Business Models

Business Club

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Strategy Team

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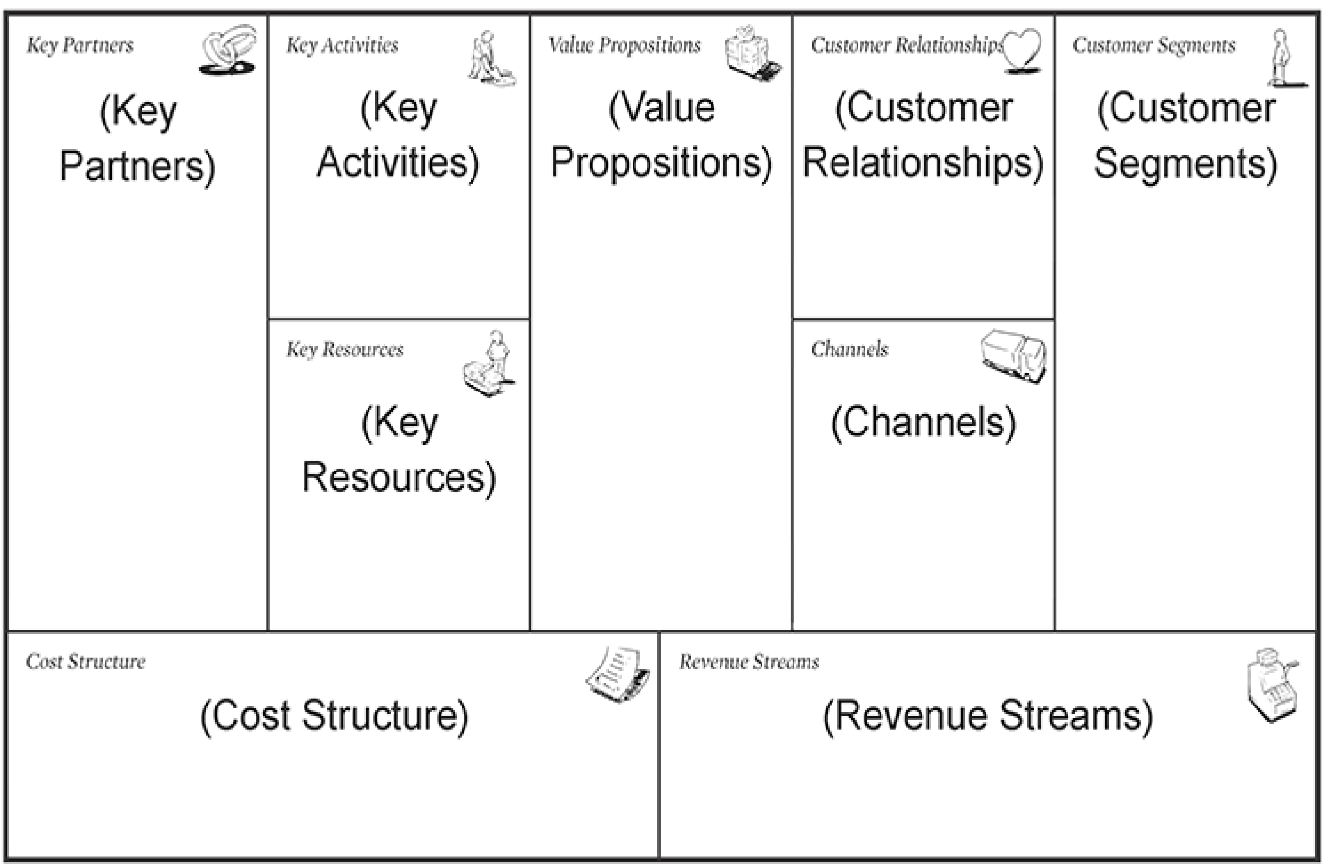
Business Models

A business model is a company's plan for making a profit. It identifies the products or services the business will sell, the target market it has identified, and the expenses it anticipates.

A new business in development has to have a business model, if only in order to attract investment, help it recruit talent, and motivate management and staff. Established businesses have to revisit and update their business plans often, or they'll fail to anticipate trends and challenges ahead. Investors need to review and evaluate the business plans of companies that interest them.

Business Model Canvas



1. Customer Segments

The Customer Segments Building Block defines the different groups of people or organizations an enterprise aims to reach and serve. Customers comprise the heart of any business model. Without (profitable) customers, no company can survive for long. In order to better satisfy customers, a company may group them into distinct segments with common needs, common behaviors, or other attributes. A business model may define one or several large or small Customer Segments. An organization must make a conscious decision about which segments to serve and which segments to ignore. Once this decision is made, a business model can be carefully designed around a strong understanding of specific customer needs.

2. Value Propositions

The Value Propositions Building Block describes the bundle of products and services that create value for a specific Customer Segment. The Value Proposition is the reason why customers turn to one company over another. It solves a customer problem or satisfies a customer need. Each Value Proposition consists of a selected bundle of products and/or services that caters to the requirements of a specific Customer Segment. In this sense, the Value Proposition is an aggregation, or bundle, of benefits that a company offers customers. Some Value Propositions may be innovative and represent a new or disruptive offer. Others may be similar to existing market offers, but with added features and attributes.

3. Channels

The Channels Building Block describes how a company communicates with and reaches its Customer Segments to deliver a Value Proposition. Communication, distribution, and sales Channels comprise a company's interface with customers. Channels are customer touchpoints that play an essential role in the customer experience. Channels serve several functions, including:

- Raising awareness among customers about a company's products and services
- Helping customers evaluate a company's Value Proposition
- Allowing customers to purchase specific products and services
- Delivering a Value Proposition to customers
- Providing post-purchase customer support

4. Customer Relationships

The Customer Relationships Building Block describes the types of relationships a company establishes with specific Customer Segments. A company should clarify the type of relationship it wants to build with each Customer Segment. Relationships can range from personal to automated. The following motivations may drive customer relationships:

- Customer acquisition
- Customer retention
- Boosting sales (upselling)

5. Revenue Streams

The Revenue Streams Building Block represents the cash a company generates from each Customer Segment (costs must be subtracted from revenues to create earnings) If customers comprise the heart of a business model, Revenue Streams are its arteries. A company must ask itself, For what value is each Customer Segment genuinely willing to pay? Successfully answering that question allows the firm to generate one or more Revenue Streams from each Customer Segment. Each Revenue Stream may have different pricing mechanisms, such as fixed list prices, bargaining, auctioning, market dependent, volume dependent, or yield management.

6. Key Resources

Every business model requires Key Resources. These resources allow an enterprise to create and offer a Value Proposition, reach markets, maintain relationships with Customer Segments, and earn revenues. Different Key Resources are needed depending on the type of business model. A microchip manufacturer requires capital-intensive production facilities, whereas a microchip designer focuses more on human resources. Key resources can be physical, financial, intellectual, or human. Key resources can be owned or leased by the company or acquired from key partners

7. Key Activities

The Key Activities Building Block describes the most important things a company must do to make its business model work. Every business model calls for a number of Key Activities. These are the most important actions a company must take to operate successfully. Like Key Resources, they are required to create and offer a Value Proposition, reach markets, maintain Customer Relationships, and earn revenues. And like Key Resources, Key Activities differ depending on business model type. For software maker Microsoft, Key Activities include software development. For PC manufacturer Dell, Key Activities include supply chain management. For consultancy McKinsey, Key Activities include problem-solving.

8. Key Partnerships

The Key Partnerships Building Block describes the network of suppliers and partners that make the business model work. Companies forge partnerships for many reasons, and partnerships are becoming a cornerstone of many business models. Companies create alliances to optimize their business models, reduce risk, or acquire resources.

We can distinguish between four different types of partnerships:
1. Strategic alliances between non-competitors
2. Coopetition: strategic partnerships between competitors
3. Joint ventures to develop new businesses
4. Buyer-supplier relationships to assure reliable supplies

9. Cost Structure

The Cost Structure describes all costs incurred to operate a business model. This building block represents the most significant costs incurred while operating under a particular business model. Creating and delivering value, maintaining Customer Relationships, and generating revenue all incur costs. Such costs can be calculated relatively easily after defining Key Resources, Key Activities, and Key Partnerships. Some business models, though, are more cost-driven than others. So-called "no frills" airlines, for instance, have built business models entirely around low-cost structures.

Business Model Patterns

Unbundling Business Model:

Over time, a company 'unbundled' into three fundamentally different business areas. Those three may coexist in one organization, but they better be distinct entities, to avoid conflicts and undesirable trade-offs.

The three entities naturally play different roles.

- **Customer relationship** identifies, attracts, and builds relationships with customers.
- **Product innovation** conceives new products and services and monetizes them.
- **Infrastructure management** focuses on building and managing facilities for high-volume, repetitive operational tasks.

Economically, **customer acquisition** is costly, so gaining a large share of wallet is necessary; economies of scope are key to this model. Companies compete for scope, rapidly consolidate, and eventually, a handful of big players dominate the market. They are highly service-oriented and adopt a customer-comes-first mentality.

For **product innovation**, early market entry allows for premium price and a large market share, so speed is crucial. They compete for talent, which means low entry barriers and many small players thrive as a result. The corporate culture is employee-centered, the creative stars are coddled.

In **infrastructure management**, high fixed costs make large volumes a necessity to achieve low unit costs, so economies of scale are key. It entails battle for scale and rapid consolidation so that a few big players dominate. They adopt a cost-focused culture with stressed standardization, predictability, and efficiency.

Long Tail Business Model

The Long Tail business model brings in focus an assortment of niche products that sell relatively infrequently. They add value in an online environment:

- Aggregate sales of niche items can be as profitable as bestsellers due to low inventory cost of online retail.
- Strong platforms make niche content readily available to interested buyers.
- Virtual space is ideal since it's limitless, accessible and friendly towards various tastes.

Merits of Long Tail

- **Increased revenue:** since both hits and misses are equal in terms of revenue, the money can add up quickly to a huge new market.
- **A better way of marketing:** it makes up for our poor understanding of the market demands – when consumers are offered infinite choice, the true shape of demand is revealed.
- **Non-discriminatory:** popularity no longer has a monopoly on profitability.
- **Infinite shelf-space effect:** no shelf space to pay for in online sales.
- **Low-cost:** no manufacturing costs; hardly any distribution fees.

Multi-Sided Business Model

Multi Sided business model, also known as P2P / sharing economy / online marketplace has this rationale:

- Two or more homogeneous groups interact and bring together supply and demand.
- An intermediary operates the platform to facilitate interactions and adds revenue streams later.

Challenges:

Multi-sided platforms are **notoriously difficult to start** for several reasons.

- **The chicken-egg problem**: buyers don't come because the platform is dubious and lacks inventory, sellers aren't interested because there's no one to sell to.
- **The double-company problem**: you're building two businesses simultaneously, and it's either both work or they don't.

Take Airbnb. They had to attract people willing to rent or lease lodgings. The market was new and so building awareness was crucial. They had to take care of SEO, design & photography, site development. It took the platform over two years to grow to 10,000 users and 2,500 listings. Want to know how they did it?

Working with Multi-Sided Models:

- **Forget automation – do everything manually.** Once the platform takes off, automation is crucial. But it doesn't mean you need to start automating right off. Setting up your business manually will give you valuable experience that you would miss otherwise.
- **Create happy buyers before the network effect.** Start generating value even while you're small. Threadless matches people seeking unique T-shirts with people who create them. Even if the site contained only ten T-shirts, as long as they were awesome, buyers would still be able to buy a cool T-shirt. Scarcity is a thing that makes a T-shirt 'cool'.
- **Serve the seller side first.** After all, they're already in business and so are easier to find. Create an irresistible offer, like 12 months' free or low-price lock-in. Sellers are alsways motivated to have more eyeballs and sales.
- **Be innovative in attracting buyers.** SEO, traditional marketing, AdWords cost a fortune. Since everybody else has long been doing the same, how can you stand out or even catch up? Do it your way. Jeff Bezos, for one, devised a winning marketing strategy for Amazon – a Virtuous Cycle.

FREE Business Model

In this model:

- at least one of the customer segments continuously uses the product/service free of charge
- different patterns make the subsidized offer possible
- non-paying customers are financed by another customer segment

Merits:

- **It's irresistible.** That's the most powerful VP. I mean, who doesn't like freebies?!
- **Best marketing tactic.** Given that sales and marketing eat up a lion's share of business funds, freebies are a great lead-generating tool (the free model invests heavily into the engineering of a great product, which at the same time becomes its marketing strategy – much leaner than the traditional marketing). Thus product development overlaps with customer development.
- **Ensures market leadership.** A large base of free users creates market value in making the product attractive to investors as potentially monetizable (think WhatsApp). Having a large market share (albeit not paying) positions you as a market leader, which is self-reinforcing in the tech industry. The financial markets and acquirers realize that market leadership is worth a significant premium over niche players that may have more revenue.

The New FREEmium Model:

A classical model where a handful of premium users subsidize a large base of free users is only viable is the marginal costs are low. A product may start as free and then switch to freemium. Think Tinder. The basic dating app was upgraded to Tinder Plus, granting its premium users with additional highly desirable features, an ad-free experience, and better search results.

Open-source: No more high costs to support teams of software experts and no more per-user licenses or product upgrades. But a product no one 'owns' can be risky. Since the open source community does a fair share of non-paid work, a little bit of testing, stabilization, and maintenance may be way cheaper. Think Red Hat. The company provides subscription-based 7-year long support and maintenance of open-source software, Linux in particular. It guarantees freeware quality and viability at a lower price than traditional software releases. Software value depends on the community of experts and users, timely upgrades, documentation, certification, and stable work. Open-source does a great job here.

The insurance model: A large base of customers pay small regular fees to protect themselves from unlikely – but financially devastating events. In short, this large paying base subsidizes a small group of people with actual claims (think Rega, the crowdsurance platform utilizing blockchain technology).

Open Business Model

Since R&D is costly or slow, acquiring R&D from external sources can be less expensive or faster-to-market. On the other hand, sharing the unused internal intellectual property creates new revenue streams.

This philosophy results in the two vectors:

- **Inside-out:** innovation occurs when organizations license or sell their intellectual property or technologies, particularly unused assets.
- **Outside-in:** innovation occurs when an organization brings external ideas, technology, or intellectual property into its development and commercialization.

Working With an Open Business Model

Several types of the Creative Commons license make it possible to benefit from opening IP to public use.That allows us to share and adapt the idea while giving credit to its creators.

But how to generate revenue with the inside-out open model? Let's look at some methods:

- **Digital-to-physical.** The CC-licensed goods are available to access/innovate/participate in online for free. When converted into physical, costs are incurred.
- **Direct connect.** Eliminates the middleman between creatives and the market. The licensed work is put up online for everyone to listen, read, use, and distribute it. The revenue streams are donations, pay-what-you-can, free & for sale, crowdfunding, unlatching, patrons.
- **Matchmaking.** Tech platforms act as a middleman creating an online presence of creatives and a one-stop shop for consumers.

- **Value-add services.** Services are built on top of a resource that is free and open. The revenue comes from the added value – customization, hosted and supported access, supplemental resources, training and education.

Business model environment

Business models are designed and executed in specific environments. Developing a good understanding of your organization's environment helps you conceive stronger, more competitive business models. Continuous environmental scanning is more important than ever because of the growing complexity of the economic landscape. A good understanding of the environment will allow you to better evaluate the different directions in which your business model might evolve.

To get a better grasp on your business model "design space," we suggest roughly mapping four main areas of your environment. These are (1) market forces, (2) industry forces, (3) key trends, and (4) macroeconomic forces.

Market forces

1. Market issues
   Identifies key issues driving and transforming your market from Customer and Offer perspectives
2. Market segments
   Identifies the major market segments, describes their attractiveness, and seeks to spot new segments
3. Needs and demands
   Outlines market needs and analyzes how well they are served
4. Switching costs
   Describes elements related to customers switching business to competitors
5. Revenue attractiveness
   Identifies elements related to revenue attractiveness and pricing power

Industry forces

1. Competitors (incumbents)
   Identifies incumbent competitors and their relative strengths
2. New entrants (insurgents)
   Identifi es new, insurgent players and determines whether they compete with a business model different from yours
3. Substitute products and services
   Describes potential substitutes for your offers—including those from other markets and industries
4. Suppliers and other value chain actors
   Describes the key value chain incumbents in your market and spots new, emerging players
5. Stakeholders
   Specifies which factors may influence your organization and business model

Key trends

1. Technology trends
   Identifies technology trends that could threaten your business model or enable it to evolve or improve
2. Regulatory trends
   Describes regulations and regulatory trends that infl uence your business model
3. Societal and cultural trends
   Identifies major societal trends that may infl uence your business model
4. Socioeconomic trends
   Outlines major socioeconomic trends relevant to your business model

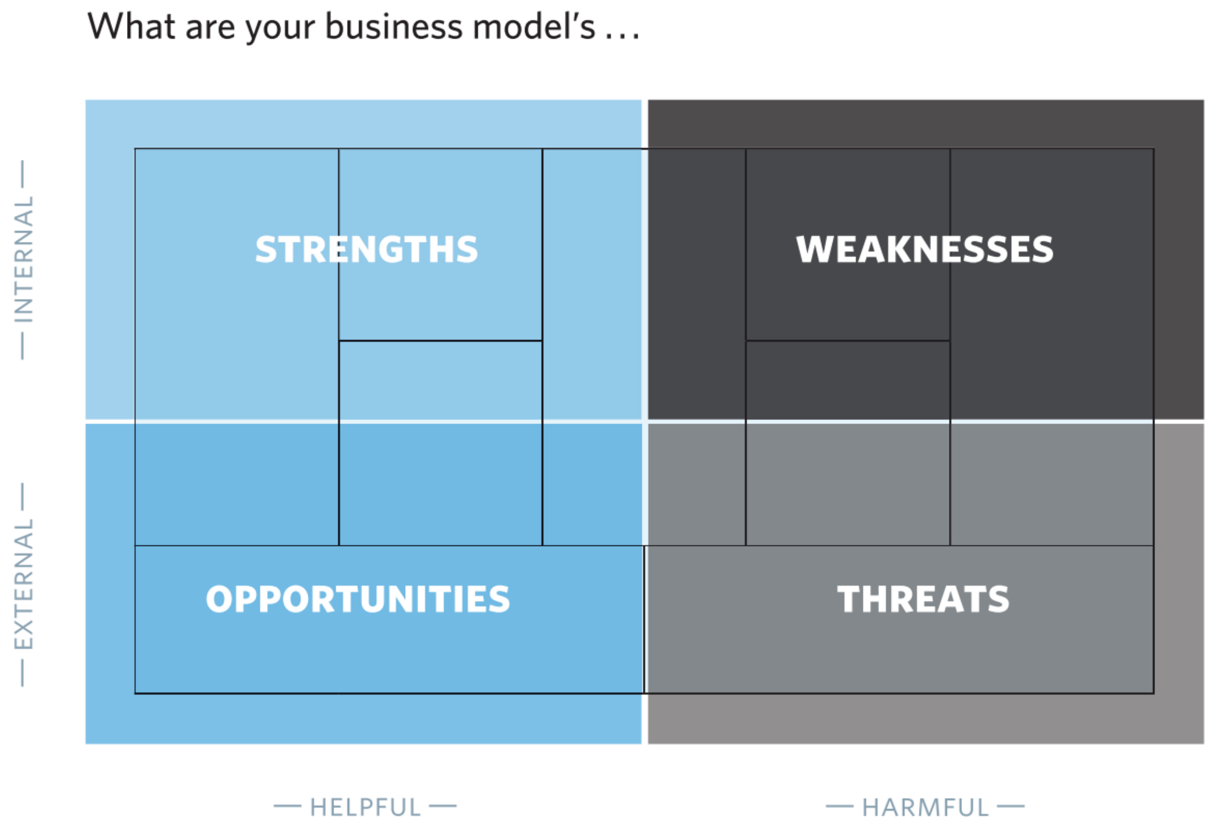
Macroeconomic forces

1. Global market conditions
   Outlines current overall conditions from a macroeconomic perspective
2. Capital markets
   Describes current capital market conditions as they relate to your capital needs
3. Economic infrastructure
   Describes the economic infrastructure of the market in which your business operates
4. Commodities and other resources
   Highlights current prices and price trends for resources required for your business model

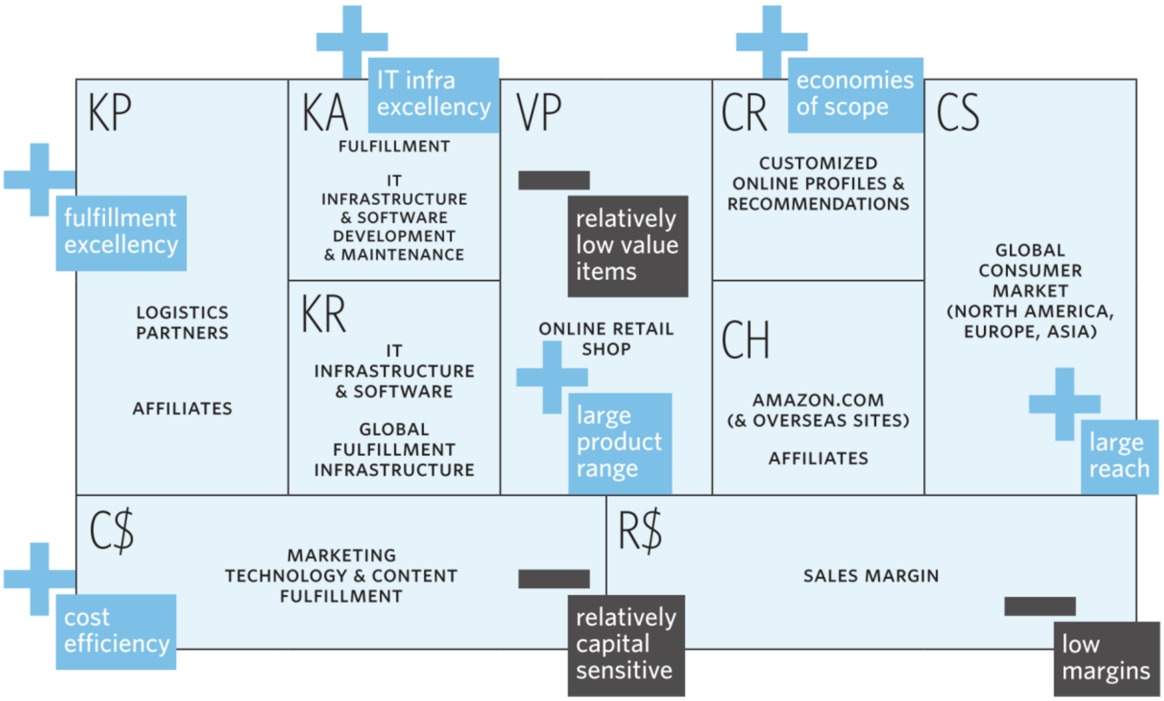
A competitive business model that makes sense in today's environment might be outdated or even obsolete tomorrow. We all have to improve our understanding of a model's environment and how it might evolve.An effective way to do this is to **combine classic strengths, weaknesses, opportunities, and threats (SWOT) analysis with the Business Model Canvas.**

SWOT analysis provides four perspectives from which to assess the elements of a business model, while the Business Model Canvas provides the focus necessary for a structured discussion

SWOT asks four big, simple questions. The first two—what are your organization's strengths and weaknesses?—assess your organization internally. The second two—what opportunities does your organization have and what potential threats does it face?—assess your organization's position within its environment.



Assessing the strengths and weaknesses of Amazon.com's business model reveals an enormous strength and a dangerous weakness. Amazon.com's strength was its extraordinary customer reach and huge selection of products for sale. The company's main costs lay in the activities in which it excelled, namely fulfillment and technology and content. The key weakness of Amazon.com's business model was weak margins, the result of selling primarily low-value, lowmargin products such as books, music CDs, and DVDs.

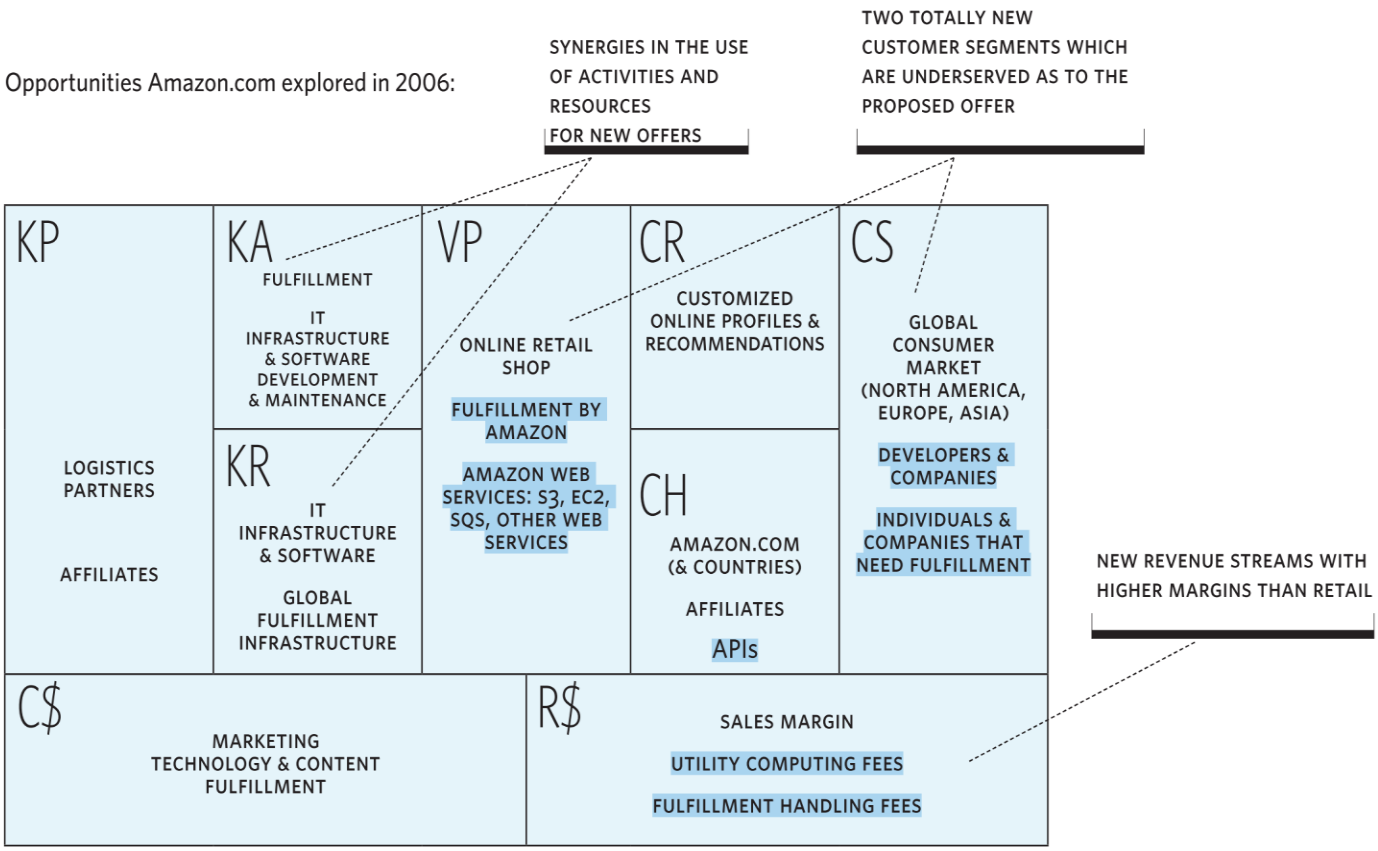


Eventually a two pronged approach was used to building on Amazon.com's business model.They had to (1) target underserved markets, (2) be scalable with potential for significant growth, and (3) leverage existing Amazon.com capabilities to bring strong customer-facing differentiation to that marketplace.

In 2006 Amazon.com focused on two new initiatives.

I) Fulfillment by Amazon allows individuals and companies to use Amazon.com's fulfillment infrastructure for their own businesses in exchange for a fee. Amazon.com stores a seller's inventory in its warehouses, then picks, packs, and ships on the seller's behalf when an order is received.

II) Amazon Web Services targets software developers and any party requiring high performance server capability by offering on-demand storage and computing capacity.



Both initiatives built on the company's core strengths—order fulfillment and Web IT expertise—and both addressed underserved markets. What's more, both initiatives promised higher margins than the company's core online retailing business.

Business model perspective on blue ocean strategy

Blue Ocean Strategy is about creating completely new industries through fundamental differentiation as opposed to competing in existing industries by tweaking established models.

The creation of blue oceans is about driving costs down while simultaneously driving value up for buyers. This is how a leap in value for both the company and its buyers is achieved. Because buyer value comes from the utility and price that the company offers to buyers and because the value to the company is generated from price and its cost structure, value innovation is achieved only when the whole system of the company's utility, price, and cost activities is properly aligned. It is this whole-system approach that makes the creation of blue oceans a sustainable strategy. Blue ocean strategy integrates the range of a firm's functional and operational activities.

Red Ocean	Blue Ocean
Compete in existing market space	Create uncontested market space.
Beat the competition	Make the competition irrelevant.
Exploit existing demand.	Create and capture new demand.
Make the value-cost trade-off	Break the value-cost trade-off
Align the whole system of a firm's activities with its strategic choice of differentiation or low cost.	Align the whole system of a firm's choices in pursuit of differentiation and low cost

Rather than outdoing competitors in terms of traditional performance metrics, it advocates creating new, uncontested market space through what the authors call value innovation. This means increasing value for customers by creating new benefits and services, while simultaneously reducing costs by eliminating less valuable features or services.

Business model innovation results from one of four objectives:
(1) To satisfy existing but unanswered market needs
(2) To bring new technologies, products, or services to market,
(3) To improve, disrupt, or transform an existing market with a better business model
(4) To create an entirely new market

The business model design process we propose has five phases: Mobilize, Understand, Design, Implement, and Manage

Mobilize

The main activities of this first phase are framing the project objectives, testing preliminary ideas, planning the project, and assembling the team.

Understanding

This second phase consists of developing a good understanding of the context in which the business model will evolve backed by research and analysis.

Design

Adapt and modify the business model in response to market response. Take the time to think through multiple business model options before selecting the one you want to implement. Experiment with different partnership models,

Implement

This includes defining all related projects, specifying milestones, organizing any legal structures, preparing a detailed budget and project roadmap, and so forth.

Manage

The Manage phase includes continuously assessing the model and scanning the environment to understand how it might be affected by external factors over the long term.