Business model

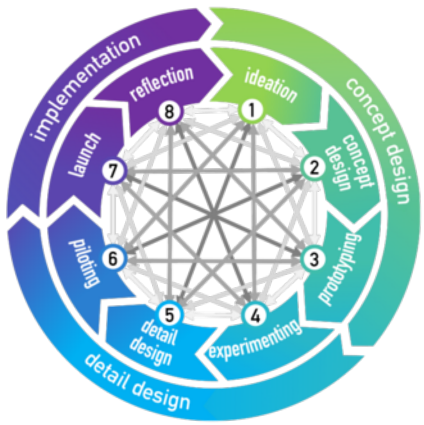

Figure 1: Business model innovation is an iterative and potentially circular process.

A business model describes how a business organization creates, delivers, and captures value, in economic, social, cultural or other contexts. The model describes the specific way in which the business conducts itself, spends, and earns money in a way that generates profit. The process of business model construction and modification is also called business model innovation and forms a part of business strategy.

In theory and practice, the term business model is used for a broad range of informal and formal descriptions to represent core aspects of an organization or business, including purpose, business process, target customers, offerings, strategies, infrastructure, organizational structures, profit structures, sourcing, trading practices, and operational processes and policies including culture.

Context

The literature has provided very diverse interpretations and definitions of a business model. A systematic review and analysis of manager responses to a survey defines business models as the design of organizational structures to enact a commercial opportunity. Further extensions to this design logic emphasize the use of narrative or coherence in business model descriptions as mechanisms by which entrepreneurs create extraordinarily successful growth firms.

Business models are used to describe and classify businesses, especially in an entrepreneurial setting, but they are also used by managers inside companies to explore possibilities for future development. Well-known business models can operate as “recipes”for creative managers. Business models are also referred to in some instances within the context of accounting for purposes of public reporting.

History

According to the Oxford English Dictionary, the term “business model”, a compound of business and model, was first used in 1832 in the sense of “a plan for the operation of a business”.

Over the years, business models have become much more sophisticated. The bait and hook business model (also referred to as the “razor and blades business model”or the “tied products business model”) was introduced in the early 20th century. This involves offering a basic product at a very low cost, often at a loss (the “bait”), then charging compensatory recurring amounts for refills or associated products or services (the “hook”). Examples include: razor (bait) and blades (hook); cell phones (bait) and air time (hook); computer printers (bait) and ink cartridge refills (hook); and cameras (bait) and prints (hook). A variant of this model was employed by Adobe, a software developer that gave away its document reader free of charge but charged several hundred dollars for its document writer.

In the 1950s, new business models came from McDonald's Restaurants and Toyota. In the 1960s, the innovators were Wal-Mart and Hypermarkets. The 1970s saw new business models from FedEx and Toys R Us; the 1980s from Blockbuster, Home Depot, Intel, and Dell Computer; the 1990s from Southwest Airlines, Netflix, eBay, Amazon.com, and Starbucks.

Today, the type of business models might depend on how technology is used. For example, entrepreneurs on the internet have also created new models that depend entirely on existing or emergent technology. Using technology, businesses can reach a large number of customers with minimal costs. In addition, the rise of outsourcing and globalization has meant that business models must also account for strategic sourcing, complex supply chains and moves to collaborative, relational contracting structures.

Theoretical and empirical insights

Design logic and narrative coherence

Design logic views the business model as an outcome of creating new organizational structures or changing existing structures to pursue a new opportunity. Gerry George and Adam Bock (2011) conducted a comprehensive literature review and surveyed managers to understand how they perceived the components of a business model. In that analysis these authors show that there is a design logic behind how entrepreneurs and managers perceive and explain their business model. In further extensions to the design logic, George and Bock (2012) use case studies and the IBM survey data on business models in large companies, to describe how CEOs and entrepreneurs create narratives or stories in a coherent manner to move the business from one opportunity to another. They also show that when the narrative is incoherent or the components of the story are misaligned, that these businesses tend to fail. They recommend ways in which the entrepreneur or CEO can create strong narratives for change. The business model concept is not without its critics (e.g., redundancy) and suggestions for further extensions (e.g., to nonmonetary exchange).

Complementarities between partnering firms

Berglund and Sandström (2013) argued that business models should be understood from an open systems perspective as opposed to being a firm-internal concern. Since innovating firms do not have executive control over their surrounding network, business model innovation tends to require soft power tactics with the goal of aligning heterogeneous interests. In a study of collaborative research and external sourcing of technology, Hummel et al. (2010) similarly found that in deciding on business partners, it is important to make sure that both parties'business models are complementary. For example, they found that it was important to identify the value drivers of potential partners by analyzing their business models, and that it is beneficial to find partner firms that understand key aspects of one's own firm's business model.

The University of Tennessee conducted research into highly collaborative business relationships. Researchers codified their research into a sourcing business model known as Vested Outsourcing, a hybrid sourcing business model in which buyers and suppliers in an outsourcing or business relationship focus on shared values and goals to create an arrangement that is highly collaborative and mutually beneficial to each.

Categorization

From about 2012, some research and experimentation has theorized about a so-called "liquid business model" .

Shift from pipes to platforms

Sangeet Paul Choudary distinguishes between two broad families of business models in an article in Wired magazine. Choudary contrasts pipes (linear business models) with platforms (networked business models). In the case of pipes, firms create goods and services, push them out and sell them to customers. Value is produced upstream and consumed downstream. There is a linear flow, much like water flowing through a pipe. Unlike pipes, platforms do not just create and push stuff out. They allow users to create and consume value.

Alex Moazed, founder and CEO of Applico, defines a platform as a business model that creates value by facilitating exchanges between two or more interdependent groups, usually consumers and producers, of a given value. As a result of digital transformation, it is the predominant business model of the 21st century.

In an op-ed on MarketWatch, Choudary, Van Alstyne and Parker further explain how business models are moving from pipes to platforms, leading to disruption of entire industries.

Platform

There are three elements to a successful platform business model. The toolbox creates connection by making it easy for others to plug into the platform. This infrastructure enables interactions between participants. The magnet creates pull that attracts participants to the platform. For transaction platforms, both producers and consumers must be present to achieve critical mass. The matchmaker fosters the flow of value by making connections between producers and consumers. Data is at the heart of successful matchmaking, and distinguishes platforms from other business models.

Chen (2009) stated that the business model has to take into account the capabilities of Web 2.0, such as collective intelligence, network effects, user-generated content, and the possibility of self-improving systems. He suggested that the service industry such as the airline, traffic, transportation, hotel, restaurant, information and communications technology and online gaming industries will be able to benefit in adopting business models that take into account the characteristics of Web 2.0. He also emphasized that Business Model 2.0 has to take into account not just the technology effect of Web 2.0 but also the networking effect. He gave the example of the success story of Amazon in making huge revenues each year by developing an open platform that supports a community of companies that re-use Amazon's on-demand commerce services.[need quotation to verify]

Jose van Dijck (2013) identifies three main ways that media platforms choose to monetize, which mark a change from traditional business models. One is the subscription model, in which platforms charge users a small monthly fee in exchange for services. She notes that the model was ill-suited for those "accustomed to free content and services", leading to a variant, the freemium model. A second method is via advertising. Arguing that traditional advertising is no longer appealing to people used to "user-generated content and social networking", she states that companies now turn to strategies of customization and personalization in targeted advertising. Eric K. Clemons (2009) asserts that consumers no longer trust most commercial messages; Van Dijck argues platforms are able to circumvent the issue through personal recommendations from friends or influencers on social media platforms, which can serve as a more subtle form of advertisement. Finally, a third common business model is monetization of data and metadata generated from the use of platforms.

Applications

Malone et al. found that some business models, as defined by them, indeed performed better than others in a dataset consisting of the largest U.S. firms, in the period 1998 through 2002, while they did not prove whether the existence of a business model mattered.

In the healthcare space, and in particular in companies that leverage the power of Artificial Intelligence, the design of business models is particularly challenging as there are a multitude of value creation mechanisms and a multitude of possible stakeholders. An emerging categorization has identified seven archetypes.

The concept of a business model has been incorporated into certain accounting standards. For example, the International Accounting Standards Board (IASB) utilizes an "entity's business model for managing the financial assets"as a criterion for determining whether such assets should be measured at amortized cost or at fair value in its International Financial Reporting Standard, IFRS 9. In their 2013 proposal for accounting for financial instruments, the Financial Accounting Standards Board also proposed a similar use of business model for classifying financial instruments. The concept of business model has also been introduced into the accounting of deferred taxes under International Financial Reporting Standards with 2010 amendments to IAS 12 addressing deferred taxes related to investment property.

Both IASB and FASB have proposed using the concept of business model in the context of reporting a lessor's lease income and lease expense within their joint project on accounting for leases. In its 2016 lease accounting model, IFRS 16, the IASB chose not to include a criterion of "stand alone utility"in its lease definition because "entities might reach different conclusions for contracts that contain the same rights of use, depending on differences between customers'resources or suppliers'business models."The concept has also been proposed as an approach for determining the measurement and classification when accounting for insurance contracts. As a result of the increasing prominence the concept of business model has received in the context of financial reporting, the European Financial Reporting Advisory Group (EFRAG), which advises the European Union on endorsement of financial reporting standards, commenced a project on the "Role of the Business Model in Financial Reporting"in 2011.

Design

Business model design generally refers to the activity of designing a company's business model. It is part of the business development and business strategy process and involves design methods. Massa and Tucci (2014) highlighted the difference between crafting a new business model when none is in place, as it is often the case with academic spinoffs and high technology entrepreneurship, and changing an existing business model, such as when the tooling company Hilti shifted from selling its tools to a leasing model. They suggested that the differences are so profound (for example, lack of resource in the former case and inertia and conflicts with existing configurations and organisational structures in the latter) that it could be worthwhile to adopt different terms for the two. They suggest business model design to refer to the process of crafting a business model when none is in place and business model reconfiguration for the process of changing an existing business model, also highlighting that the two processes are not mutually exclusive, meaning reconfiguration may involve steps which parallel those of designing a business model.

Economic consideration

Al-Debei and Avison (2010) consider value finance as one of the main dimensions of business modelling which depicts information related to costing, pricing methods, and revenue structure. Stewart and Zhao (2000) defined the business model as "a statement of how a firm will make money and sustain its profit stream over time."

Component consideration

Osterwalder et al. (2005) consider the Business Model as the blueprint of how a company does business. Slywotzky (1996) regards the business model as "the totality of how a company selects its customers, defines and differentiates it offerings, defines the tasks it will perform itself and those it will outsource, configures its resources, goes to market, creates utility for customers and captures profits."

Strategic outcome

Mayo and Brown (1999) considered the business model as "the design of key interdependent systems that create and sustain a competitive business."Casadesus-Masanell and Ricart (2011) explain a business model as a set of "choices (policy, assets and governance)"and "consequences (flexible and rigid)"and underline the importance of considering "how it interacts with models of other players in the industry"instead of thinking of it in isolation.

Definitions of design or development

Zott and Amit (2009) consider business model design from the perspectives of design themes and design content. Design themes refer to the system's dominant value creation drivers and design content examines in greater detail the activities to be performed, the linking and sequencing of the activities and who will perform the activities.

Figure 2: Environment-strategy-structure-operations business model development

Design themes emphasis

Developing a framework for business model development with an emphasis on design themes, Lim (2010) proposed the environment-strategy-structure-operations (ESSO) business model development which takes into consideration the alignment of the organization's strategy with the organization's structure, operations, and the environmental factors in achieving competitive advantage in varying combination of cost, quality, time, flexibility, innovation and affective.

Design content emphasis

Business model design includes the modeling and description of a company's:

- value propositions
- target customer segments
- distribution channels
- customer relationships
- value configurations
- core capabilities
- commercial network
- partner network
- cost structure
- revenue model

A business model design template can facilitate the process of designing and describing a company's business model. In a paper published in 2017, Johnson demonstrated how matrix methods may usefully be deployed to characterise the architecture of resources, costs, and revenues that a business uses to create and deliver value to customers which defines its business model. Systematisation of this technique (Johnson settles on a business genomic code of seven matrix elements of a business model) would support a taxonomical approach to empirical studies of business models in the same way that Linnaeus'taxonomy revolutionised biology.

Daas et al. (2012) developed a decision support system (DSS) for business model design. In their study a decision support system (DSS) is developed to help SaaS in this process, based on a design approach consisting of a design process that is guided by various design methods.

Examples

In the early history of business models it was very typical to define business model types such as bricks-and-mortar or e-broker. However, these types usually describe only one aspect of the business (most often the revenue model). Therefore, more recent literature on business models concentrate on describing a business model as a whole, instead of only the most visible aspects.

The following examples provide an overview for various business model types that have been in discussion since the invention of term business model:

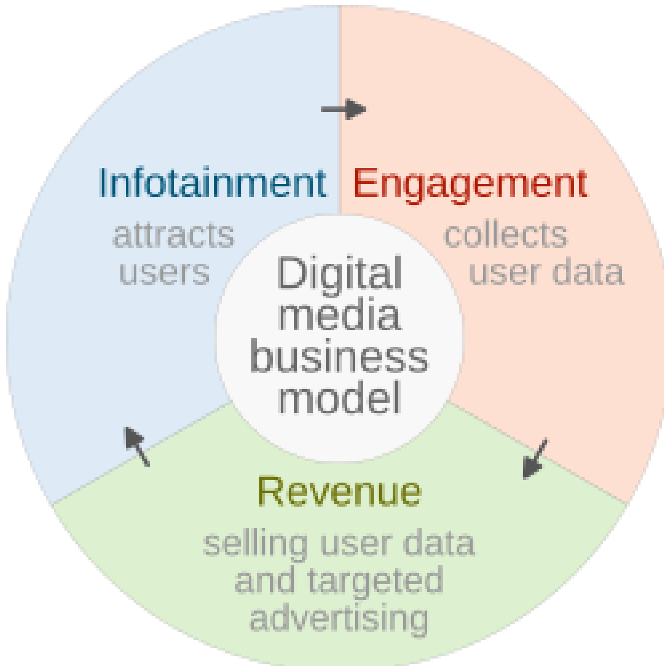

Figure 3: Some digital media platforms use a “triple-product”business model in which infotainment (information and entertainment) is exchanged for attention and user surveillance data, which in turn is monetized for targeted ad revenue.

Other examples of business models are:

- Auction business model
- All-in-one business model
- Chemical leasing
- Low-cost carrier business model
- Loyalty business models
- Monopolistic business model
- Multi-level marketing business model
- Network effects business model
- Online auction business model
- Online content business model
- Premium business model
- Professional open-source model
- Pyramid scheme business model
- Razor and blades model
- Servitization of products business model
- Subscription business model
- Network Orchestrators Companies
- Virtual business model

Frameworks

Technology centric communities have defined “frameworks”for business modeling. These frameworks attempt to define a rigorous approach to defining business value streams. It is not clear, however, to what extent such frameworks are actually important for business planning. Business model frameworks represent the core aspect of any company; they involve “the totality of how a company selects its customers defines and differentiates its offerings, defines the tasks it will perform itself and those it will outsource, configures its

Figure 4: Although Webvan failed in its goal of disintermediating the North American supermarket industry, several supermarket chains (like Safeway Inc.) have launched their own delivery services to target the niche market to which Webvan catered.

Figure 5: Example of Business Model Canvas

resource, goes to market, creates utility for customers, and captures profits". A business framework involves internal factors (market analysis; products/services promotion; development of trust; social influence and knowledge sharing) and external factors (competitors and technological aspects).

- Business reference model
- Component business model
- Industrialization of services business model
- Business Model Canvas
- OGSM

Related concepts

The process of business model design is part of business strategy. Business model design and innovation refer to the way a firm (or a network of firms) defines its business logic at the strategic level.

In contrast, firms implement their business model at the operational level, through their business operations. This refers to their process-level activities, capabilities, functions and infrastructure (for example, their business processes and business process modeling), their organizational structures (e.g. organograms, workflows, human resources) and systems (e.g. information technology architecture, production lines).

The brand is a consequence of the business model and has a symbiotic relationship with it, because the business model determines the brand promise, and the brand equity becomes a feature of the model. Managing this is a task of integrated marketing.

The standard terminology and examples of business models do not apply to most nonprofit organizations, since their sources of income are generally not the same as the beneficiaries. The term 'funding model'is generally used instead.

The model is defined by the organization's vision, mission, and values, as well as sets of boundaries for the organization—what products or services it will deliver, what customers or markets it will target, and what supply and delivery channels it will use. Mission and vision together make part of the overall business purpose. While the business model includes high-level strategies and tactical direction for how the organization will implement the model, it also includes the annual goals that set the specific steps the organization intends to undertake in the next year and the measures for their expected accomplishment. Each of these is likely to be part of internal documentation that is available to the internal auditor.

Business model innovation

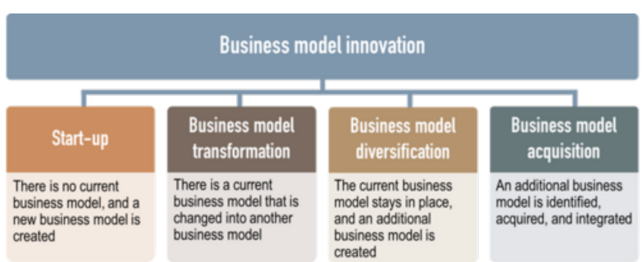

Figure 6: Business model innovation types

When an organisation creates a new business model, the process is called business model innovation. There is a range of reviews on the topic, The concept facilitates the analysis and planning of transformations from one business model to another. Frequent and successful business model innovation can increase an organisation' s resilience to changes in its environment and if an organisation has the capability to do this, it can become a competitive advantage. Although business model innovation promises financial returns, periods of radical business model innovation can reduce the person-organization fit and thus lead to a greater fluctuation in the workforce.

Business model adaptation

As a specific instance of business model dynamics, a research strand derived from the evolving changes in business models, BMA identifies an update of the current business model to changes derived from the context. BMA can be innovative or not, depending on the degree of novelty of the changes implemented. As a consequence of the new context, several business model elements are promoted to answer those challenges, pivoting the business model towards new models. Companies adapt their business model when someone or something such as COVID-19 has disrupted the market. BMA could fit any organization, but incumbents are more motivated to adapt their current BM than to change it radically or create a new one.