

Def_Business Model

A business model describes the rationale of how an organization creates, delivers, and captures value

The starting point for any good discussion, meeting, or workshop on business model innovation should be a shared understanding of what a business model actually is. We need a business model concept that everybody understands: one that facilitates description and discussion. We need to start from the same point and talk about the same thing. The challenge is that the concept must be simple, relevant, and intuitively understandable, while not oversimplifying the complexities of how enterprises function.

In the following pages we offer a concept that allows you to describe and think through the business model of your organization, your competitors, or any other enterprise. This concept has been applied and tested around the world and is already used in organizations such as IBM, Ericsson, Deloitte, the Public Works and Government Services of Canada, and many more.

This concept can become a shared language that allows you to easily describe and manipulate business models to create new strategic alternatives. Without such a shared language it is difficult to systematically challenge assumptions about one's business model and innovate successfully.

We believe a business model can best be described through nine basic building blocks that show the logic of how a company intends to make money. The nine blocks cover the four main areas of a business: customers, offer, infrastructure, and financial viability. The business model is like a blueprint for a strategy to be implemented through organizational structures, processes, and systems.

The 9 Building Blocks



CS

1 Customer Segments

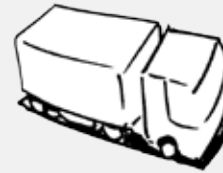
An organization serves one or several Customer Segments.



VP

2 Value Propositions

It seeks to solve customer problems and satisfy customer needs with value propositions.



CH

3 Channels

Value propositions are delivered to customers through communication, distribution, and sales Channels.



CR

4 Customer Relationships

Customer relationships are established and maintained with each Customer Segment.



R\$

5 **Revenue Streams**

Revenue streams result from value propositions successfully offered to customers.



KR

6 **Key Resources**

Key resources are the assets required to offer and deliver the previously described elements...



KA

7 **Key Activities**

...by performing a number of Key Activities.



KP

8 **Key Partnerships**

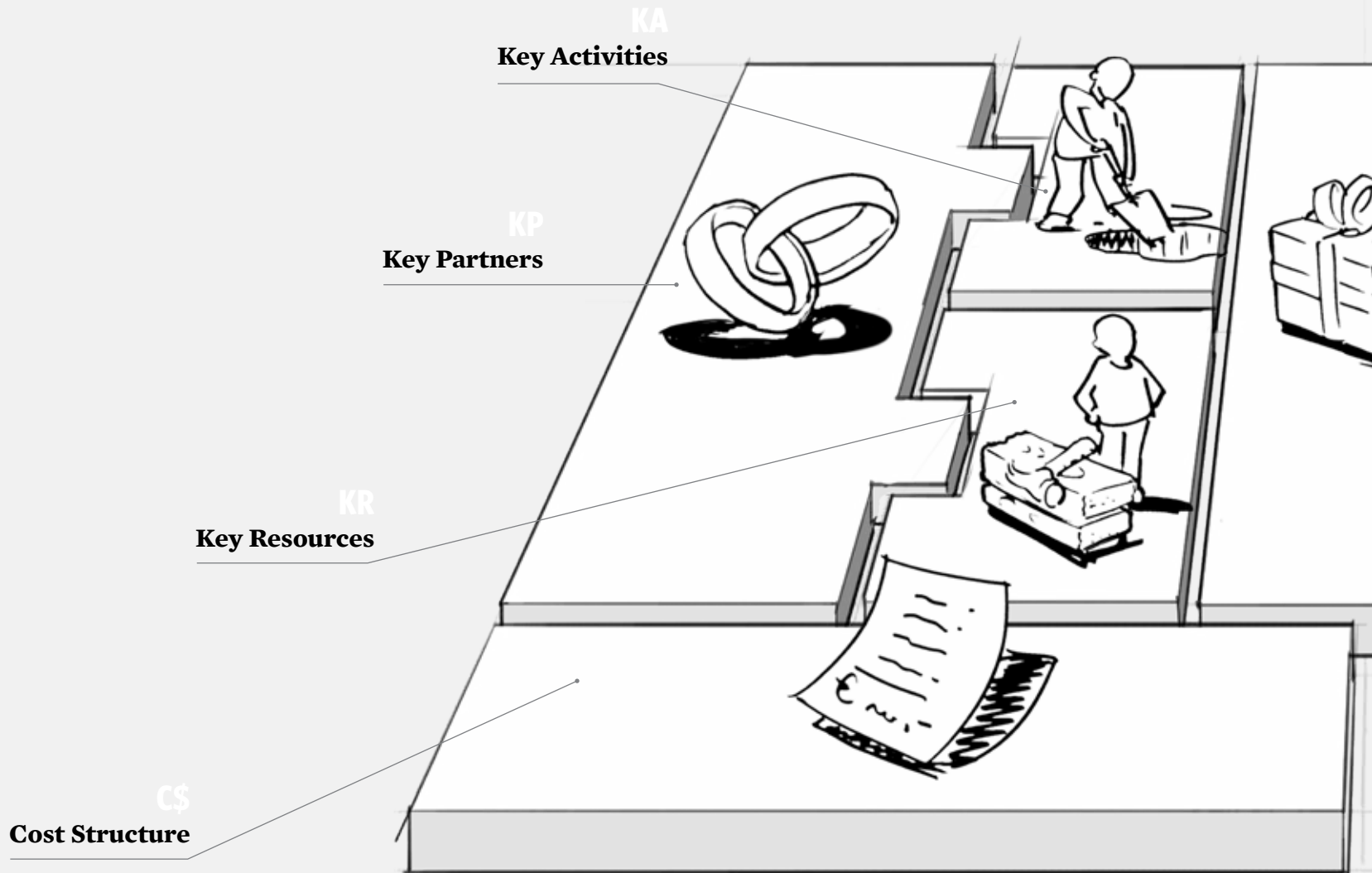
Some activities are outsourced and some resources are acquired outside the enterprise.

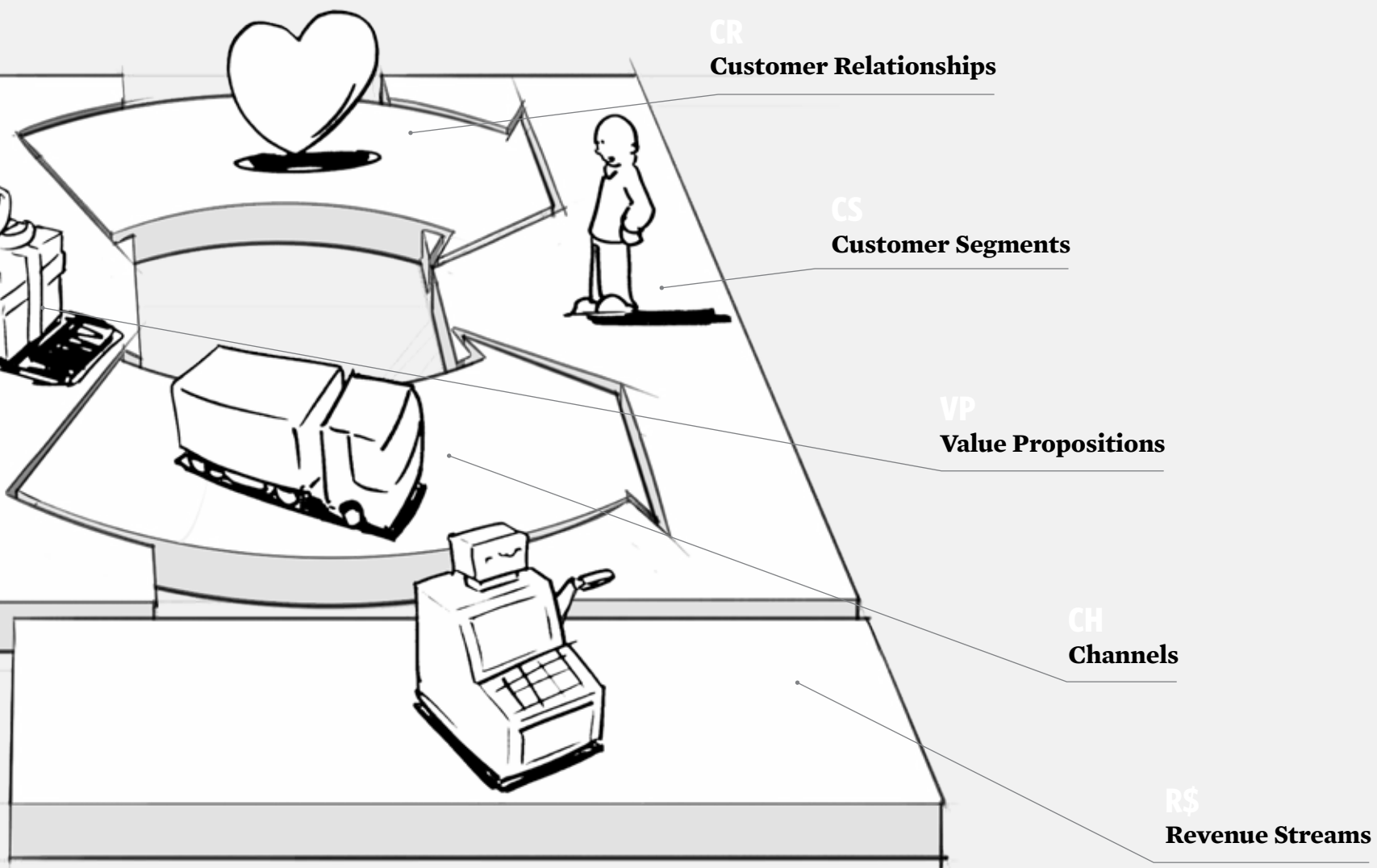


C\$

9 **Cost Structure**

The business model elements result in the cost structure.





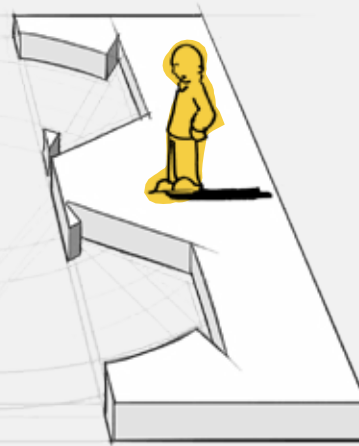
Customer Segments

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.

Customer groups represent separate segments if:

- *Their needs require and justify a distinct offer*
- *They are reached through different Distribution Channels*
- *They require different types of relationships*
- *They have substantially different profitabilities*
- *They are willing to pay for different aspects of the offer*



For whom are we creating value?

Who are our most important customers?

There are different types of Customer Segments.

Here are some examples:

Mass market

Business models focused on mass markets don't distinguish between different Customer Segments. The Value Propositions, Distribution Channels, and Customer Relationships all focus on one large group of customers with broadly similar needs and problems. This type of business model is often found in the consumer electronics sector.

Niche market

Business models targeting niche markets cater to specific, specialized Customer Segments. The Value Propositions, Distribution Channels, and Customer Relationships are all tailored to the specific requirements of a niche market. Such business models are often found in supplier-buyer relationships. For example, many car part manufacturers depend heavily on purchases from major automobile manufacturers.

Segmented

Some business models distinguish between market segments with slightly different needs and problems. The retail arm of a bank like Credit Suisse, for example, may distinguish between a large group of customers, each possessing assets of up to U.S. \$100,000, and a smaller group of affluent clients, each of whose net worth exceeds U.S. \$500,000. Both segments have similar but varying needs and problems. This has implications for the other building blocks of Credit Suisse's business model, such as the Value Proposition, Distribution Channels, Customer Relationships, and Revenue streams. Consider Micro Precision Systems, which specializes in providing outsourced micromechanical design and manufacturing solutions. It serves three different Customer Segments — the watch industry, the medical industry, and the industrial automation sector — and offers each slightly different Value Propositions.

Diversified

An organization with a diversified customer business model serves two unrelated Customer Segments with very different needs and problems. For example, in 2006 Amazon.com decided to diversify its retail business by selling "cloud computing" services: online storage space and on-demand server usage. Thus it started catering to a totally different Customer Segment — Web companies — with a totally different Value Proposition. The strategic rationale behind this diversification can be found in Amazon.com's powerful IT infrastructure, which can be shared by its retail sales operations and the new cloud computing service unit.

Multi-sided platforms (or multi-sided markets)

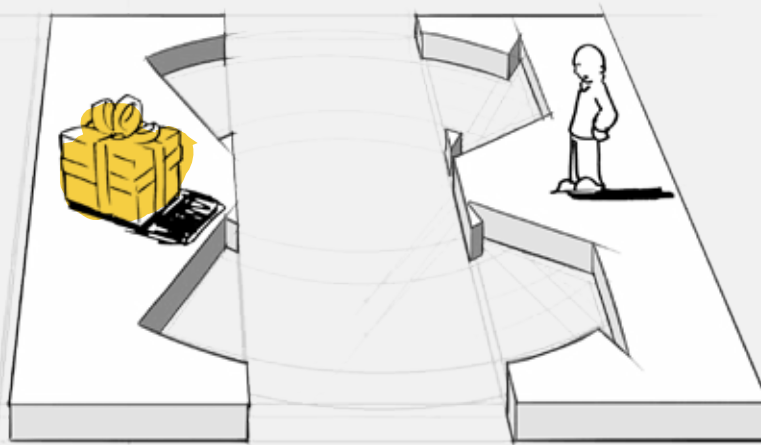
Some organizations serve two or more interdependent Customer Segments. A credit card company, for example, needs a large base of credit card holders and a large base of merchants who accept those credit cards. Similarly, an enterprise offering a free newspaper needs a large reader base to attract advertisers. On the other hand, it also needs advertisers to finance production and distribution. Both segments are required to make the business model work (read more about multi-sided platforms on p. 76).

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.



What value do we deliver to the customer?
 Which one of our customer's problems are we helping to solve? Which customer needs are we satisfying?
 What bundles of products and services are we offering to each Customer Segment?

A Value Proposition creates value for a Customer Segment through a distinct mix of elements catering to that segment's needs. Values may be quantitative (e.g. price, speed of service) or qualitative (e.g. design, customer experience).

Elements from the following non-exhaustive list can contribute to customer value creation.

Newness

Some Value Propositions satisfy an entirely new set of needs that customers previously didn't perceive because there was no similar offering. This is often, but not always, technology related. Cell phones,

for instance, created a whole new industry around mobile telecommunication. On the other hand, products such as ethical investment funds have little to do with new technology.

Performance

Improving product or service performance has traditionally been a common way to create value. The PC sector has traditionally relied on this factor by bringing more powerful machines to market. But improved performance has its limits. In recent years, for example, faster PCs, more disk storage space, and better graphics have failed to produce corresponding growth in customer demand.

Customization

Tailoring products and services to the specific needs of individual customers or Customer Segments creates value. In recent years, the concepts of mass customization and customer co-creation have gained importance. This approach allows for customized products and services, while still taking advantage of economies of scale.



“Getting the job done”

Value can be created simply by helping a customer get certain jobs done. Rolls-Royce understands this very well: its airline customers rely entirely on Rolls-Royce to manufacture and service their jet engines. This arrangement allows customers to focus on running their airlines. In return, the airlines pay Rolls-Royce a fee for every hour an engine runs.

Design

Design is an important but difficult element to measure. A product may stand out because of superior design. In the fashion and consumer electronics industries, design can be a particularly important part of the Value Proposition.

Brand/status

Customers may find value in the simple act of using and displaying a specific brand. Wearing a Rolex watch signifies wealth, for example. On the other end of the spectrum, skateboarders may wear the latest “underground” brands to show that they are “in.”

Price

Offering similar value at a lower price is a common way to satisfy the needs of price-sensitive Customer Segments. But low-price Value Propositions have important implications for the rest of a business model. No frills airlines, such as Southwest, easyJet, and Ryanair have designed entire business models specifically to enable low cost air travel. Another example of a price-based Value Proposition can be seen in the Nano, a new car designed and manufactured by the Indian conglomerate Tata. Its surprisingly low price makes the automobile affordable to a whole new segment of the Indian population. Increasingly, free offers are starting to permeate various industries. Free offers range from free newspapers to free e-mail, free mobile phone services, and more (see p. 88 for more on FREE).

Cost reduction

Helping customers reduce costs is an important way to create value. Salesforce.com, for example, sells a hosted Customer Relationship management (CRM) application. This relieves buyers from the expense and trouble of having to buy, install, and manage CRM software themselves.

Risk reduction

Customers value reducing the risks they incur when purchasing products or services. For a used car buyer, a one-year service guarantee reduces the risk of post-purchase breakdowns and repairs. A service-level guarantee partially reduces the risk undertaken by a purchaser of outsourced IT services.

Accessibility

Making products and services available to customers who previously lacked access to them is another way to create value. This can result from business model innovation, new technologies, or a combination of both. NetJets, for instance, popularized the concept of fractional private jet ownership. Using an innovative business model, NetJets offers individuals and corporations access to private jets, a service previously unaffordable to most customers. Mutual funds provide another example of value creation through increased accessibility. This innovative financial product made it possible even for those with modest wealth to build diversified investment portfolios.

Convenience/usability

Making things more convenient or easier to use can create substantial value. With iPod and iTunes, Apple offered customers unprecedented convenience searching, buying, downloading, and listening to digital music. It now dominates the market.