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# 4

# BUSINESS MODELS

## LEARNING OBJECTIVES

- 4.1:** Define business model.
- 4.2:** Discuss the most common components of a business model.
- 4.3:** Explore the most often used business models employed in business today.
- 4.4:** Illustrate the Business Model Canvas as a tool for business model development.
- 4.5:** Examine entrepreneurship as disrupting existing business models.

## BUSINESS CASE 4.1: IMPERFECT FOODS—SAN FRANCISCO, CALIFORNIA

### Goal 15: Life on Land

Imperfect Foods delivers groceries on a mission. Co-founder Ben Simon, while attending the University of Maryland, was shocked to see how much food was being thrown away in his college cafeteria. He recalls: “I was shocked to see someone buy a full sandwich, eat half of it, and throw the other half out. It was not the values I grew up with.”<sup>1</sup>

Ben, along with three of his classmates, started the Food Recovery Network (FRN) in 2011. They recovered good dining hall food at the end of the night and provided meals to homeless shelters. By the end of the school year, they had recovered 30,000 meals for Washington, D.C.–area hunger-fighting nonprofits. During the spring semester of 2012, the second chapter of FRN was started at Brown University, which was co-founded by Benjamin Chesler. In 2013, the Sodexo Foundation provided FRN with funds to hire full-time staff and turn it into a professional nonprofit. Today, FRN has 230 chapters in 44 states.

Given the founders' early success with FRN, they founded a new business in 2015 called Imperfect Produce—a service that delivers seasonal produce that is cosmetically imperfect or deformed but perfectly safe to consume. “We wanted to think bigger about how to fight this food waste and create a more sustainable food system that was scalable,” Ben said during a CNN interview.<sup>2</sup> Later, in 2019, Imperfect Produce changed its name to Imperfect Foods in order to expand its offerings.

The origin of Imperfect Foods was a reaction to daunting waste statistics. Approximately 20 billion pounds of produce go to waste on farms every year simply because “ugly” or “imperfect” produce does not match the aesthetic standards of grocery stores in the United States.<sup>3</sup> These aesthetic standards require uniform sizing and symmetry as well as being free from too many blemishes and scars. As a result, farmers are also unable to sell a large portion of their crop—anywhere from 5% to 30%. This has a trickle-down impact on the amount of resources such as the loss of labor, land, and water that are needed to grow the unsaleable produce.

At the start of Imperfect Foods, the founders wanted to sell their produce through grocery stores, but quickly learned that grocery stores had little interest given the beauty standards they wanted. So, the business model changed and Imperfect Foods became an online store, supplying ugly produce at a 30% reduced cost directly to consumers using a subscription model.<sup>4</sup> The company operates six distribution centers across the United States (as of June 2019), where they supply food to their 200,000+ subscriber base across 43 states.<sup>5</sup> They source their produce from 250 local producers all across the country and currently offer 50 to 60 produce items, plus 200 grocery items to customers.

According to Ben Simon in his CNN interview, “The important part of running a company founded by Millennials is to use the role of business to look out for people and the planet. As much as it’s about making a profit, we hope to elevate the conversation about food waste, climate change and creating an equitable food system.”<sup>6</sup>

### Critical Thinking Questions

1. What is the business model of Imperfect Foods?
2. Who do you think is its primary customer?
3. Are there other ways to tackle the problem of food waste?

## WHAT IS A BUSINESS MODEL?

Successful businesses meet customer needs by offering something of value. A **business model** describes the rationale of how a business creates, delivers, and captures value. Imperfect Foods provides value to the customer by selling heavily discounted produce, and its business rationale to fight food waste also benefits farmers, families with low incomes, and the planet.<sup>7</sup> It includes a network of activities and resources that interact to deliver value to customers.

The term **business model** was rarely in use before the 1990s, but the advent of the personal computer and the growing popularity of spreadsheets and modeling made it possible for people to strategically design the businesses they wanted before launching.<sup>8</sup> This meant entrepreneurs were able to create a roadmap that captures what the business is, how it works, and how it is financially sustainable. In other words, the business model is a roadmap that helps entrepreneurs to better understand how the pieces of their business fit together in relation to what they are doing, how they are doing it, for whom, and why.<sup>9</sup> Business models are relevant to both startup and existing businesses. For startups, thinking about the overall business model is a way to test the feasibility of a new opportunity. For existing businesses, it’s a way to articulate how you are doing business as well as think about new spaces for innovation or growth. Business models are constantly evolving to reflect changing business environments and customer needs. The very idea of calling it a “model” shows that it’s temporary, subject to change, adjustable, and flexible. Companies need to ensure and continuously reassess that their products and services both offer value to customers and generate profits needed to sustain the business in the long term.

### The Four Parts of a Business Model

A business model consists of four main interlocking parts that together create “the business”: the *offering*, the *customers*, the *infrastructure*, and the *financial viability*.<sup>10</sup> No business is able to survive without these four parts. Each part has the potential to give the organization advantage over the competition. In other words, competitive advantage doesn’t always come from the product or service you are offering; it can come from the other areas of the business as well. Let’s apply the four parts to our opening case, Imperfect Foods.

## The Offering

The first part of the business model is the **offering**, which identifies what you are offering to a particular customer segment, the value generated for those customers, and how you will reach and communicate with them. The offering includes the **customer value proposition (CVP)**, which explains how your products and services can help customers do something more inexpensively, easily, effectively, or quickly than before. Imperfect Foods' CVP is to deliver seasonal produce to consumers that costs 30% less than that of the grocery stores. Not only does it save customers money, but it also adds value by saving customers the time they would have spent on going to the grocery store to buy this produce.

## The Customers

**Customers** are the people who populate the segments of a market that your offering is serving. They are the individuals or businesses willing to pay for what you are offering. As you won't be able to serve everyone, you will need to choose the customers you most want to target, determine how you will reach them, and figure out how you will build and maintain a relationship with them. The majority of Imperfect Foods customers are people in their 20s, 30s, and 40s who want to play their part in tackling climate change by eliminating food waste. Imperfect Foods supplies food to over 200,000 subscribers in over 40 states and reaches its customers through its online store.<sup>11</sup>

## The Infrastructure

**Infrastructure** generally includes all the key resources (people, technology, products, suppliers, partners, facilities) that an entrepreneur must have to drive the value proposition. Imperfect Foods' infrastructure comprises customer data, employees (office staff and delivery drivers), an office based in San Francisco, distribution, and local producers from across the country who supply the produce.

## Financial Viability

**Financial viability** defines the revenue and cost structures a business needs to meet its operating expenses and financial obligations. It helps entrepreneurs assess how much it will cost to deliver the offering to their customers and the amount of revenue that can be generated from customers. Imperfect Foods generates revenue by running a subscription-based model that offers its customers a 30% discount on produce.

But the business model is more than just about how to make money. It is a fundamental way for entrepreneurs to assess why customers would buy from you in the first place: What's in it for them? This is where the most common components of a business model come in.

## THE MOST COMMON COMPONENTS OF A BUSINESS MODEL

The components of a business model enable the entrepreneur to explore in greater depth how the company will create real value for customers, employees, and prospective partners, in addition to assessing the degree of competition in the marketplace, as well as many other important factors. There are 13 common components of a business model.<sup>12</sup> Let's apply these components to a global outdoor clothing company, Patagonia (featured in Chapter 1: The Business of Business).

### The Problem

Every new business begins with a problem. Successful entrepreneurs uncover what target customers need, provide solutions to meet those needs, and relieve the pain points. Patagonia addressed pain points by first designing lighter, more functional climbing tools before going on to offer high-quality general outdoor clothing and equipment.

## The Solution

The **solution** outlines how the company intends to meet the customers' needs. Patagonia not only uncovered a solution to climbing gear and outdoor apparel, but did so with a focus on protecting the environment—a factor that appeals greatly to its target customer base.

## Key Resources

**Key resources** consist of the physical, intellectual, human, and financial assets at a company. Patagonia's key resources include the fiber and materials used for clothing and equipment, its employees, partners, technology, offices, retail stores, distribution centers, and intellectual property. **Intellectual property** is a category of property created by human intelligence that includes ideas, inventions, slogans, logos, designs, and symbols.

## Customer Segments

**Customer segments** involve identifying the company's target customers. Dividing customers into particular groups helps companies to market to each group more effectively. Patagonia's customer segments include environmentally conscious consumers, climbers, surfers, snowboarders, camping and fishing enthusiasts, and hunters.

## Unique Value Proposition

The **unique value proposition** explains why the customer is willing to buy the solution. For example, Patagonia's value proposition is attractive to customers because it provides long-lasting, high-quality, sustainable products that cause no unnecessary harm to the environment. It also donates 1% of company proceeds to grassroots environmental initiatives, which appeals to socially conscious consumers.

## Competitive Landscape

Every company has to deal with a certain amount of competition in its industry. Entrepreneurs need to assess the **competitive landscape** by focusing on the other alternatives that customers could use. For instance, Patagonia's main competitors include outdoor clothing companies The North Face and LL Bean.

## Competitive Advantage

Companies gain **competitive advantage** by showcasing characteristics that are not easily copied or bought elsewhere. Patagonia's greatest competitive advantage is maintaining high ethical and environmental standards that many of its rivals have found difficult to replicate to the same degree.

## Sales Channels

A company's **sales channels** determine how the company reaches its customers. Patagonia's sales channels include its website, brick and mortar stores, and selected retail stores. Patagonia also engages with its customers by launching initiatives such as the Worn Wear Wagon—a mobile repair shop that travels around the country educating people how to mend their own gear to avoid buying new apparel unnecessarily.<sup>13</sup> Customers are also able to resell second-hand Patagonia clothing through the Patagonia website and trade in their old garments at a Patagonia store for store credit.

## Revenue Streams

**Revenue streams** describe how the company generates income. Patagonia generates revenue from selling its products online or through brick and mortar stores.

## Revenue Model

A company's **revenue model** identifies how the company will make money and generate profits. Patagonia's revenue model is based on manufacturing and selling high-quality outdoor apparel and creating social impact through its commitment to sustainability and environmental practices.

## Key Partners

Entrepreneurs can't do everything alone, which is why they need to team up with other **key partners** such as suppliers, distributors, and other business associates to help grow the company and make it become more efficient. Patagonia's partners include selected retailers, distributors, suppliers, and manufacturers.

## Cost Structure

The **cost structure** represents all the expenses required to run the company and how those costs impact pricing. Patagonia's cost structure includes employees, raw materials, store rentals, donations, taxes, suppliers, distributors, and manufacturers.

## Key Metrics

A company's **key metrics** show how the company measures success by tracking its overall performance. Patagonia founder Yvon Chouinard explains how Patagonia uses its key metrics: "At the end of the year, we measure success by how much good we've done and what impact we're having on society, not by profit."<sup>14</sup>

Now that we have explored the different components of business models, let's take a look at the different types of business models used in today's companies.

## TYPES OF BUSINESS MODELS

There are different types of business models used for different businesses. Each type determines how the company makes its profits and who its customers will be. For example, a traditional car manufacturer's business model is mostly based on generating income from selling to retailers rather than selling the finished product directly to the customer. Let's take a look at 12 main types of business models (see Table 4.1).

### Distributor

A **distributor** buys products from manufacturers and resells them to retailers or the public. For example, wholesale food company UNFI is a distributor that sources high-quality organic, natural, and specialty products locally and around the globe from producers and resells them to selected stores, which then sell the items on to their customers.

### Retailer

A **retailer** is a person or business that sells products directly to the public either from a store or a website. For example, retail company Target sells general merchandise to customers through its stores and online.

### Franchising Business Model

Recall from Chapter 3 (Business Creation) that a *franchise* is a type of license purchased by an individual (franchisee) from an existing business (franchisor) that allows the franchisee to trade under the name of that business. The **franchising business model** is based on the franchisor helping the franchisee by providing support in marketing, operations, and financing. In return, the franchisee pays the franchisor royalties based on an agreed percentage of sales. The Mathnasium Learning Center based in Los Angeles, California, is a franchise that was set up to help children understand and master math using certain instructional techniques.

### Subscription Business Model

The **subscription business model** involves charging customers to gain continuous access to a product or service and earns money through repeat purchases. Before the Internet took off, this type of model

had been traditionally applied to magazines and newspapers that charged customers a subscription fee to receive each issue of the publication. Although these types of subscriptions still exist today, a growing number of online businesses also use the subscription revenue model. TV and movie-streaming on-demand service Hulu operates a subscription-based model whereby customers sign up to a variety of subscription plans to gain access to their favorite shows.

### Aggregator Business Model

The **aggregator business model** is a model whereby the company connects vendors and buyers on the same platform and sells its services under its own brand. Customers make purchases through the aggregators, which turns into commission for those companies. Online hospitality marketplace Airbnb operates an aggregator business model as it connects customers with owners to offer lodging or tourism experiences. It also makes a social impact by extending its services to house refugees and people who have been affected by natural disasters. Airbnb earns revenue by taking a percentage of commission on every booking.

### Advertising Business Model

The **advertising business model** relies on the amount of revenue gained through advertising products and services. In the past, the advertising model was based on magazines and newspapers accepting advertisements and charging by the space or by the word; early radio and television did something similar by charging by the minute or second to broadcast ads. Today the advertising business models are most relevant in the digital world, where information is provided for free but ads are paid for by recognized sponsors. Google relies on advertising for most of its revenue. Vendors are charged for ad placement or sponsored search results. Google AdWords service charges the advertiser a fee every time a user clicks on the ad. AdWords also includes the cost-per-action (CPA) advertising model, whereby advertisers pay only when the click converts to an actual sale of a product or service.

### Data Selling Model

Companies use the **data licensing/selling model** when they generate revenue by selling or licensing high-quality, exclusive, valuable information to other parties. Some technology companies sell or license user data to third parties that use the data for advertising and analysis. There are more than 120 data brokers operating in the United States that buy and sell third-party data. However, some companies use data for different reasons altogether. Canadian digital company Bluedot uses data to help prepare the world for infectious diseases by gaining insight into the location of the outbreaks. By analyzing the data, Bluedot is able to figure out the best approach to combat the outbreak.<sup>15</sup>

### Software as a Service (SaaS)

**Software as a Service (SaaS)** is a distribution model in which companies offer their applications, software, and platforms to customers over the Internet. The SaaS model operates on the basis of “pay as you go” where customers only pay for the services they are using. Multinational computer technology corporation Oracle uses an SaaS model that includes a wide range of cloud-based applications to meet the business needs of other organizations.

### Utility and Usage Business Model

The **utility and usage business model** charges customers fees on the basis of how often goods or services are used. It operates in a similar way to the SaaS model, as it also offers a pay-as-you-go system. Mobile phone carriers may use this model by charging users a fee for the number of minutes used on calls or for the volume of text messages; hotels also use this model by charging customers by the night; and car rental companies also generate revenue through this model by charging per unit of time.



Eight-year-old Travis Maag-Brown studies math with Lisa Iguchi, co-owner of Mathnasium, after school. The tutoring franchise helps students in grades 2–12 with math only.

Marty Caivano/Digital First Media/Boulder Daily Camera/Getty Images

### Professional Business Model

The **professional business model** provides professional services on a time and materials contract. For example, consultants, lawyers, and accountants often charge by the hour for their services. Websites like Get a Freelancer, PeoplePerHour, and Elance also use this model by allowing freelancers to charge a fixed fee for projects posted online by other companies.

### Licensing Business Model

The **licensing business model** is a way of earning revenue by giving permission to other parties to use protected intellectual property (copyrights, patents, and trademarks) in exchange for fees. In the technology industry, the software we use on our computers is often under license from the developer of that software. Similarly, people who design the apps we use on our smartphones sell them to companies, such as Apple, that have the capability to market them to a wider audience. Global research organization Battelle, headquartered in Ohio, is another example of a company that licenses its technology to other organizations.

### Freemium Business Model

The **freemium business model** involves mixing free (mainly web-based) basic services with premium or upgraded services. In this model, businesses create at least two versions or tiers of products or services. The company gives away the basic low-end version of the service, which comes with limits on usage, storage, and functionality, but charges certain premiums for higher-end versions that offer more storage, functionality, and performance. Professional networking service LinkedIn offers its core features for free but charges recruiters and job seekers for enhanced features that support job search.

## ETHICS IN BUSINESS: CAN A BUSINESS MODEL BE UNETHICAL?

Running has always been a passion of yours and your “go-to” exercise for fitness and stress reduction. You decide to turn your passion into a business of making and selling running shoes. But you are faced with a quandary in terms of what business model to follow. You could follow one of two options: [1] You could design your running shoes to last only 6 months to a year; [2] You could design your running shoes to last double that time, and you know this is possible and doable given the materials available on the market. Yet you know if you go with option 1 you will make more revenue, given runners will have to buy shoes more often. What should you do? What is the most ethical business model to follow?

### Critical Thinking Questions

1. Is the business model described in option 1 ethical or unethical? Why or why not?
2. What other companies in other industries use the business model in option 1?
3. What if you went with the business model in option 2? How could you make that work for your company to succeed?

## THE BUSINESS MODEL CANVAS TOOL

Earlier in the chapter, we described the four major parts of the business model—the offering, the customers, the infrastructure, and the financial viability—and identified the most common components. In this section, we further explore how a company creates, delivers, and captures value for customers through the [Business Model Canvas \(BMC\)](#), which is a one-page framework and tool, introduced in 2008 by Swiss business theorist Alexander Osterwalder, that divides the business model’s four parts into nine components (also discussed earlier) to further understand how to create, capture, and deliver value.<sup>16</sup> When the four parts are divided into nine components, the result looks like this:

The offering constitutes the (1) value proposition.

Customers relate to (2) customer segments, (3) channels, and (4) customer relationships.

Infrastructure includes (5) key activities, (6) key resources, and (7) key partners.

Financial viability includes (8) cost structure and (9) revenue streams.

Figure 4.1 illustrates the nine components of a BMC-using, ride-sharing company, Uber. As you can see from the figure, Uber’s main *value proposition* is to connect riders with drivers—both of whom function as its main *customer segments*. It builds *customer relationships* through a rating system accessed by the *channel*, the Uber App. Uber’s *key activities* include refining the Uber platform, recruiting drivers, and marketing and advertising, drawing from *key resources* such as its talented employee pool and driver network. *Key partners* such as payment processor, map tech companies, and investors enable Uber to adapt and grow as a business and help manage its *cost structure*, largely associated with paying employees, drivers, and legal fees. Uber’s *revenue streams* include taking a cut of the fares, and surge pricing (charging higher fares at peak times). Over the last few years, Uber has added UberEATS to its services—an app that allows people to order food from restaurants remotely for either pickup or delivery. For the purposes of this example, we have focused solely on the ride-sharing side of the business.

## Using the BMC for Ideation and Innovation

The BMC is a useful tool for inspiring creativity (ideation) and innovation, but there are several techniques that help to tell the “story” of what a company does and how it works. The following methods help to kickstart the ideation process when applied to an existing business model.

### Freshwatching

The term *freshwatching* originated from the Netherlands. **Freshwatching** involves focusing on other companies, often from outside your own business or industry, to ignite new ideas.<sup>17</sup> In other words, looking at your company through the lens of another company. Applying other business models to your own allows you to think more deeply about how your company operates, and provides you with different ideas about how to make money. For example, your BMC for a traditional house-cleaning business overlayed by the Uber BMC (Figure 4.1 ) might inspire you to think about enhancing your business by offering an app that matches your customers with cleaners. On the face of it, a cleaning business has nothing to do with a ride-sharing business; yet looking at both together can provide you with some interesting opportunities and ideas.

### Remove the Core

Removing the core is another ideation technique that involves taking out the core value proposition from your business model.<sup>18</sup> Figure 4.2 illustrates the Business Model Canvas for high-end car manufacturer BMW. BMW’s core value proposition is offering its customers the “ultimate driving experience.” What would happen if you were to remove this value proposition? What would the company look like without it? How would you fix it? Imposing constraints leads to new ideas.

### Epicenters

Every part of the Business Model Canvas is dependent on each other. In other words, changing a component in one block will automatically impact another component in a different block. *Epicenter-based ideation* involves removing all the components apart from one.<sup>19</sup> Using the BMW example, what would happen if you removed everything but its key resources? Everything else might be gone, but you are still left with the BMW brand, a large pool of talented employees, a sophisticated manufacturing



People gather around a speaker during a lunchtime seminar on Elance, an online site for hiring freelancers, at a WeWork co-operative co-working space in Washington, D.C.

Mandel Ngan/AFP/Getty Images

system, and efficient dynamics. The epicenter technique encourages us to think about what else we could do if we were left with such resources. Some of the answers could then be incorporated into the original Business Model Canvas.

### Follow Patterns

Because each part of the Business Model Canvas is dependent on each other, they tend to create a pattern whereby one part depends on the other part to perform a number of activities such as addressing new customer needs, creating new revenue streams, and so on. Recall from section 4.3 that some business model patterns follow subscription models to generate revenue, while others might use the freemium model to attract new customers. Following patterns on an existing Business Model Canvas helps to establish the type of business model for your new venture.

**TABLE 4.1 ■ Types of Business Models**

Distributor	A model based on buying products from manufacturers and reselling them to retailers or the public
Retailer	A person or business that sells products directly to the public either from a store or a website
Franchising	The process whereby franchises are sold by an existing business to allow another party to trade under the name of that business
Subscription	The amount of revenue generated by charging customers payment to gain continuous access to a product or service
Aggregator	A model whereby the company connects vendors and buyers on the same platform and sells its services under its own brand
Advertising	The process that generates revenue by advertising products and services
Data selling	The revenue generated by selling high-quality, exclusive, valuable information to other parties
Software as a Service (SaaS)	A distribution model in which companies offer their applications, software, and platforms to customers over the Internet
Utility and usage	The amount of revenue generated by charging customers fees on the basis of how often goods or services are used
Professional	The amount of revenue generated by providing professional services on a time and materials contract
Licensing	A way of earning revenue by giving permission to other parties to use protected intellectual property (copyrights, patents, and trademarks) in exchange for fees
Freemium	The amount of revenue gained by mixing free (mainly web-based) basic services with premium or upgraded services

### Ask Trigger Questions

Asking trigger questions such as “what if?” is a powerful way to inspire new, creative ideas. This method works best with a team. You could apply “what if?” questions to each part of the Business Model Canvas and make a list of the ideas with the most potential. Let’s take the “channels” component from the BMW model, for instance. BMW’s channels include car dealers and car rentals. What if those cars were sold online instead? What would this mean for the business? What would it take to make such a significant change?

These four techniques are a great starting point for ideation and innovation. Some of the ideas may fall into the scrap heap, but there will be some that could easily shift your perspective, helping you to see your existing Business Model Canvas in an entirely new light. Remember, a business model is really about how a business captures and delivers value, and sometimes the business model itself can be new

and never before seen. In the next section, we will explore how some of today's most successful startups created a business model that not only captures and delivers value, but also disrupts existing markets by displacing big, established companies.

## ENTREPRENEURIAL MINDSET ACTIVITY

Identify a company you admire that also connects to one of the UN Sustainable Development Goals. For more information on the goals, see <https://www.un.org/sustainabledevelopment/sustainable-development-goals/>. Once you identify the company, complete a Business Model Canvas on this company. You may use the template for a Business Model Canvas provided in Figure 4.3 . Read about and research your most-admired company and work to fill in the components of the business model. If you want to take this activity a little further, try completing a canvas on a business idea you have!

### Critical Thinking Questions

1. What information was most difficult to find about the company you admire most?
2. Can you identify the part of the canvas that really separates the company from others in its industry?
3. What type of business model would you classify your most-admired company? (See Table 4.1.)

## BUSINESS MODEL DISRUPTION

The vast number of new technologies over the last few decades have changed customers' needs and behaviors. Many of today's successful companies have developed a **disruptive business model**, which is a model that creates new markets by addressing unmet or new needs by improving or changing an existing business model.<sup>20</sup> Companies using this model (known as "disruptors") tend to start off by focusing on small or niche markets rather than immediately trying to compete with the bigger organizations. Unlike more established organizations, disruptors have more freedom to pursue opportunities, trial their ideas, and take risks without suffering any major blows to the bottom line or their reputation. In other words, they have less to lose. A classic example of a successful disruption is the failure of movie-rental company Blockbuster.<sup>21</sup> Although Netflix was on the horizon, Blockbuster stuck to its retail business model, focusing on its rental stores. Netflix disrupted Blockbuster's business model by providing on-demand access to movies, TV shows, and documentaries. When Netflix started to become successful, Blockbuster tried to make some changes, but by that time it was too late. Today, Netflix is one of the most successful startups in the world, while Blockbuster is operating with just one store. Table 4.2 lists some more companies with disruptive business models.

### Disruptive Innovation

Disruptive business models are powered by **disruptive innovation**, a term coined by U.S. academic and business consultant Clayton M. Christensen, that means an innovation that either disrupts the existing market by displacing established companies or creates an entirely new market segment.<sup>22</sup> Over the last few decades, many products and services have succeeded in shaking up the market: Reference services like Wikipedia have disrupted traditional encyclopedias, video-streaming services like Netflix have disrupted movie rental stores and cable channels, and cell phone cameras have disrupted photography companies, to name just a few.

A disruptive innovation usually starts off as a second-rate, low-cost, simple solution initially launched in small markets. Because these innovations are looked down upon by the more established companies and tend to operate in smaller markets, disruptors do not face any challenges from competitors, at least at first. Because of this, the disruptors are able to move quickly from the bottom of

FIGURE 4.1 ■ The Business Model Canvas: Uber

BUSINESS MODEL CANVAS				
Key Partners	Key Activities	Value Proposition	Customer Relationship	Customer Segment
<ul style="list-style-type: none"> <li>• Payment processors</li> <li>• Map tech companies</li> <li>• Investors</li> </ul>	<ul style="list-style-type: none"> <li>• Platform development and maintenance</li> <li>• Marketing and ads</li> <li>• Hiring drivers</li> <li>• Operations</li> </ul>	<ul style="list-style-type: none"> <li>• Platform to connect riders with drivers</li> <li>• Easiest way around</li> <li>• Anywhere, anytime</li> <li>• Low cost luxury</li> </ul>	<ul style="list-style-type: none"> <li>• Rating system</li> </ul>	<ul style="list-style-type: none"> <li>• Riders: People who need a ride</li> <li>• Drivers: People who want to earn money driving</li> </ul>
	<b>Key Resources</b> <ul style="list-style-type: none"> <li>• Tech platform</li> <li>• Driver network</li> <li>• Talented employees</li> <li>• Brand</li> </ul>	<ul style="list-style-type: none"> <li>• Various levels of service</li> <li>• Earn money when you want</li> </ul>	<b>Distribution Channels</b> <ul style="list-style-type: none"> <li>• Uber app</li> </ul>	
Cost Structure		Revenue Streams		
	<ul style="list-style-type: none"> <li>• Employee payroll</li> <li>• Driver payouts</li> <li>• Legal fees</li> <li>• Marketing and ads</li> <li>• Tech platform costs</li> </ul>	<ul style="list-style-type: none"> <li>• \$/km or mile</li> <li>• Surge pricing</li> </ul>		

Source:Lokitz,J.(2017,November2).Howtousethebusinessmodelcanvasforinnovation.DesignaBetterBusiness.  
<https://designabetterbusiness.com/2017/11/02/how-to-use-the-business-model-canvas-for-innovation/>



View of a BMW car for sale at a dealership in Shanghai, China. China is the main growth driver for the German luxury car maker.

Imagine China/Newscom

FIGURE 4.2 ■ Business Model Canvas: BMW				
BUSINESS MODEL CANVAS				
Key Partners	Key Activities	Value Proposition	Customer Relationship	Customer Segment
<ul style="list-style-type: none"> <li>• Visionaries</li> <li>• Supply chain partners</li> <li>• Other car companies (e.g., Toyota)</li> <li>• IT companies</li> </ul>	<ul style="list-style-type: none"> <li>• Sales, marketing, and production</li> <li>• Innovation for a better driving experience</li> <li>• Develop future of mobility</li> <li>• Accelerating the pulse of the time (iVisions)</li> </ul>	<ul style="list-style-type: none"> <li>• Ultimate driving experience</li> <li>• 1, 2, 3, 4, 5, 6, 7, X, M series</li> <li>• Connected drive: Reach destination on time and relax</li> <li>• Remote services (find car, lock, comfort)</li> <li>• Active cruise control with stop and go</li> <li>• Full-electric i3, i8 (hybrid)</li> <li>• Connected drive, parking and charging included</li> </ul>	<ul style="list-style-type: none"> <li>• Always by your side, at your service</li> <li>• Love brand (car for life)</li> <li>• Co-pilot driver assistance</li> </ul>	<ul style="list-style-type: none"> <li>• Performance-driven, quality-minded people</li> <li>• Urbanites, sports, life</li> </ul>
Key Resources		Distribution Channels		
<ul style="list-style-type: none"> <li>• Efficient dynamics (fuel down, pleasure up)</li> <li>• Agile manufacturing system</li> <li>• BMW brand</li> <li>• Talented people</li> </ul>		<ul style="list-style-type: none"> <li>• Online rental booking</li> <li>• Dealers</li> <li>• 3rd party mobility service providers</li> </ul>		
Cost Structure		Revenue Streams		
<ul style="list-style-type: none"> <li>• Research and development</li> <li>• Innovation and explorations</li> <li>• Production</li> <li>• Sales and marketing</li> <li>• People training</li> </ul>		<ul style="list-style-type: none"> <li>• Car sales</li> <li>• Service &amp; maintenance</li> <li>• Leasing fees</li> <li>• Rental fees</li> </ul>		

Source: Lokitz, J. (2017, November 2). *How to use the business model canvas for innovation*. Design a Better Business. <https://designabetterbusiness.com/2017/11/02/how-to-use-the-business-model-canvas-for-innovation/>

the market to the top, often throwing existing industries into disarray and toppling existing market leaders.

That's not to say that established companies don't innovate. In fact, most of them are innovating all the time. However, this level of innovation usually applies to modifications and improvements to existing products and services based on the demands of their current customer base, rather than the creation of new innovations. On the face of it, this might seem like a sensible move—to continue satisfying top-tier customers—but often taking the “safe” path puts the company at risk of being disrupted. Table 4.3 outlines some characteristics of disruptive innovators.

### How Companies Can Develop a Disruptive Business Model

As Table 4.3 shows, many of today's most successful companies operate with disruptive business models. Here's what it takes to achieve this level of disruption.<sup>23</sup>

#### Disruption Requires Research

Successful disruption involves a great deal of research. Entrepreneurs need to take the time to identify the customer pain points that lead to viable opportunities. This involves focusing on the areas that are being neglected by other companies and working on some ideas and solutions that will go toward filling these gaps. Digital writing tool Grammarly uncovered some repressed demands of users to successfully

check articles, emails, and dissertations for grammatical errors. Its digital tool allows you to check your writing for contextual grammatical errors, incorrect spellings, and more.

### Unmet Needs

During your research, you may uncover some unmet needs. You might come across customers who are using existing products but are not fully happy with them, or you could discover a product that isn't doing enough to make the customer's life easier. For example, Airbnb discovered that the existing hospitality industry wasn't capitalizing on the unused properties available from owners to rent or lease to guests. It was also able to create more affordable service for a larger amount of people.

### Innovation Is Key

Disruptive business models cannot exist without innovative ideas. Innovative products and ideas will only become disruptive when they have the ability to make people's lives easier at an affordable cost. Sony is a good example of an established company that consistently explores innovative ideas. When it brought out portable cassette player the Walkman in the late 1970s, it succeeded in creating an entirely new market of young people who were keen to listen to music while on the move.

### Market Creation

Creating a new market isn't easy. The pain point is identified, and the disruptive business model developed; then you can start attracting people to your innovation. Instagram created a whole new market by providing a social network where people could share their lives visually.

## BUSINESS CASE 4.2: BETTER WORLD BOOKS

MISHAWAKA, INDIANA

### Goal 4: Quality Education

Better World Books was founded in 2002 at the University of Notre Dame in South Bend, Indiana, by a group of college friends and Frisbee teammates. Christopher Fuchs, Xavier Helgesen, Jeff Kurtzman, and David Murphy banded together to establish a company that would change the world through used books.

Pressed for luck in securing post-graduation employment, Xavier Helgesen and Christopher "Kreece" Fuchs turned an idea to make extra income into an unforeseen business plan. Kreece posted a few old textbooks belonging to his roommate online and, to his surprise, they sold quickly. Xavier, noticing the valuable market that Kreece stumbled upon, began to look for more used textbooks they could sell for profit online. The idea and plan to sell used textbooks online proved to be beyond successful.

The team found a space at the Robinson Community Learning Center. Within months they secured over 2,000 books and raised nearly \$10,000. By this time, Jeff Kurtzman stepped in to help formally develop a business plan. With not much capital, the team decided to submit their idea to the Notre Dame Business Plan competition in order to receive funding: a competition that they won, securing \$7,000 in startup money. With this financial foundation, Better World Books spread across the country at various college campuses. The first CEO of the company was Dan Murphy, who happened to be one of the judges in the business plan competition.

Better World Books operates through a few different avenues, such as libraries, campuses, booksellers, and other individuals. The company has drop boxes at various locations across the country and, in partnership with communities, allows people to deposit unwanted books, which are then recycled, reused, or sold. Working with formal organizations like libraries or college campuses, Better World Books helps facilitate the removal of old books, reducing the waste caused by disposal. These partnerships help schools clear valuable space, create a stream of income, and maintain staff effectiveness by reducing employee time spent managing bookstores and libraries. Booksellers maintain a current inventory as well as generate income by using Better World Books services.

Today, Better World Books has donated 26 million books, raised over \$28 million, and reused or recycled over 320 million books for literacy across the world through library grants and direct book donations.<sup>24</sup> Better World Books started with a distinctive business plan that was a creative way of

using old books to make money; however, as the business grew, the business model shifted toward funding literacy while making enough profit to grow the business. The business model was originally built around a traditional business plan, which included a focus on the four parts of business (offering, customers, infrastructure, financial viability), and gradually, as the model shifted, so did the company's focus toward social community benefits like literacy.

Better World Books has several exceptional aspects of its business model. Its purpose statement speaks directly to the business aspect of selling books, but also to the social focus of the company:

We believe in the power of knowledge. So our goal is to help those who supply it and share it with those who crave it. Which is why every action we take, and every book purchase you make helps fund it.<sup>25</sup>

What are most impressive are the values of Better World Books, which explicitly and clearly state how the company is focused on impacting the world through literacy. Better World Books' company values are: Customer Focused, People Matter, Do the Right Thing, Foster Innovation, Passion for Literacy, and People/Planet/Profit. These company values not only show a commitment to the business model, which produces income for the company to survive; they also show a commitment to the sustainable practices. The fact that they are focused on Customer Service and People Matter shows they understand the need to serve all customers well to have a successful business. Also, passion for literacy coupled with the 3 Ps of sustainability (People, Planet, Profit) clearly show that Better World Books has a successful, profitable business that is also changing the world for the better by addressing quality education and other sustainable issues.

The business model Better World Books has created for itself includes a focus on the environment through sustainability efforts. Better World Books is addressing quality education issues through the one for one book program, book grants programs, and the Better World Books Cares Foundation. Its sustainability efforts are not limited to quality education; it also addresses reducing waste and carbon offsets. One challenge that was discovered was that old books from libraries were filling landfills and negatively impacting our environment. Being socially responsible, Better World Books takes those old books and resells them, reducing waste. Those funds are dispersed back to libraries to fund literacy and pursuit of knowledge. To reduce carbon output, Better World Books provides an option to ship books carbon balanced. Year to date, it has offset carbon by 87,000 tons. As a result of this business model and a committed focus on the social and environmental issues, Better World Books has been certified as a B Corporation. Certified B Corporations are businesses that meet the highest standards of verified social and environmental performance that contribute to a global culture that redefines success in business through a more inclusive and sustainable economy.<sup>26</sup> Other notable B Corporations are Patagonia and Allbirds shoes, so Better World Books is among reputable companies doing good, sustainable business.

In May 2021, Better World Books hit 100 million books sold and, in celebration, the company gave \$10,000 to the Robinson Community Learning Center, where it started its very first book drive. Additionally, it gave \$2,500 to the North Carolina library that acquired the 100 millionth book. Both

**FIGURE 4.3 ■ Create Your Own Business Model Canvas**

BUSINESS MODEL CANVAS				
Key Partners	Key Activities	Value Proposition	Customer Relationship	Customer Segment
Who will help you?	How do you do it?  Key Resources  What do you need?	What do you do?	How do you interact?  Distribution Channels  How do you reach them?	Who do you help?
Cost Structure		Revenue Streams		
What will it cost?		How much will you make?		

**TABLE 4.2 ■ Companies With Disruptive Business Models**

Company	What It Does	Disruptive Business Model	How It Works
LinkedIn	Professional networking site	Freemium	Offers basic options for free and charges for premium options
Netflix	Leading Internet entertainment service	Subscription	Customer signs up and benefits from improvements or extensions to the service
Google	Multinational technology company	Free offerings	Provides free access to search engine but charges for advertising and personalized offers
eBay	Multinational e-commerce company	Marketplace Model	Connects sellers and buyers on a common platform
Lyft	Ride-sharing company	Sharing Economy	Allows access to goods and services for a limited period of time
Tesla	Electric vehicle and clean air company	User Experience Premium	Customers are charged a premium based on their levels of satisfaction for a product
Dropbox	File hosting service	Pyramid	Recruits people connected to the organization to resell products and services
Apple	Multinational technology company	Ecosystem	Designs a "lock in" system where people can only use hardware or software from that particular company
Uber	Multinational ride-hailing company	On-demand	Provides immediate access to services that save customers time and money

Source: Talin, V. B. (2019, December 30). 9 disruptive business models for 2020—New opportunities for companies. *More Than Digital*. Retrieved from <https://morethandigital.info/en/9-disruptive-business-models-new-opportunities-for-companies/>.

**TABLE 4.3 ■ Characteristics of Disruptive Innovators**

Offers a more affordable and accessible option
Serves the bottom of the market first (and then expands to a bigger market)
Progresses slowly and goes largely unnoticed by the more established organizations
Provides innovations that make life easier and are more accessible to people
Creates new value rather than just improving on what already exists
Addresses unmet or repressed needs of customers who want a new way of doing things
Provides products and services that are convenient, and have the ability to be personalized and customized

Source: Wood, M. (2020, January 31). Why your company needs a disruptive business model. *Fundera*. Retrieved from <https://www.fundera.com/blog/disruptive-business-model>



Sony introduced the first model of their Walkman in the summer of 1979. The Walkman was the first product that allowed individuals to listen to music whenever and wherever they wanted.

Thomas Graal/Alamy Stock Photo

gifts align with the company's business model of changing the world through books. As the company looks forward, it is focused more than ever on books. Current president/CEO Dustin Holland was quoted saying "There is no doubt books change lives" in response to the impact the company has had on the book industry. Furthermore, he was quoted, "At 100 million books sold, Better World Books is in business to make a difference in the world, and we are thrilled to share this milestone and achievement with our customers, partners and team members."<sup>27</sup>

### Critical Thinking Questions

1. What is the business model of Better World Books?
2. Who do you think is its primary competitor?
3. What other ways can companies address quality education?

**IN REVIEW****4.1 Define business model.**

A *business model* describes the rationale of how a business creates, delivers, and captures value. It includes a network of activities and resources that interact to deliver value to customers. The business model consists of four main interlocking parts that together create “the business”: the *offering*, the *customers*, the *infrastructure*, and the *financial viability*.

**4.2 Discuss the most common components in a business model.**

There are 13 common components of a business model: the problem, the solution, key resources, customer segments, unique value proposition, competitive landscape, competitive advantage, sales channels, revenue streams, revenue model, key partners, cost structure, and key metrics.

**4.3 Explore different types of business models most used in business today.**

There are different types of business models used for different businesses. Each type determines how the company make its profits and who its customers will be. There are 12 main types of business models: distributor, retailer, franchising model, subscription model, aggregator model, advertising model, data licensing/selling model, software as a service (SaaS), utility and usage business model, professional business model, licensing model, and freemium model.

**4.4 Illustrate the Business Model Canvas as a tool for business model development.**

Companies create, deliver, and capture value for customers through the *Business Model Canvas (BMC)*, which is a one-page plan that divides the business model's four parts into nine components. The offering constitutes the (1) value proposition. Customers relate to (2) customer segments, (3) channels, and (4) customer relationships. Infrastructure includes (5) key activities, (6) key resources, and (7) key partners. Financial viability includes (8) cost structure and (9) revenue streams.

**4.5 Examine entrepreneurship as disrupting existing business models.**

Many of today's successful companies have developed a *disruptive business model* to address unmet needs by improving or changing an existing business model. Companies using this model (known as “disruptors”) tend to start off by focusing on small or niche markets rather than immediately trying to compete with the bigger organizations. Unlike more established organizations, disruptors have freedom to pursue opportunities, test their ideas, and take risks without constraints that large companies may have.

Disruptive business models are powered by *disruptive innovation*, which means innovations that either disrupt the existing market by displacing established companies or create an entirely new market segment.

**UN GOALS**

- Airbnb 7, 11
- Apple 7, 12
- Batelle 7, 11, 12
- Bluedot 3
- BMW 12
- Dropbox 4
- eBay 7, 8, 12, 13, 17
- Google 12, 14, 15
- Grammarly 4
- Hulu 7
- Imperfect Foods 15
- Instagram 4

LinkedIn 5, 10, 13, 17  
 Lyft 11,13  
 Mathnasium 4  
 Netflix 12  
 Oracle 3, 4, 7, 8, 9, 11, 12, 13  
 Patagonia 12, 13  
 Sony 13  
 Target 5, 6, 8, 11, 12, 13  
 Tesla 12, 13  
 Uber 11,13  
 UNFI 3

## KEY TERMS

advertising business model	infrastructure
aggregator business model	intellectual property
business model	key metrics
Business Model Canvas (BMC)	key partners
competitive advantage	key resources
competitive landscape	licensing business model
cost structure	offering
customer segments	professional business model
customer value proposition (CVP)	retailer
customers	revenue model
data licensing/selling model	revenue streams
disruptive business model	sales channels
disruptive innovation	Software as a Service (SaaS)
distributor	solution
financial viability	subscription business model
franchising business model	unique value proposition
freemium business model	utility and usage business model
freshwatching	

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