

Business Models

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Summary

1. Business model (definition)
2. Business model canvas
3. Value proposition
4. Value capture
5. Value creation
6. Business model types

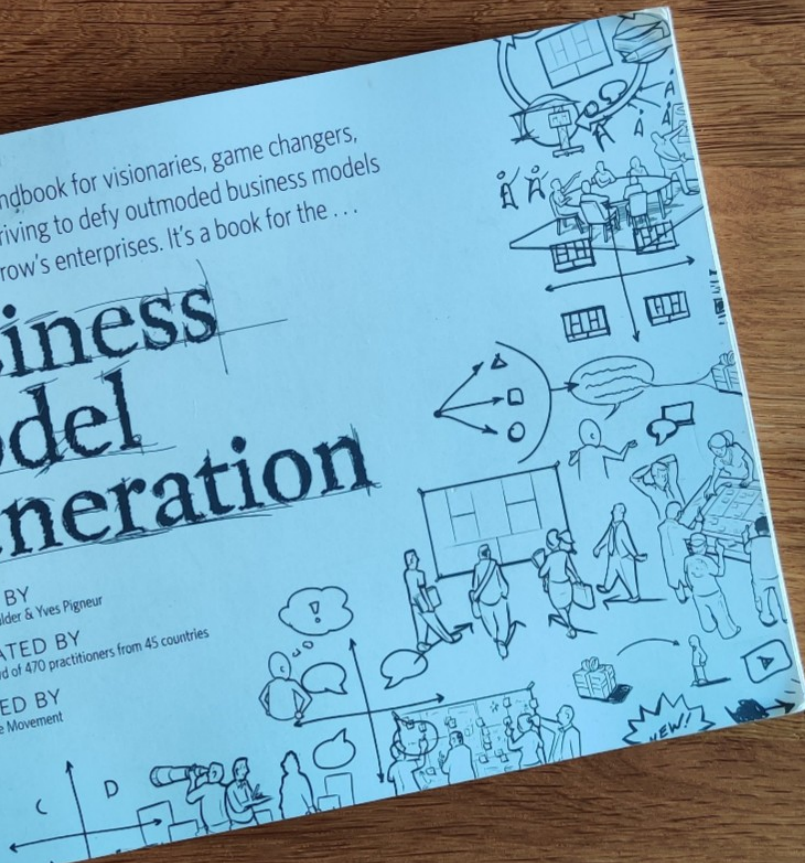
You're holding a handbook for visionaries, game changers,
and challengers striving to defy outmoded business models
and design tomorrow's enterprises. It's a book for the ...

Business Model Generation

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CO-CREATED BY
An amazing crowd of 470 practitioners from 45 countries

DESIGNED BY
Alan Smith, The Movement



1. What is a Business Model?

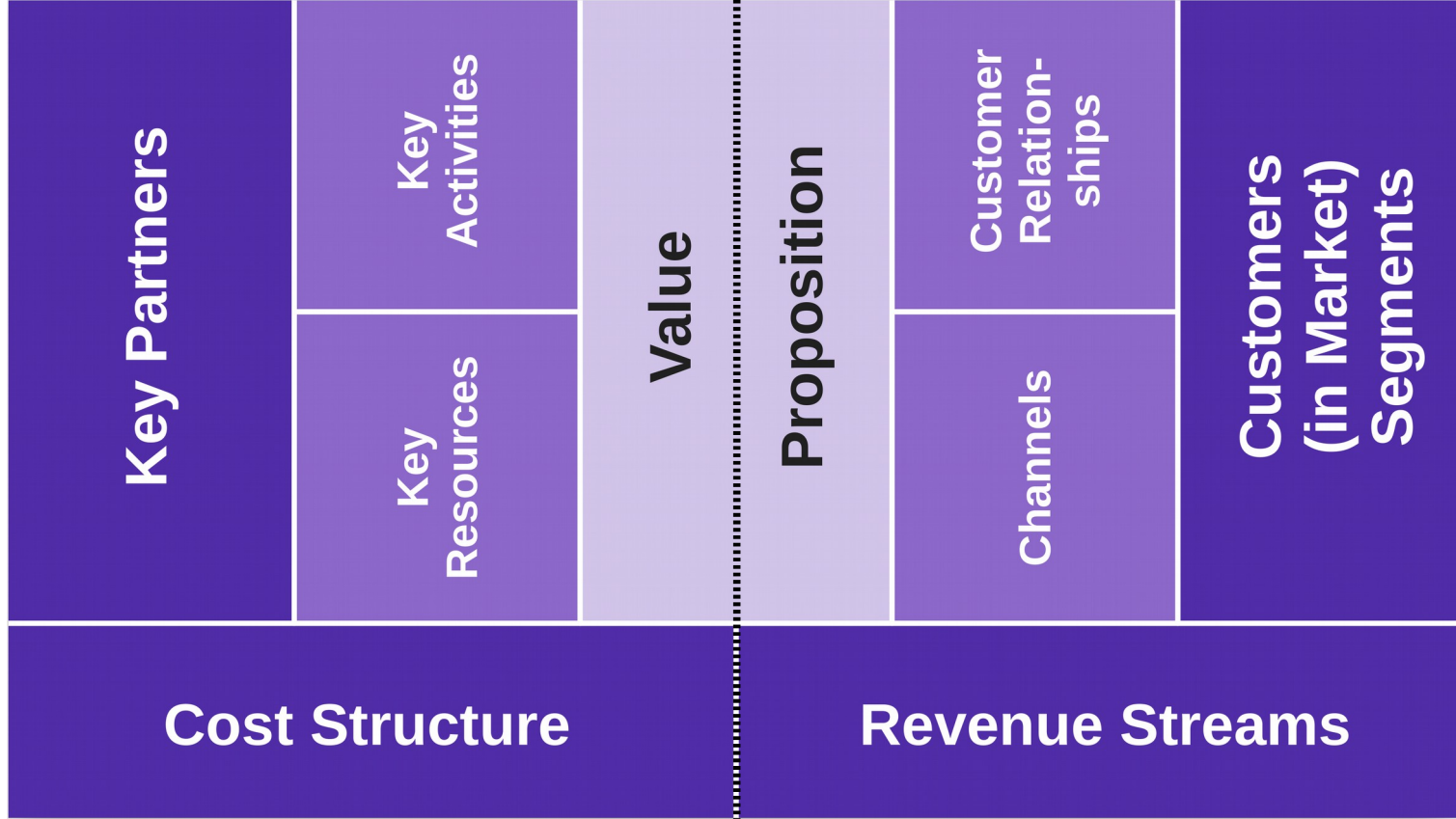
Business Model (Definition)

- A business model
 - A model (description) of how an organization creates, delivers, and captures value
- A model
 - Is a description of components and how they interact for a purpose
- A model gets instantiated a.k.a. executed

2. The Business Model Canvas

The Business Model Canvas (BMC)

Value creation



Value capture

Components (of a Business Model)

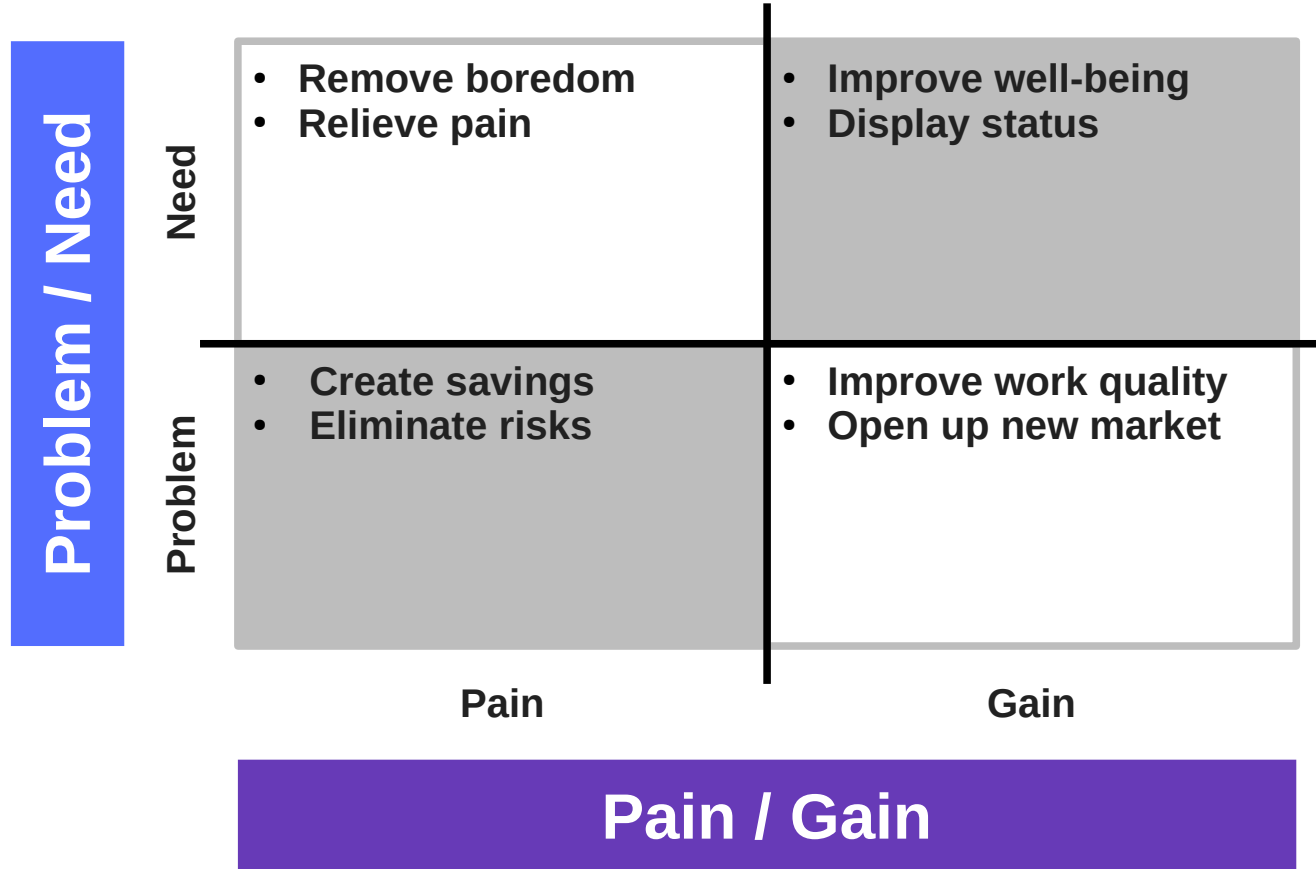
- Value proposition
- Value capture
 - Market segments
 - Channels
 - Customer relationships
 - Revenue streams
- Value creation
 - Key partners
 - Key activities
 - Key resources
 - Cost structure

3. Value Proposition

1. Value Proposition

- The value proposition
 - Is the value to customers (so they buy)
 - Creating a gain or relieving a pain
 - Solving a problem or fulfilling a need
 - Turned into a product or service
 - Cast as a minimum viable product
 - Consisting of distinct features
- The value to customers can be predominantly
 - Quantitative (speed, price)
 - Qualitative (convenience, novelty)

Examples of Creating a Gain or Relieving a Pain



Quantifying the Customer Gain or Pain

- By intensity or relevance of incidents
- By frequency of incidence

4. Value Capture

Value Capture

- Value capture (also: appropriation)
 - Is the comprehensive process of
 - Deriving a **revenue stream**
 - By selling to **customers in a market segment**
 - A product or service built on a **value proposition**
 - Through a **channel** that reaches the segment
 - Using **customer relationships**
 - Can vary by market segment
 - Creates a unique combination then

2. Customers (in Market) Segments

- A market segment
 - Is a cohesive cluster of similar customers
- In multi-sided markets
 - You have multiple types of customers, split further into segments
- All market segments together constitute the total market

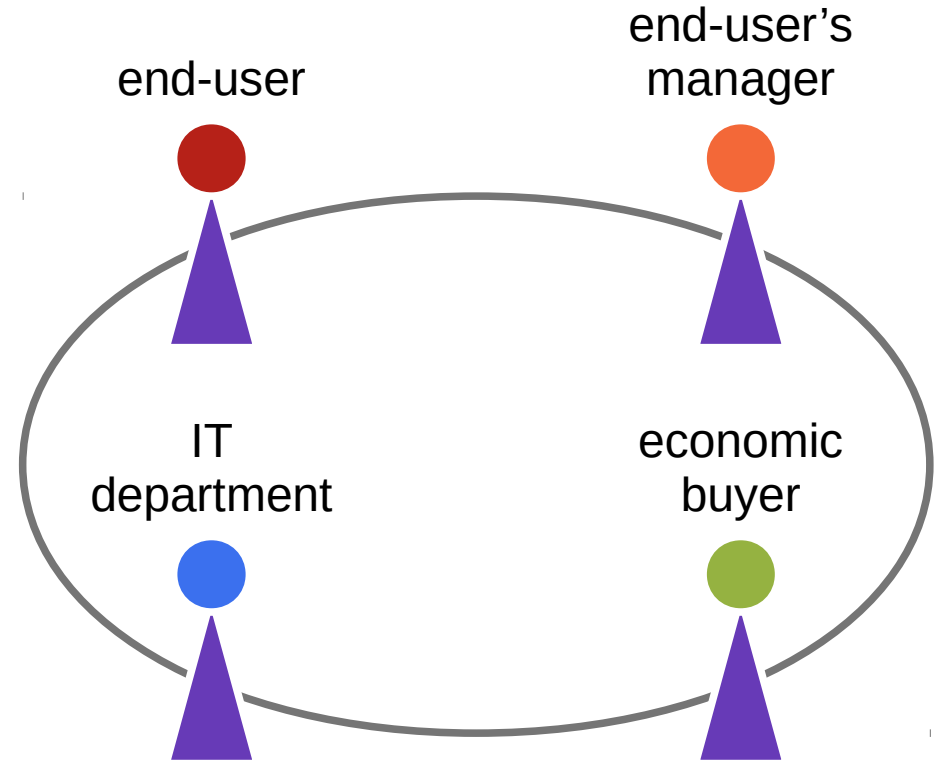
Value Proposition Matches Market Segment

- Value proposition varies by segment
 - Specific value proposition defines the profile that marks the segment
- Market segment profiles can vary significantly
 - Various characteristic properties



Personas

- A persona
 - Is an archetypal [1] person
 - Within an archetypal customer
 - Within a market segment
- At any customer
 - There are likely to be several personas
 - All with different powers re: purchase
 - And different profiles



[1] Archetypal = representing a cluster of similar people

Users vs. Customers

Customer = user, and economic buyer = end-user



Customer = user (same legal entity, but economic buyer is different from end-user)



Customer



User



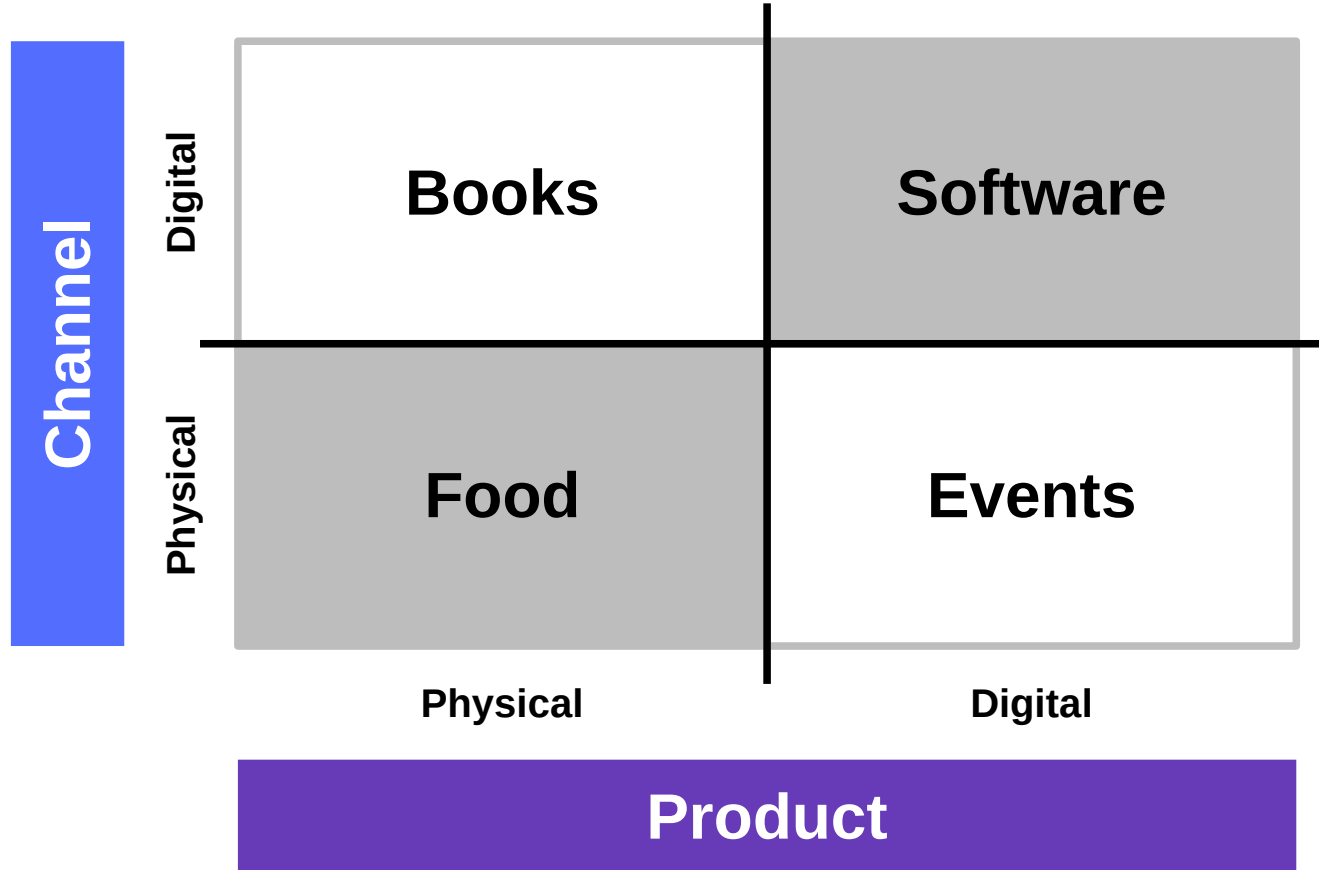
Example Market Structure Breakdown

| Dimension | Example |
|-----------------|--|
| Markets | Cars; beanie babies; ... |
| Customer types | Car buyers, car sellers; beanie baby collectors; ... |
| Market segments | Truck buyers/sellers; minivan buyers/sellers; sports car buyers/sellers; ... |
| Personas | Truck-buyer-user, truck-buyer-economic-buyer, truck-buyer-maintainer, ... |

3. Channels

- A channel
 - Is a well-defined process (conduit) of reaching a market segment
 - Can be physical or digital
- Channels are used to
 - Talk to customers (communication channels)
 - Sell to customers (sales channels)
 - Deliver to customers (distribution channels)

Physical vs. Digital



Examples of Software Distribution Channels

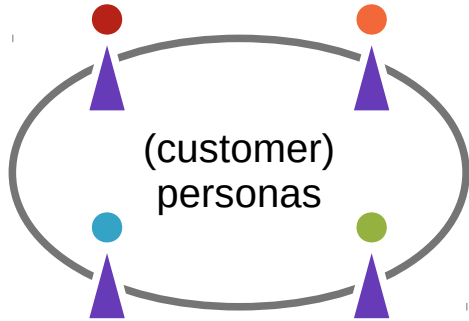
- Digital
 - Own web store
 - Platform app store
 - Digital retailers
- Physical
 - Book stores
 - Electronic stores
 - System integrators

Direct vs. Indirect Channel Sales

- In a direct channel sale
 - Your company sells directly to the customer
 - You make maximum profit
- In an indirect channel sale
 - Your company sells through a reseller
 - Your profit drops by the cut intermediaries are taking
 - Some of your SG&A costs drop because selling got simpler

4. Customer Relationships

- As a business, you need to understand how to
 - **Get**
 - **Keep**, and
 - **Grow** your customer base
- For this, you use personas (see market segment discussion)



Customer Acquisition (Getting Customers)

- Marketing primes the sales funnel
 - Tries to create demand
 - Advertising
 - Trade shows
 - Trade magazines
 - Email, webinars
 - Output: Qualified leads
- Sales takes over qualified leads
 - Consumer
 - Low-touch sales
 - Web store
 - Enterprise
 - High-touch sales
 - Evaluation
 - Sale
 - Output: Sale + customer



Customer Acquisition Cost (CAC)

- Each step in the sales funnel
 - Has a cost associated with every potential customer entering it
 - Reduces the number of potential customers moving forward
- Customer acquisition cost
 - Is the accumulated cost normalized for one realized customer
 - Is a key metric (cost) to be matched against revenue

Example CAC for Enterprise Software Product

| | Cost per lead | Survival rate | No customers | Total stage cost |
|-----------------------------|---------------|---------------|--------------|------------------|
| Trade show lead | 100 € | 100 % | 10 | 1.000 € |
| Evaluation | 5.000 € | 20 % | 2 | 10.000 € |
| Sale | 2.000 € | 50 % | 1 | 2.000 € |
| Customer acquisition cost = | | | | 13.000 € |

Customer Retention (Keeping Customers)

- Retaining existing customers is 5-10 times cheaper than acquiring new ones
- Techniques for retaining customers
 - Foremost, keep delivering a great product
 - Then create loyalty program, added benefits
 - Increase switching costs to lock-in customers

Customer Attrition (Churn)

- Customer churn
 - Is the percentage of customers you loose in a given time period

| Churn | Period | | | | | |
|-------|--------|---------|---------|--------|---------|---------|
| | Start | 1 month | 6 month | 1 year | 2 years | 5 years |
| 20 % | 100 | 80 | 26 | 7 | 0 | 0 |
| 10 % | 100 | 90 | 53 | 28 | 8 | 0 |
| 5 % | 100 | 95 | 74 | 54 | 29 | 5 |
| 1 % | 100 | 99 | 94 | 89 | 79 | 55 |

- Customer lifetime = $1 / \text{churn}$
 - For example, a 1% churn rate = 100 months of customer lifetime

Customer Growth

- Growing your customer base is cheaper than acquiring new customers
- Techniques for growing your customer base
 - Up-sell your customers
 - Cross-sell them
 - Get referrals

Customer Lifetime Value (CLV)

- The lifetime value of a customer is
 - The total profits from the customer over time in today's currency
- Steps to calculate (the average) CLV
 - Determine customer lifetime (from customer churn)
 - Determine customer margin from revenues and variable costs
 - Discount period profits by how far out the revenues are
- Customer costs include
 - Relationship costs (acquisition, retention, growth)
 - Variable product or service provision costs

Heuristics for the Customer Lifetime Value

- CLV should be \gg than CAC
 - CAC dominates most costs
- Rules of thumb vary by domain

5. Revenue Streams

- Revenue (income)
 - A payment received from a customer
- A revenue source
 - Is a synonym for customer, sometimes also the product
- A revenue stream
 - Is the stream of revenues received from a source over time
- An aggregate revenue stream
 - Is the aggregation of several revenue streams from different sources
- The total revenue stream
 - Is the aggregation of all revenue streams
- Business intelligence lets you analyze your revenue streams

Pricing

- The price of a unit of product or service
 - Is the money charged to the customer for that unit of product or service
 - Is best set equal to the value the potential customer sees in it
 - The value of a unit of product or service varies by time
 - This maximizes revenues by customer
- Price discrimination
 - Is the process of setting prices specific to a customer
 - Then, you can try to capture maximum value
- If you can't price discriminate, you price
 - By segment
 - By channel
- Always price based on value, never on costs

How Revenue Streams are Structured

- Individual sale (revenue)
 - Is **price** x **no units** of product or service sold
- Revenues can be aggregated resp. broken down in many ways
 - By market structure: Markets → market segments → customers
 - By classic (physical) break-down: location, demographics
 - By channel: Web store, retailer, etc.
- Prices (incl. volume discounts) may vary by breakdown

5. Value Creation

Value Creation

- Value creation
 - Is the comprehensive process of
 - Creating your product or service for customers and evolving it
 - Also: production and operations

6. Key Partners

- A key partner is another organization you strike a deal with
 - To operate your own organization or
 - To produce your product or service

Types of Partnerships

- Suppliers
 - To build your product from components
 - Example: Apple + Foxconn
- Strategic alliances
 - To build a whole product
 - Example: SAP and its consulting partners
- Joint business development
 - To jointly promote complementary products
 - Example: Intel (Inside) and computer manufacturers
- Strategic investors
 - To raise funds and gain access to important resources
 - Example: Daimler investment in Tesla

Success Factors and Failure Reasons of Partnerships

- Success factors
 - Understand your core value proposition
 - Focus on your competitive differentiation
- Failure reasons
 - Not understanding each other's motivation
 - Not seeing eye to eye (small vs. large co.)

7. Key Resources

- A key resource
 - Is an asset (resource) needed to operate your business
 - Is therefore a key competitive differentiator
- Resource categories (types)
 - Materials
 - **Tangible** (raw materials, production facility)
 - **Intellectual property**
 - **Capital**
 - **Labor**

Tangible Materials (Resources 1 / 4)

- Types of tangible resources
 - Raw materials
 - Input to production
 - Production facilities, e.g. machinery
 - Used to produce
- Sources of tangible resources
 - Owned or paid for

Intellectual Property (Resources 2 / 4)

- Types of intellectual property
 - Copyright
 - Patents
 - Trademarks
 - Trade secrets
 - Contracts
- Sources of intellectual property
 - Own invention
 - Built-up over time
 - University and research institutions
 - Purchased from elsewhere
 - Strategic partnerships

Capital (Resources 3 / 4)

- Types of capital
 - Financial resources
 - Operating capital
- Sources of capital
 - Friends and family
 - Bank loans
 - Venture capital
 - Leasing, factoring

Labor (Resources 4 / 4)

- Relevant aspects
 - Quality of labor (how skilled a workforce?)
 - Quantity of labor (how many?)
- Sources of labor
 - Local labor market
 - Local universities
 - Globally sourced remote work

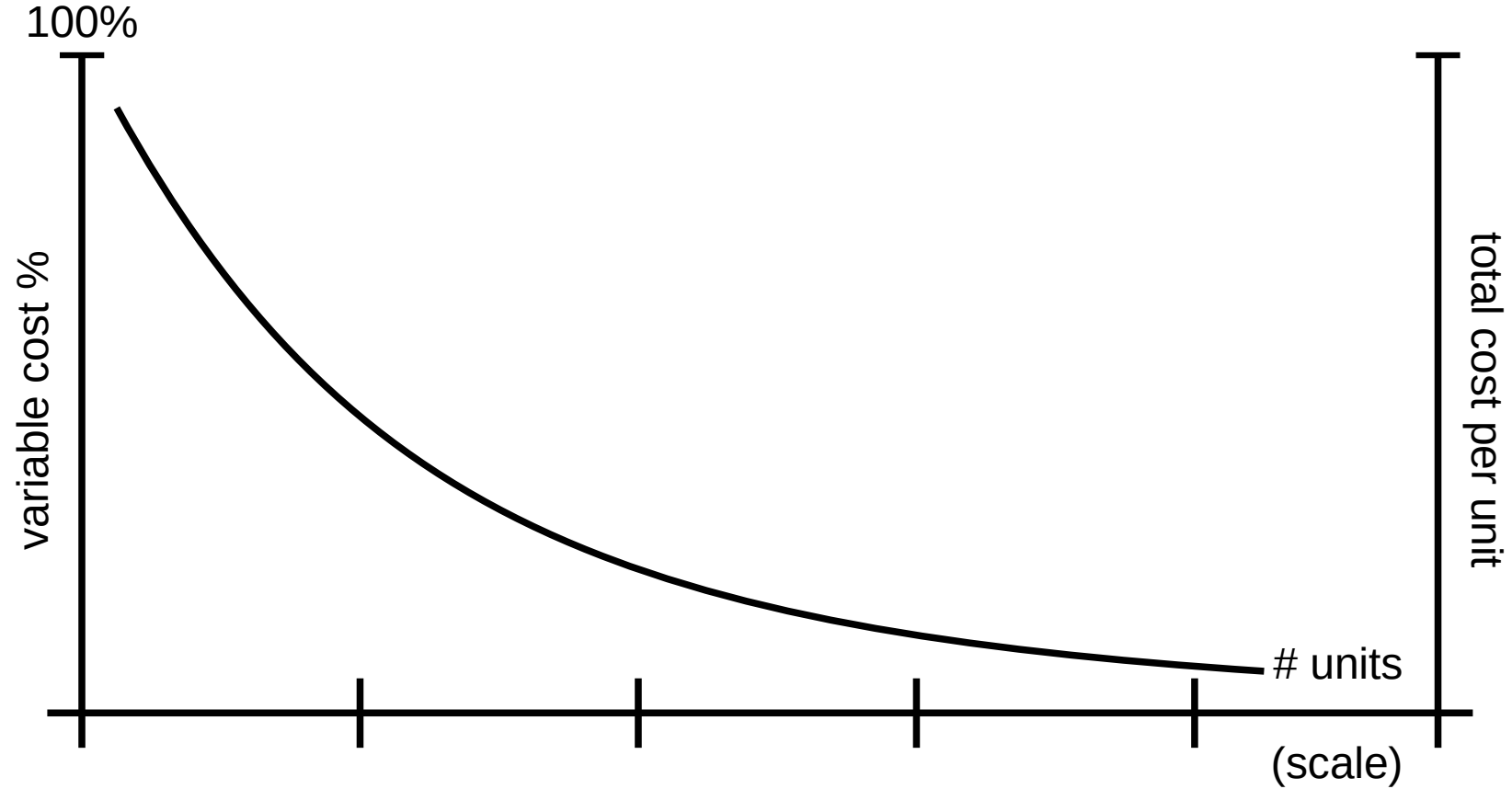
8. Key Activities

- A key activity
 - Is a core business process needed to operate the business
 - Therefore is critical to create, deliver, and maintain value proposition
 - Is a key competitive differentiator
 - Should not be outsourced
- Example key activities
 - Software development
 - Cloud operations

9. Cost Structure

- The cost structure of a business
 - Is a model of the costs (expenses) needed to operate and scale your business
- Cost categories
 - Fixed costs
 - Variable costs
- Traditionally, the cost structure is expressed in the income statement

Fixed vs. Variable Costs / Economies of Scale



Fixed / Variable Costs in Software / Software-as-a-Service

- Software / fixed costs
 - Software development
 - Initial software development
 - Continued development
- Software / variable costs
 - Customer support services
- Software-as-a-Service / fixed costs
 - Software development
 - Initial software development
 - Continued development
 - Operations
 - Cloud infrastructure (fixed costs)
 - Site reliability engineering
- Software-as-a-Service / variable costs
 - Customer support services
 - Operations
 - Compute power per customer

6. Business Model Types

Types of Business (Models) [HS99]

| | Product Innovation | Customer Relationship Management | Infrastructure Management |
|-------------|--|--|---|
| Economics | Early market entry allows for a premium price and large market share; speed is key | High cost of customer acquisition makes it imperative to gain large shares of wallet; economies of scope are key | High fixed costs make large volumes essential to achieving low unit costs; economies of scale are key |
| Culture | Employee centered; coddling the creative “stars” | Highly service-oriented, “customer-first” | Cost focused; stress on standardization, predictability, efficiency |
| Competition | Battle for talent; low barriers to entry; many small players thrive | Battle for scope; rapid consolidation; a few big players dominate | Battle for scope; rapid consolidation; a few big players dominate |

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Thank you! Questions?

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