BUSINESS MODEL

What is a BM?

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

Components of a BM:

- Customer segments:

  Customers comprise the heart of any business model. An organisation serves one or several CS. Without profitable customers, no business can survive for long. In order to better satisfy customers, a company may group them into distinct segments with common needs, common behaviours, or other attributes. An organisation must make a conscious decision about which segments to serve and which segments to ignore.

  Customer groups represent separate segments if:

  1. Their needs require and justify a distinct offer
  2. They are reached through different distribution channels
  3. They require different types of relationships
  4. They have substantially different profitabilities
  5. They are willing to pay for different aspects of the offer

  - A credit card company needs a large base of credit card holders and a large base of merchants who accept those credit cards.

- **Value proposition:**

  The VP building block describes the bundle of products and services that create value or benefits (it could be quantitative e.g. price, cost reduction, speed of service or qualitative e.g. risk reduction e.g. 1 year guarantee, accessibility, convenience/usability, superior design, customer experience, performance, brand status, customization i.e. tailoring products and services to the specific needs of individual customers) for a specific CS. A business seeks to solve customer problems and satisfy customer needs with value propositions.

The VP is the reason why customers turn to one company over another. Some VP may be new and innovative while others may be similar to existing market offers, but with added features and attributes.

- **Channels:**

  The channels describes how a company communicates with and reaches its CS to deliver a VP. Value propositions are delivered to customers through communication, distribution, and sales channels.

  Channels serve several functions, including:

1. Raising awareness among customers about a company's products or services
2. Helping customers evaluate a company's VP
3. Allowing customers to purchase specific products or services
4. Delivering a VP to customers
5. Providing post-purchase customer support

- Through which channels do our CS want to be reached?
- How are we reaching them now?
- Which ones work best?
- Which ones are most cost-efficient?

Types of channels:

Own (Sales force, Web sales, our own stores), Partner (partner stores, wholesaler). Owned channels have higher margins, but can be costly to put in place and to operate. The trick is to find the right balance between the different types of channels, to integrate them in a way to create a great customer experience, and to maximize revenues.

- Customer relationships:

  CR describes the types of relationships a company establishes with specific CS. Relationships can range from personal to automated. CR is driven by the following motivations: customer acquisition e.g. free sim cards, customer retention (when market is saturated), boosting sales. CR are established and maintained with each CS.

  - What type of relationship does each of our CS expect us to establish and maintain with them?
  - Which ones have we established?
  - How costly are they?

  Examples of CR:

  1. Personal assistance: through a customer care representative.
  2. Dedicated personal assistance: by dedicating a customer representative specifically to an individual client. It represents the deepest and most intimate type of relationship and normally develops over a long period of time.

3. Self-service: here the company maintains no direct relationship with customers. It provides all the necessary means for customers to help themselves.
4. Automated services: it is a form of self-service with automated processes.
5. Co-creation: e.g. Amazon.com invites customers to write reviews and thus create value for other book lovers. YouTube.com solicit customers to create content for public consumption.

- Revenue streams:

  RS represents the cash a company generates from each CS (cost must be subtracted from revenues to create earnings). If customers comprise the heart of a BM, RS are its arteries. A company must ask itself, For what value is each CS truly willing to pay? RS may may have different pricing mechanisms, such as fixed list prices, bargaining, auctioning, market dependent, volume dependent, or yield mgt.

  A BM can involve two different types of RS:

  1. Transaction revenues resulting from one-time customer payments
  2. Recurring revenues resulting from ongoing payments to either deliver a VP to customer or provide post-purchase customer support.

  RS result from vp successfully offered to customers.

  - For what value are our customers really willing to pay?
  - For what do they currently pay?
  - How are they currently paying?
  - How would they prefer to pay?

- How much does each RS contribute to overall revenues?

  There are several ways to generate RS:

  1. Asset sale: selling a product
  2. Usage fee: for the use of a particular service
  3. Subscription fees: generated by selling continuous access to a service
  4. Lending/renting/leasing: by temporarily granting someone the exclusive right to use a particular asset for a fixed period in return for a fee.
  5. Licensing: generated by giving customers permission to use protected intellectual property in exchange for licensing fees.
  6. Brokerage fees: derives from intermediation services performed on behalf of two or more parties e.g. brokers and real estate agents. Credit card providers earn revenues by taking a percentage of the value of each sales transaction executed between credit card merchants and customers.
  7. Advertising: fees for advertising a particular product, service, or brand.

Price mechanisms	
Fixed Menu Pricing Predefined prices are based on static variables	Dynamic Pricing Prices change based on market conditions
List price: Fixed prices for individual products, services, or other VP	Negotiation (bargaining): Price negotiated between two or more partners depending on negotiation power and/or negotiation skills
Product feature dependent:	Yield mgt.

Price depends on the number or quality of VP features	Price depends on inventory and time of purchase (normally used for perishable resources such as hotel rooms or airline seats)
Customer segment dependent: Price depends on the type and characteristic of a CS	Real-time market: Price is established dynamically based on supply and demand
Volume dependent: Price as a function of the quantity purchased	Auctions: Price determined by outcome of competitive bidding

- Key resources:

  KR describes the most important assets required to make a BM work. These resources allow an enterprise to create and offer a VP, reach markets, maintain relationships with CS, and earn revenues. Different KR are needed depending on the type of BM.

  KR can be physical assets (manufacturing facilities, buildings, vehicles, machines, systems, point-of-sales systems, and distribution network), financial (cash, lines of credit, or a stock option pool for hiring key employees), intellect resources (brands, proprietary knowledge, patents and copyrights, partnerships, and customer databases) or human. KR can be owned or leased by the company or acquired from key partners.

  - What KR do our VP require?
  - What KR do our DC require?
  - What KR do our CR require?

- What KR do our RS require?

- Key activities:

  KA describes the most important things a company must do to make its BM work. These are the most important actions a company must take to operate successfully. Like KR, they required to create and offer a VP, reach markets, maintain CR, and earn revenues. And like KR, KA differ depending on BM type.

  KA can be categorized as follows:

  1. Production: designing, making, and delivering a product in substantial quantities and/or of superior quality. E.g. manufacturing firms.
  2. Problem solving: coming up with new solutions to individual customer problems. E.g. consultants and hospitals.
  3. Platform/network: maintaining websites or transaction channel, service provisioning and platform promotion.

- Key partnerships:

  KP describes the network of suppliers and partners that make the BM work. Companies create alliances to optimize their business models, reduce risk, or acquire resources. Some activities are outsourced and some resources are required outside the enterprise.

  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

- Who are our key partners?
- Who are our key suppliers?
- Which KR are we acquiring from partners?
- Which KA do partners perform?

Motivations for creating partnerships:

1. Optimization and economy of scale: this type of partnership is formed to reduce costs, and often involve outsourcing or sharing infrastructure. It is illogical to own all resources or perform every activity yourself.
2. Reduction of risk and uncertainty: competitors can form a strategic alliance in one area while competing in another. Blu-ray, for example, is an optical disc format jointly developed by a group of the world's leading consumer electronics, pc, and media manufacturers. The group cooperated to bring Blu-ray technology to market, yet individual members compete in selling their own Blu-ray products.
3. Acquisition of particular resources and activities: here one company relies on other firms to furnish particular resources or perform certain activities. Such partnerships can be motivated by needs to acquire knowledge, licenses, or access to customers. E.g. a mobile phone manufacturer may license an operating system for its handsets rather than develop one in-house.

- Cost structure:

CS describes all costs incurred to operate a BM. Creating and delivering value, maintaining CR, and generating revenue all incur costs. Such costs can be calculated relatively easily after defining KR, KA, and KP.

- What are the most important costs inherent in our BM?
- Which KR are most expensive?
- Which KA are most expensive?

Types of BM:

1. Cost-driven: focus on minimizing costs wherever possible. This approach aims at creating and maintaining the leanest possible CS, using low price VP, maximum automation, and extensive outsourcing.
2. Value-driven: premium VP and a high degree of personalized service e.g. luxury hotels.

CS can have the following characteristics:

- Fixed costs: costs that remain the same despite the volume of goods or services produced. E.g. salaries, rents. Some businesses such as manufacturing companies are characterized by a high proportion of FC.
- Variable costs: costs that vary proportionally with the volume of goods or services produced.
- Economies of scale: cost advantages that a business enjoys as its output expands. Large companies benefit from lower bulk purchase rates. This and other factors cause average cost per unit to fall as output rises.
- Economies of scope: cost advantages that a business enjoys due to a larger scope of operations. In a large enterprise, the same marketing activities or DC may support multiple products.