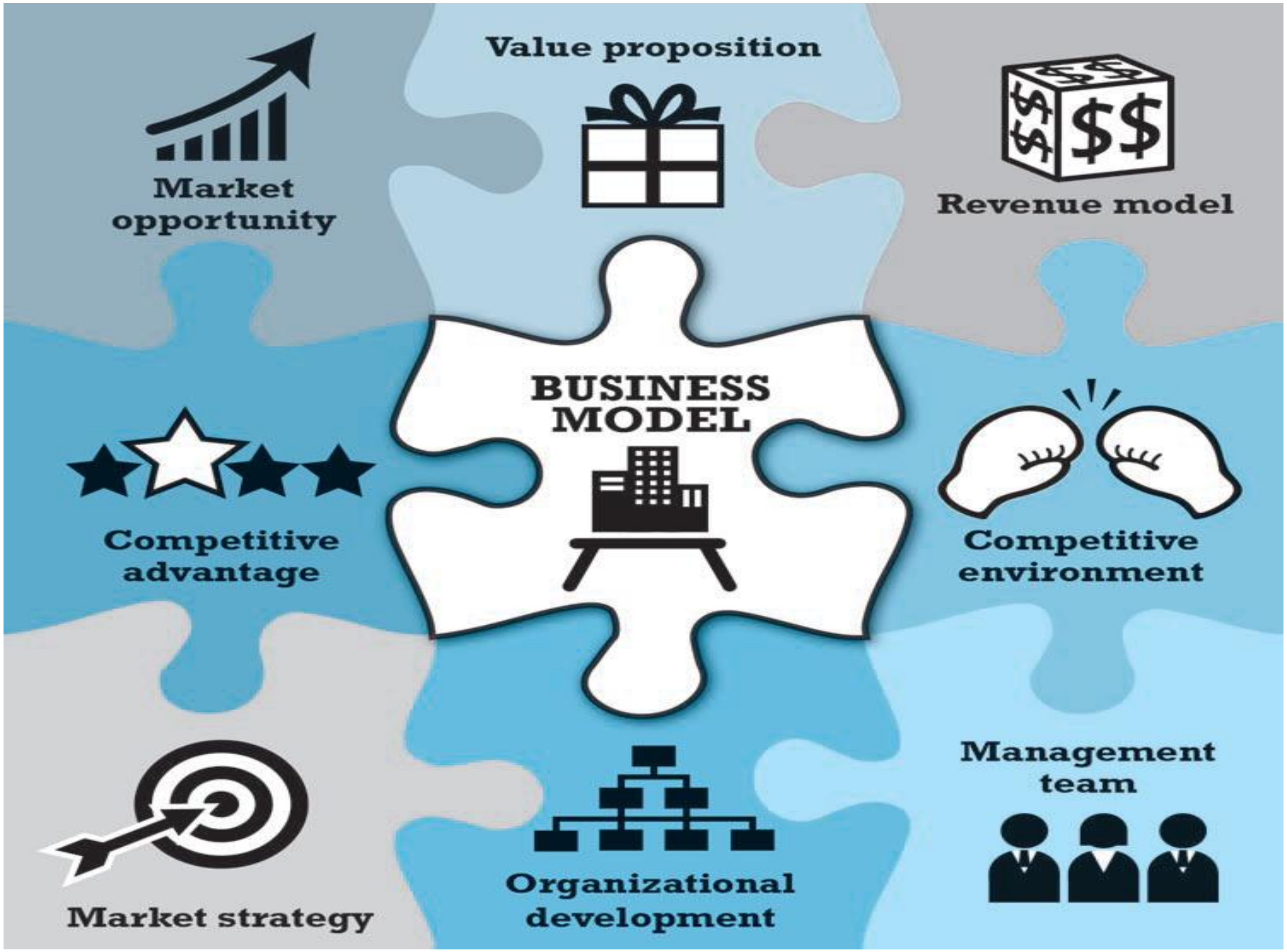
Unit 2: E-Commerce Business Model (8 Hrs.)

E-commerce Business Model

- A **business model is a set of planned activities (sometimes referred to as *business*** *processes) designed to result in a profit in a marketplace.*
- *A business model is not* always the same as a business strategy, although in some cases they are very close insofar as the business model explicitly takes into account the competitive environment
- The business model is at the center of the business plan.
- A **business plan is a document that describes a firm's business model.**
- **A business plan** always takes into account the competitive environment.
- An **e-commerce business model aims to use and leverage the unique qualities of the Internet, the Web, and the** mobile platform.

Elements of Business Model: 8 Elements



1. Value Proposition

- A company's value proposition is at the very heart of its business model.
- A **value proposition defines how a company's product or service fulfills the needs of customers**.
- To develop and/or analyze a firm's value proposition, you need to understand why customers will choose to do business with the firm instead of another company and what the firm provides that other firms do not and cannot.
- From the consumer point of view, successful e-commerce value propositions include:
  - personalization and customization of product offerings,
  - reduction of product search costs,
  - reduction of price discovery costs, and
  - facilitation of transactions by managing product delivery.

2. Revenue Model

- A firm's **revenue model describes how the firm will earn revenue, generate profits,** and produce a superior return on invested capital.
- We use the terms *revenue model and financial model interchangeably.*
- *The function of business organizations is both to* generate profits and to produce returns on invested capital that exceed alternative investments.
- Profits alone are not sufficient to make a company "successful".
- In order to be considered successful, a firm must produce returns greater than alternative investments.
- Firms that fail this test go out of existence.

Types of Revenue Models: 5 Models

2.1 Advertising revenue model:

- **A company that offers content, services,** and/or products also provides a forum for advertisements and receives fees from advertisers.
- Companies that are able to attract the greatest viewership or that have a highly specialized, differentiated viewership and are able to retain user attention ("stickiness") are able to charge higher advertising rates.
- Yahoo, for instance, derives a significant amount of revenue from display and video advertising.

2.2 Subscription revenue model:

- **A company that offers content or services** charges a subscription fee for access to some or all of its offerings.
- For instance, the digital version of *Consumer Reports provides online and mobile access to premium* content, such as detailed ratings, reviews, and recommendations, only to subscribers, who have a choice of paying a $6.95 monthly subscription fee or a $30.00 annual fee.
- Experience with the subscription revenue model indicates that to successfully overcome the disinclination of users to pay for content, the content offered must be perceived as a high-value-added, premium offering that is not readily available elsewhere nor easily replicated.
- Companies successfully offering content or services online on a subscription basis include eHarmony (dating services), Ancestry (genealogy research), Microsoft's Xbox Live (video games), Pandora, Spotify, and Apple Music (music), Scribd and Amazon's Kindle Unlimited program (e-books), and Netflix and Hulu (television and movies).

2.3 Transaction fee revenue model

- **A company receives a fee for enabling** or executing a transaction.
- For example, eBay provides an auction marketplace and receives a small transaction fee from a seller if the seller is successful in selling the item.
- E*Trade, a financial services provider, receives transaction fees each time it executes a stock transaction on behalf of a customer.

2.4 Sales revenue model

- **Companies derive revenue by selling goods, content,** or services to customers.
- Companies such as Amazon, L.L.Bean, and Gap all have sales revenue models.
- A number of companies are also using a subscription-based sales revenue model.
- Birchbox, which offers home delivery of beauty products for a $10 monthly or $100 annual subscription price, is one example.
- Dollar Shave Club, which sells razor blades by subscription and was recently acquired by Unilever for $1 billion, is another.

2.5 Affiliate revenue model

- **Companies that steer business to an “affiliate”** receive a referral fee or percentage of the revenue from any resulting sales.
- For example, MyPoints makes money by connecting companies with potential customers by offering special deals to its members.
- When they take advantage of an offer and make a purchase, members earn “points” they can redeem for freebies, and MyPoints receives a fee.
- Community feedback companies typically receive some of their revenue from steering potential customers to websites where they make a purchase.

Summary of Revenue Models

TABLE 5.2 FIVE PRIMARY REVENUE MODELS

REVENUE MODEL	EXAMPLES	REVENUE SOURCE
Advertising	Yahoo	Fees from advertisers in exchange for advertisements
Subscription	eHarmony Consumer Reports Online Netflix	Fees from subscribers in exchange for access to content or services
Transaction Fee	eBay E*Trade	Fees (commissions) for enabling or executing a transaction
Sales	Amazon L.L.Bean Birchbox iTunes	Sales of goods, information, or services
Affiliate	MyPoints	Fees for business referrals

3. Market Opportunity

- The term **market opportunity refers to the company's intended marketspace (i.e.,** an area of actual or potential commercial value) and the overall potential financial opportunities available to the firm in that marketspace.
- The market opportunity is usually divided into smaller market niches.
- The realistic market opportunity is defined by the revenue potential in each of the market niches where you hope to compete.

4. Competitive Environment

- A firm's **competitive environment refers to the other companies selling similar** products and operating in the same marketspace.
- It also refers to the presence of substitute products and potential new entrants to the market, as well as the power of customers and suppliers over your business.
- The competitive environment for a company is influenced by several factors:
  - how many competitors are active,
  - how large their operations are,
  - what the market share of each competitor is,
  - how profitable these firms are, and
  - how they price their products.

5. Competitive Advantage

- Firms achieve a **competitive advantage when they can produce a superior product** and/or bring the product to market at a lower price than most, or all, of their competitor.
- Firms also compete on scope.
- Some firms can develop global markets, while other firms can develop only a national or regional market.
- Firms that can provide superior products at the lowest cost on a global basis are truly advantaged.

6. **Market Strategy**

- No matter how tremendous a firm's qualities, its marketing strategy and execution are often just as important.
- The best business concept, or idea, will fail if it is not properly marketed to potential customers.
- Everything you do to promote your company's products and services to potential customers is known as marketing.
- **Market strategy is the plan you put together that** details exactly how you intend to enter a new market and attract new customers.
- For instance, Twitter, YouTube, and Pinterest have a social network marketing strategy that encourages users to post their content for free, build personal profile pages, contact their friends, and build a community.
- In these cases, the customer becomes part of the marketing staff!

7. **Organizational Development**

- Companies that hope to grow and thrive need to have a plan for **organizational development that describes how the company will organize the work that needs to** be accomplished.
- Typically, work is divided into functional departments, such as production, shipping, marketing, customer support, and finance.
- Jobs within these functional areas are defined, and then recruitment begins for specific job titles and responsibilities.
- Typically, in the beginning, generalists who can perform multiple tasks are hired.
- As the company grows, recruiting becomes more specialized.
- For instance, at the outset, a business may have one marketing manager.
- But after two or three years of steady growth, that one marketing position may be broken down into seven separate jobs done by seven individuals.

8. **Management Team**

- The single most important element of a business model is the **management team responsible for making the model work.**
- **A strong management team gives a** model instant credibility to outside investors, immediate market-specific knowledge, and experience in implementing business plans.
- A strong management team may not be able to salvage a weak business model, but the team should be able to change the model and redefine the business as it becomes necessary.
- To be able to identify good managers for a business start-up, first consider the kinds of experiences that would be helpful to a manager joining your company.
  - What kind of technical background is desirable?
  - What kind of supervisory experience is necessary?
  - How many years in a particular function should be required?
  - What job functions should be fulfilled first: marketing, production, finance, or operations?
  - Especially in situations where financing will be needed to get a company off the ground,
  - do prospective senior managers have experience and contacts for raising financing from outside investors?

Summary of Key Elements

TABLE 5.3 KEY ELEMENTS OF A BUSINESS MODEL

COMPONENTS	KEY QUESTIONS
Value proposition	Why should the customer buy from you?
Revenue model	How will you earn money?
Market opportunity	What marketspace do you intend to serve, and what is its size?
Competitive environment	Who else occupies your intended marketspace?
Competitive advantage	What special advantages does your firm bring to the marketspace?
Market strategy	How do you plan to promote your products or services to attract your target audience?
Organizational development	What types of organizational structures within the firm are necessary to carry out the business plan?
Management team	What kinds of experiences and background are important for the company's leaders to have?

MAJOR BUSINESS-TO-CONSUMER (B2C) BUSINESS MODELS: 7 Models

TABLE 5.6 B2C BUSINESS MODELS

BUSINESS MODEL	VARIATIONS	EXAMPLES	DESCRIPTION	REVENUE MODELS
E-tailer	Virtual Merchant	Amazon Blue Nile Bluefly	Online version of retail store, where customers can shop at any hour of the day or night without leaving their home or office	Sales of goods
	Bricks-and-Clicks	Walmart Sears	Online distribution channel for a company that also has physical stores	Sales of goods
	Catalog Merchant	L.L.Bean LillianVernon	Online version of direct mail catalog	Sales of goods
	Manufacturer-Direct	Dell Mattel	Manufacturer uses online channel to sell direct to customer	Sales of goods
Community Provider		Facebook LinkedIn Twitter Pinterest	Sites where individuals with particular interests, hobbies, common experiences, or social networks can come together and "meet" online	Advertising, subscription, affiliate referral fees
Content Provider		Wall Street Journal CNN ESPN Netflix Apple Music	Offers customers newspapers, magazines, books, film, television, music, games, and other forms of online content	Advertising, subscription fees, sales of digital goods

Portal	Horizontal/ General	Yahoo AOL MSN Facebook	Offers an integrated package of content, search, and social network services: news, e-mail, chat, music downloads, video streaming, calendars, etc. Seeks to be a user's home base	Advertising, subscription fees, transaction fees
	Vertical/ Specialized (Vortal)	Sailnet	Offers services and products to specialized marketplace	Advertising, subscription fees, transaction fees
	Search	Google Bing Ask	Focuses primarily on offering search services	Advertising, affiliate referral
Transaction Broker		E*Trade Expedia Monster Travelocity Orbitz	Processors of online sales transactions, such as stockbrokers and travel agents, that increase customers' productivity by helping them get things done faster and more cheaply	Transaction fees
Market Creator		eBay Etsy Amazon Priceline	Businesses that use Internet technology to create markets that bring buyers and sellers together	Transaction fees
Service Provider		VisaNow Wave RocketLawyer	Companies that make money by selling users a service, rather than a product	Sales of services

E-TAILER

- Online retail stores, often called **e-tailers, come in all sizes, from giant Amazon to tiny** local stores.
- E-tailers are similar to the typical bricks-and-mortar storefront, except that customers only have to connect to the Internet or use their smartphone to place an order.
- Some e-tailers, which are referred to as “bricks-and-clicks,” are subsidiaries or divisions of existing physical stores and carry the same products.
- REI, JCPenney, Barnes & Noble, Walmart, and Staples are examples of companies with complementary online stores. Others, however, operate only in the virtual world, without any ties to physical locations.
- Amazon, Blue Nile, and Bluefly are examples of this type of e-tailer.
- Several other variations of e-tailers—such as online versions of direct mail catalogs, online malls, and manufacturer-direct online sales—also exist.

COMMUNITY PROVIDER

- Although community providers are not a new phenomenon, the Internet has made such sites for like-minded individuals to meet and converse much easier, without the limitations of geography and time to hinder participation.
- **Community providers** create an online environment where people with similar interests can transact (buy and sell goods); share interests, photos, videos; communicate with like-minded people; receive interest-related information; and even play out fantasies by adopting online personalities called avatars.
- Facebook, LinkedIn, Twitter, and Pinterest, and hundreds of other smaller, niche social networks all offer users community-building.
- The basic value proposition of community providers is to create a fast, convenient, one-stop site where users can focus on their most important concerns and interests, share the experience with friends, and learn more about their own interests.
- Community providers typically rely on a hybrid revenue model that includes subscription fees, sales revenues, transaction fees, affiliate fees, and advertising fees from other firms that are attracted by a tightly focused audience.
- Community providers make money from advertisingtools and services.

Content providers

- **distribute information content, such as digital video, music,** photos, text, and artwork.
- Content providers can make money via a variety of different revenue models, including advertising, subscription fees, and sales of digital goods.
- For instance, in the case of Spotify, a monthly subscription fee provides users with access to millions of music tracks.
- Other content providers, such as the *Financial Times* online newspaper, *Harvard Business Review, and many others, charge customers for* content downloads in addition to, or in place of, a subscription fee.
- Generally, the key to becoming a successful content provider is owning the content.
- Traditional owners of copyrighted content—publishers of books and newspapers, broadcasters of radio and television content, music publishers, and movie studios—have powerful advantages over newcomers who simply offer distribution channels and must pay for content, often at very high prices.

PORTAL

- **Portals such as Yahoo, MSN, and AOL offer users powerful search tools as well as** an integrated package of content and services, such as news, e-mail, instant messaging, calendars, shopping, music downloads, video streaming, and more, all in one place.
- Initially, portals sought to be viewed as “gateways” to the Internet.
- Today, however, the portal business model is to be a destination.
- They are marketed as places where consumers will hopefully stay a long time to read news, find entertainment, and meet other people (think of destination resorts).
- Portals do not sell anything directly—or so it seems—and in that sense they can present themselves as unbiased.
- Portals generate revenue primarily by charging advertisers for ad placement, collecting referral fees for steering customers to other sites, and charging for premium services.

TRANSACTION BROKER

- Companies that process transactions for consumers normally handled in person, by phone, or by mail are **transaction brokers.**
- **The largest industries using this model** are financial services, travel services, and job placement services.
- The online transaction broker’s primary value propositions are savings of money and time.
- In addition, most transaction brokers provide timely information and opinions.
- Companies such as Monster offer job searchers a national marketplace for their talents and employers a national resource for that talent.
- Both employers and job seekers are attracted by the convenience and currency of information.
- Online stock brokers charge commissions that are considerably less than traditional brokers, with many offering substantial deals, such as cash and a certain number of free trades, to lure new customers.

MARKET CREATOR

- **Market creators build a digital environment in which buyers and sellers can meet,** display and search for products and services, and establish prices.
- Prior to the Internet and the Web, market creators relied on physical places to establish a market.
- Beginning with the medieval marketplace and extending to today's New York Stock Exchange, a market has meant a physical space for transacting business.
- There were few private digital network marketplaces prior to the Web.
- The Web changed this by making it possible to separate markets from physical space.
- Prime examples are Priceline, which allows consumers to set the price they are willing to pay for various travel accommodations and other products (sometimes referred to as a reverse auction), and eBay, the online auction site utilized by both businesses and consumers.
- Market creators make money by either charging a percentage of every transaction made, or charging merchants for access to the market.

SERVICE PROVIDER

- While e-tailers sell products online, **service providers offer services online.**
- **There's** been an explosion in online services that is often unrecognized.
- Photo sharing, video sharing, and user-generated content (in blogs and social networks) are all services provided to customers.
- Google has led the way in developing online applications such as Google Maps, Google Docs, and Gmail.
- Other personal services such as online medical bill management, financial and pension planning, and travel recommendation are showing strong growth.
- Service providers use a variety of revenue models.
- Some charge a fee, or monthly subscriptions, while others generate revenue from other sources, such as through advertising and by collecting personal information that is useful in direct marketing.
- Many service providers employ a freemium revenue model, in which some basic services are free, but others require the payment of additional charges.
- Much like retailers who trade products for cash, service providers trade knowledge, expertise, and capabilities for revenue.

MAJOR BUSINESS-TO-BUSINESS (B2B) BUSINESS MODELS: 2 Models

- In Chapter 1, we noted that business-to-business (B2B) e-commerce, in which businesses sell to other businesses, is more than 10 times the size of B2C e-commerce, even though most of the public attention has focused on B2C.
- For instance, it is estimated that revenues for all types of B2B e-commerce worldwide will total around €19.8 trillion in 2016, compared to about €2.35 trillion for retail and travel-related B2C e-commerce.
- Clearly, most of the revenues in e-commerce involve B2B e-commerce.

TABLE 5.7 **B2B BUSINESS MODELS**

BUSINESS MODEL	EXAMPLES	DESCRIPTION	REVENUE MODEL
(1) NET MARKETPLACE			
E-distributor	Grainger Amazon Business	Single-firm online version of retail and wholesale store; supply maintenance, repair, operation goods; indirect inputs	Sales of goods
E-procurement	Ariba Supplier Network PerfectCommerce	Single firm creating digital markets where sellers and buyers transact for indirect inputs	Fees for market-making services, supply chain management, and fulfillment services
Exchange	Go2Paper	Independently owned vertical digital marketplace for direct inputs	Fees and commissions on transactions
Industry Consortium	TheSeam SupplyOn	Industry-owned vertical digital market open to select suppliers	Fees and commissions on transactions
(2) PRIVATE INDUSTRIAL NETWORK			
	Walmart Procter & Gamble	Company-owned network that coordinates supply chains with a limited set of partners	Cost absorbed by network owner and recovered through production and distribution efficiencies

E-DISTRIBUTOR

- Companies that supply products and services directly to individual businesses are **e-distributors.**
- **W.W. Grainger, for example, is the largest distributor of maintenance,** repair, and operations (MRO) supplies.
- In the past, Grainger relied on catalog sales and physical distribution centers in metropolitan areas.
- Its catalog of equipment went online in 1995. In 2015, Grainger's e-commerce platform, which includes websites and mobile apps, produced $3.3 billion in sales (41% of its total revenue) for the company.
- E-distributors are owned by one company seeking to serve many customers.
- However, as with exchanges (described on the next page), critical mass is a factor.
- With e-distributors, the more products and services a company makes available, the more attractive it is to potential customers. One-stop shopping is always preferable to having to visit numerous sites to locate a particular part or product.

E-PROCUREMENT

- Just as e-distributors provide products to other companies, **e-procurement firms** create and sell access to digital markets.
- Firms such as Ariba, for instance, have created software that helps large firms organize their procurement process by creating minidigital markets for a single firm.
- Ariba creates custom-integrated online catalogs (where supplier firms can list their offerings) for purchasing firms.
- On the sell side, Ariba helps vendors sell to large purchasers by providing software to handle catalog creation, shipping, insurance, and finance.
- Both the buy and sell side software is referred to generically as “value chain management” software.

EXCHANGES

- Exchanges have garnered most of the B2B attention and early funding because of their potential market size even though today they are a small part of the overall B2B picture.
- An **exchange is an independent digital marketplace where hundreds of suppliers** meet a smaller number of very large commercial purchasers (Kaplan and Sawhney, 2000).
- Exchanges are owned by independent, usually entrepreneurial startup firms whose business is making a market, and they generate revenue by charging a commission or fee based on the size of the transactions conducted among trading parties.
- They usually serve a single vertical industry such as steel, polymers, or aluminum, and focus on the exchange of direct inputs to production and short-term contracts or spot purchasing.
- For buyers, B2B exchanges make it possible to gather information, check out suppliers, collect prices, and keep up to date on the latest happenings all in one place.
- Sellers, on the other hand, benefit from expanded access to buyers.
- The greater the number of sellers and buyers, the lower the sales cost and the higher the chances of making a sale.
- The ease, speed, and volume of transactions are summarily referred to as *market liquidity.*

INDUSTRY CONSORTIA

- **Industry consortia are industry-owned *vertical marketplaces that serve specific industries,*** such as the automobile, aerospace, chemical, floral, or logging industries.
- In contrast, *horizontal marketplaces sell specific products and services to a wide range of* companies.
- Vertical marketplaces supply a smaller number of companies with products and services of specific interest to their industry, while horizontal marketplaces supply companies in different industries with a particular type of product and service, such as marketing-related, financial, or computing services.
- For example, SupplyOn, founded in 2000 and owned by industrial giants Bosch (one of the world's largest suppliers of automotive components), Continental (a leading automotive manufacturing company), and Schaeffler (a global manufacturer of various types of bearings), among others, provides a shared supply chain collaboration platform for companies in various manufacturing industries.
- In 2016, in addition to its shareholders, its customers include Airbus, BMW, BorgWarner, Siemens, Thales, and many other major global manufacturing companies.
- Industry consortia have tended to be more successful than independent exchanges in part because they are sponsored by powerful, deep-pocketed industry players, and also because they strengthen traditional purchasing behavior rather than seek to transform it.

PRIVATE INDUSTRIAL NETWORKS

- A **private industrial network (sometimes referred to as a private trading exchange** or PTX) is a digital network designed to coordinate the flow of communications among firms engaged in business together.
- The network is owned by a single large purchasing firm.
- Participation is by invitation only to trusted long-term suppliers of direct inputs.
- These networks typically evolve out of a firm’s own enterprise resource planning (ERP) system, and are an effort to include key suppliers in the firm’s own business decision making.
- For instance, Walmart operates one of the largest private industrial networks in the world for its suppliers, who on a daily basis use Walmart’s network to monitor the sales of their goods, the status of shipments, and the actual inventory level of their goods.

ELECTRONIC DATA INTERCHANGE (EDI)

- EDI is a broadly defined communications protocol for exchanging documents among computers using technical standards developed by the American National Standards Institute (ANSI X12 standards) and international bodies such as the United Nations (EDIFACT standards).
- EDI was developed to reduce the cost, delays, and errors inherent in the manual exchanges of documents such as purchase orders, shipping documents, price lists, payments, and customer data.
- EDI differs from an unstructured message because its messages are organized with distinct fields for each of the important pieces of information in a commercial transaction such as transaction date, product purchased, amount, sender’s name, address, and recipient’s name.

E Commerce: INDUSTRY STRUCTURE

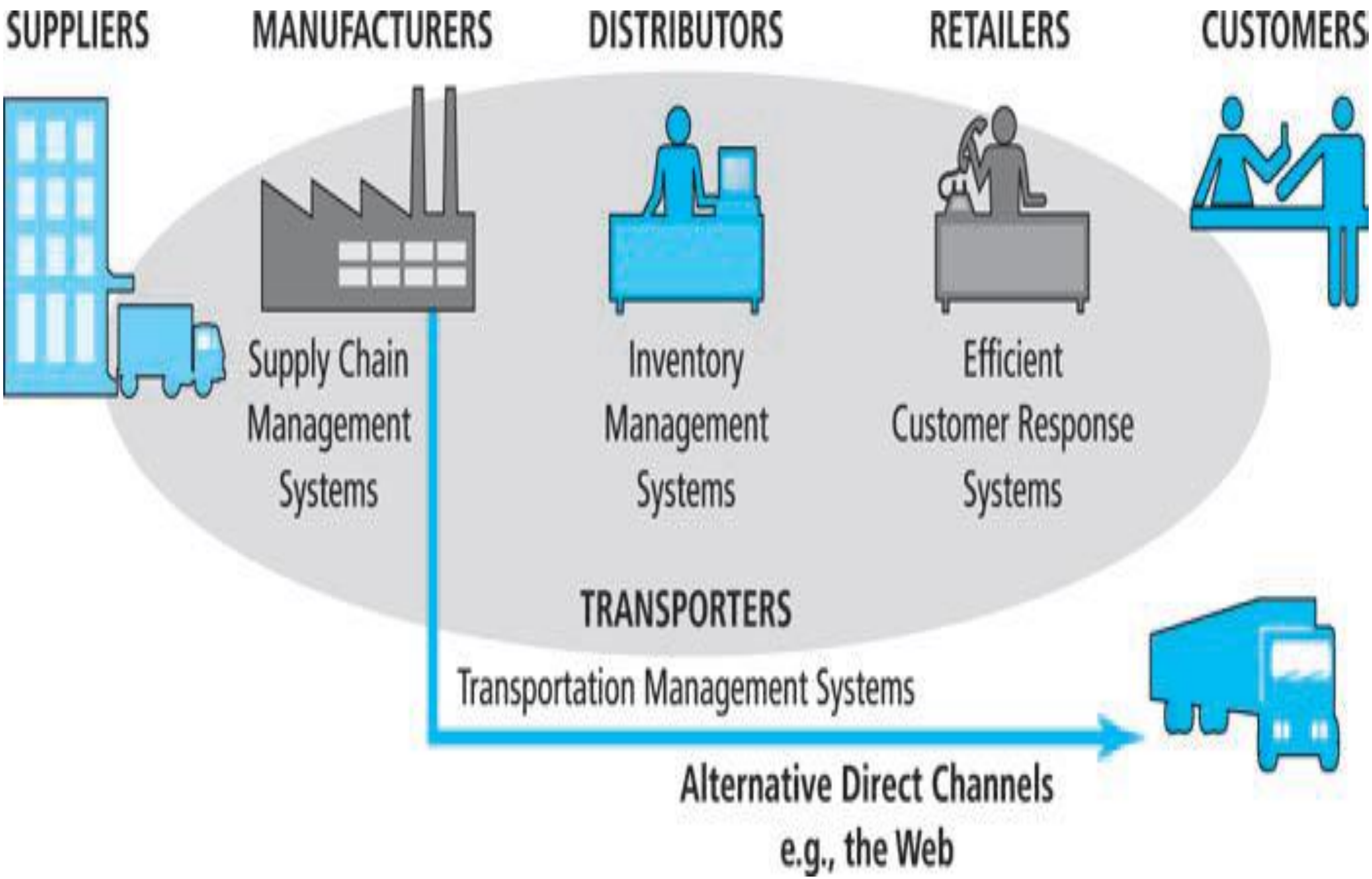
- E-commerce changes industry structure, in some industries more than others.
- **Industry structure refers to the nature of the players in an industry and their relative** bargaining power.
- An industry's structure is characterized by five forces: *rivalry among existing competitors, the threat of substitute products, barriers to entry into the industry,* the *bargaining power of suppliers, and the bargaining power of buyers.*
- When you describe an industry's structure, you are describing the general business environment in an industry and the overall profitability of doing business in that environment.
- E-commerce has the potential to change the relative strength of these competitive forces.

HOW E-COMMERCE INFLUENCES INDUSTRY STRUCTURE

INDUSTRY VALUE CHAINS

- While an industry structural analysis helps you understand the impact of e-commerce technology on the overall business environment in an industry, a more detailed industry value chain analysis can help identify more precisely just how e-commerce may change business operations at the industry level.
- One of the basic tools for understanding the impact of information technology on industry and firm operations is the value chain.
- The concept is quite simple: A **value chain is the set of activities performed** in an industry or in a firm that transforms raw inputs into final products and services.
- Each of these activities adds economic value to the final product; hence, the term *value chain as an interconnected set of value-adding activities.*

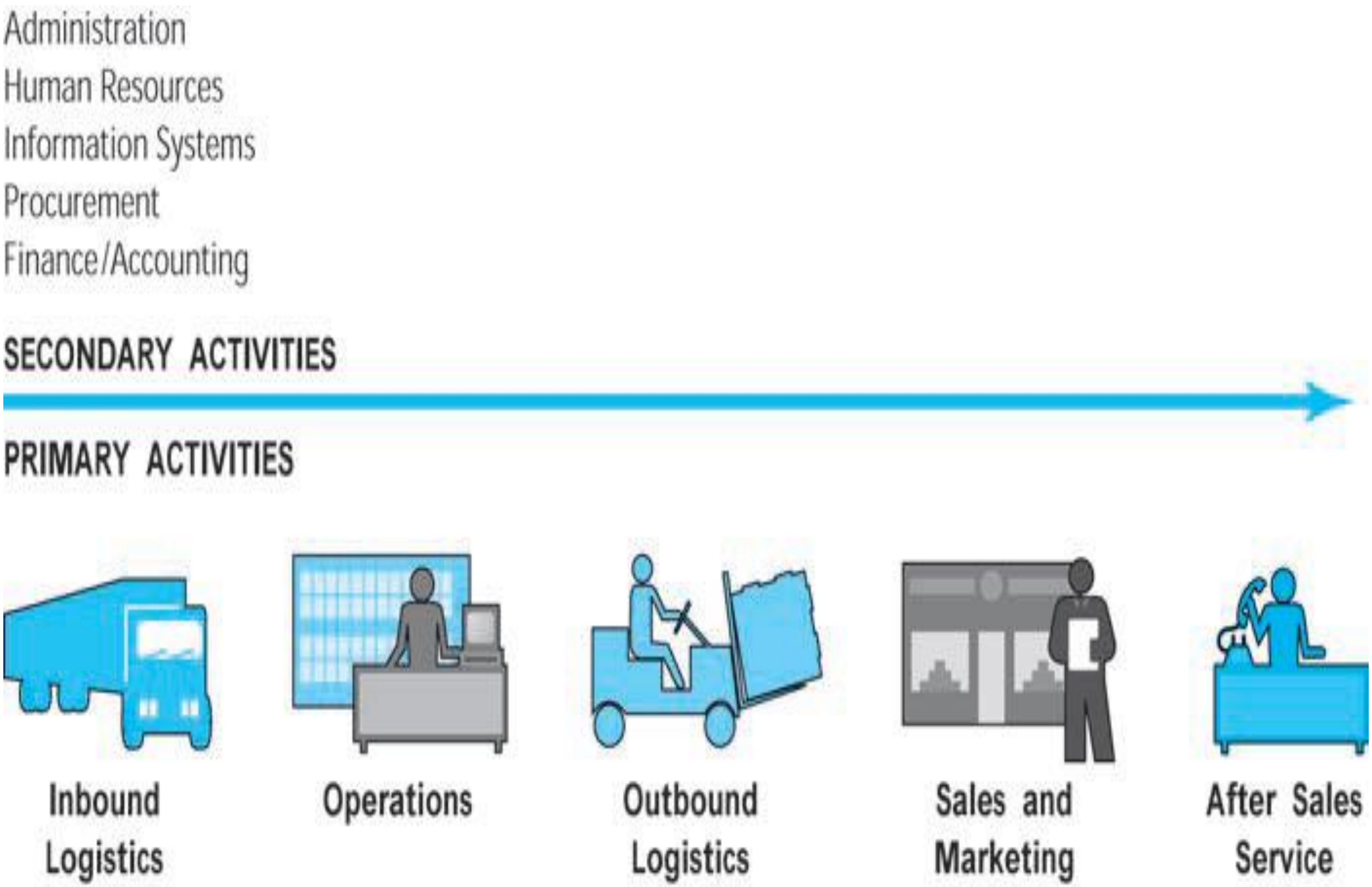
E-COMMERCE AND INDUSTRY VALUE CHAINS



FIRM VALUE CHAINS

- The concept of value chain can be used to analyze a single firm's operational efficiency as well.
- The question here is: How does e-commerce technology potentially affect the value chains of firms within an industry?
- A **firm value chain is the set of activities** a firm engages in to create final products from raw inputs.
- Each step in the process of production adds value to the final product.
- In addition, firms develop support activities that coordinate the production process and contribute to overall operational efficiency.

E-COMMERCE AND FIRM VALUE CHAINS



FIRM VALUE WEBS

- While firms produce value through their value chains, they also rely on the value chains of their partners—their suppliers, distributors, and delivery firms.
- E-commerce creates new opportunities for firms to cooperate and create a value web.
- A **value web** is a networked business ecosystem that uses e-commerce technology to coordinate the value chains of business partners within an industry, or at the first level, to coordinate the value chains of a group of firms.

INTERNET-ENABLED VALUE WEB