, to hardware leaser, to a vendor of mainframe, minicomputer, and even PC hardware
- Big Blue finally runs adrift on its assumption that it's essentially in the hardware business but does manage to make money through services

# Business Models

- Business models are not generally strategy
  - A **business model is an outcome of a strategy**
  - For entrepreneurs, they are often the same
- If you start to compare one model with another, you're entering the realms of strategy
- A **business model is a description of how your business runs**, but a competitive **strategy explains how you will do better than your rivals**

*Note: a competitive strategy could be by offering a better business model — but it can also be by offering the same business model to a different market.*

# Business Models

## Joan Magretta:

- Business models are “stories that explain how enterprises work”
- A solid business model enables companies to tie marketplace insights to the resulting economics; linking assumptions to numbers (i.e. P&L)

# Business Models

*A business model is Narrative AND Numbers*

# Business models



# Business models



*name-your-own-price business model*

# Business models



*Offer aggregation business model*

# Business models



*Going after Small Markets*



The collage features five logos arranged in a grid-like fashion. At the top left is the PayPal logo in blue. To its right is the Etsy logo in white on an orange background. Below these are three smaller logos: Craigslist in purple, New York City Craigslist in a grey header with a table of categories, and the Kickstarter logo in white and green on a black background.

***Person-to-Person Sales***  
***One-on-one Transactions***

# Business Models



*Speed, Quality, Consistency  
and Real Estate!*

# Business Models

- What is a business model?
  - How do we guide someone through the model?
  - What assumptions are most important?

***Narrative AND Numbers***

# Business Models: Basic Forms

- **Brokerage**
  - Bring together buyers and sellers, charging a fee per transaction to one or another party
  - Example: Century 21, Orbitz



# Business Models: Basic Forms

- **Bundling**
  - Package related goods and services together
  - Example: Fast-food value meals, iPod/iTunes



# Business Models: Basic Forms

- **Cell phone**
  - Charge different rates for discrete levels of a service
  - Example: Sprint



# Business Models: Basic Forms

- **Crowdsourcing**
  - Get a large group of people to contribute content for free in exchange for access to other people's content
  - Example: Wikipedia, YouTube



# Business Models: Basic Forms

- **Disintermediation**
  - Sell direct, sidestepping traditional middlemen
  - Examples: Dell, WebMD





# Business Models: Basic Forms

- Fractionalization
  - Sell partial use of something
  - Examples: NetJets, Time-shares



# Business Models: Basic Forms

- **Freemium**
  - Offer basic services for free, charge for premium service
  - Example: LinkedIn, Facebook



# Business Models: Basic Forms

- **Leasing**
  - Rent, rather than sell, high-margin, high-priced products
  - Example: MachineryLink



# Business Models: Basic Forms

- **Low-touch**
  - Lower prices by decreasing service
  - Example: Walmart, IKEA



# Business Models: Basic Forms

- **Negative operating cycle**
  - Lower prices by receiving payment before delivering the offering
  - Example: Amazon



# Business Models: Basic Forms

- **Razor/blades**
  - Offer the high-margin razor below cost to increase volume sales of the low-margin razor blades
  - Example: Printers and ink



# Business Models: Basic Forms

- **Reverse Razor/blades**
  - Offer the low-margin item below cost to encourage sales of the high-margin companion product
  - Example: Kindle, iPod/iTunes



# Business Models: Basic Forms

- **Reverse auction**
  - Set a ceiling price and have participants bid as the price drops
  - Example: Elance.com





# Business Models: Basic Forms

- **Pay as you go**
  - Charge for actual, metered usage
  - Example: Electric companies



# Business Models: Basic Forms

- **Product to service**
  - Rather than sell a product, sell the service the product performs
  - Example: Zipcar



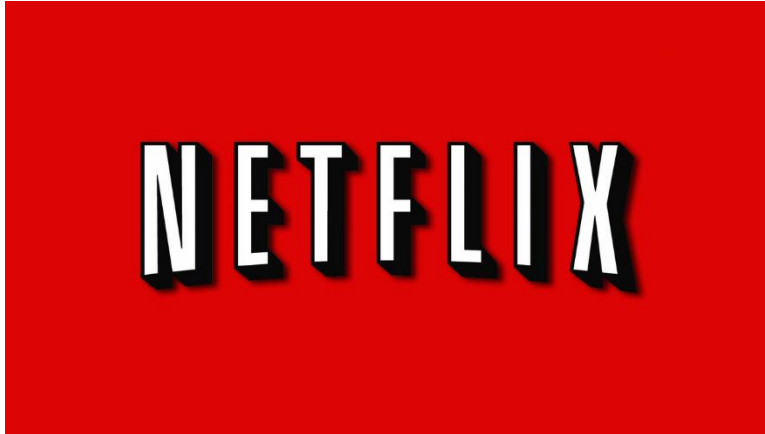
# Business Models: Basic Forms

- **Standardization**
  - Standardize a previously personalized service to lower costs
  - Example: MinuteClinic



# Business Models: Basic Forms

- Subscription
  - Charge a subscription fee to gain access to a service
  - Example: Netflix



# Business Models: Basic Forms

- User communities
  - Grant members access to a network, charging both membership fees and advertising
  - Example: Angie's List



# Summary



## Key points:

- The business model construct is useful for understanding value creation for new ventures & can be a source of venture differentiation
- Diving into the details of revenues, profits (and other numbers) are important for thinking through how your new venture's value proposition to key stakeholders can be converted
- Storytelling matters





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