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Business Model- A Meaning to your Endeavor

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Abstract

The business model is like a blue print, for a strategy to be implemented through organizational structures, processes and systems. It is an outline of specific processes, functions or activities a company uses to produce consumer goods and services in the business environment. Organizations typically create a business model to ensure that they can produce goods and services in the most efficient and effective manner possible. It is the firms answer to the question- what to produce, for whom to produce and how to make money doing so. It can also be called as "The Business Recipe"

We are living at the turning point of history. In business the only viable response to the challenge of our transition times is to launch new business models and leverage their potential through bold entrepreneurial strategies. The idea behind business modeling is to see if we can proactively create a model around the business, rather than just accept the model that gets created. This paper aims to highlight the concept, components of a business model and the different types of business models that one can consider.

Keywords: Business model, Value generation, Organizational structures.

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1. Introduction

The pressure to crack open the markets in developing countries is driving a surge in business model innovation. The economic slowdown in developed countries is also forcing companies to modify and create new business models. Most enterprises have not come to fully understand how to compete through business models; this is due to their unwavering focus on creating innovative models and evaluating their efficiency in isolation. The success or failure of a company's business model depends largely on how it interacts with models of other players in the industry. One business model may appear better to other when analyzed in isolation but create less value than the others when interactions are considered.

Appraising models in a standalone fashion leads to faulty assessment of its strength and weakness and bad decision making. When you define your business via the value proposition you offer to your customers that is exactly the bridge between your company's purpose and the need and wants of your customers. In a philosophical way the business model is a vehicle for the meaning to your endeavor and that meaning drives the employees, the management and the customers of the firm. Every business, whether a new player or a seasoned veteran, needs at least one solid business model to survive and grow. Business models are also referred to as profit models.

One of the reasons why the term business model has became popular is, that people want to answer the question about the purpose of their business. This question was raised by Peter Drucker, the management philosopher and thinker. For Drucker "the only valid definition of business purpose is: to create a customer." And you get your customers only if you do a job they need, you fulfill a want they have. At the core, all business models address the questions: how do we sustainably deliver value to our customers?

2. Definition of a Business Model

A business model is a framework, the engine room that you use to run and have visibility to your business. It answers the questions for all business decisions that you make. How do you intend to make money and what model will you use to sustain your business.

A business model is focused on value creation. It acts as a framework to take what you create or make and turn that innovation into an economic equation. It takes into account the entire value chain of the organization.

The business model is simply a working description that includes the general details about the operations of a business. The components that are contained within a business model will address all functions of a business, including factors as the expenses, revenues, operating strategies, corporate structure, sales and marketing procedures. Generally speaking, anything that has to do with the day to day functionality of the corporation can be said to be part of the business model.

Management writer Joan Magretta defines a business model as “the story that explains how an enterprise works”.

Afuah defines “A business model is the set of which activities a firm performs, how it performs them and when it performs them as it uses its resources to perform activities, given its industry, to create superior customer value (low cost or differentiated products) and put itself in a position to appropriate the value.”

A business model is an outline of specific processes, functions or activities a company uses to produce consumer goods and services in the business environment. Organizations typically create a business model to ensure they can produce goods and services in the most efficient and effective manner possible. Business models can offer benefits if companies properly implement and maintain a model. A good business model remains essential to every successful organization, whether it is a new venture or an established player.

3. Basic Components Of A Business Model

1) Determine the nature of your business or in what industry you intend to operate. For example, you might be interested in baking cookies, providing administrative services to the legal industry or manufacturing sports equipment.

2) Reaching customers. Research to determine if there are enough customers in your target market to allow you to be profitable. Be sure you know how you are going to find and reach them.

3) Differentiating your product. There is always competition, whether you realize it or not. You need to thoroughly understand the competition and effectively communicate the unique advantages of your product.

4) Pricing. Start by understanding how much customers' value what they are gaining from you, estimate your total costs, analyze the competitive landscape and then map out your long-term strategy.

5) Selling. Persuading customers to buy a product is one of the most important skills an entrepreneur must learn, you have to understand what it takes to close a deal and put together the necessary sales process.

6) Delivery/Distribution.

Your products need to be designed and packaged for the channel through which they will be distributed to customers. Evaluate your own expertise and interest then build this into your business model.

7) Supporting Customers.

Educate customers how to use your product, ensure that you can deal with defects and returns, answer product questions and incorporate valuable suggestions for improvement. Provide consulting services to help customers integrate and implement your products.

8) Achieving customer satisfaction.

The ultimate success or failure of a business depends on how much it helps customers achieve their objectives. Happy customers will become your best sales people .Unhappy customers will become your biggest liability.

9) Write out your business model.

This should be a short phrase, such as "franchise" or "razors and blades." Then describe how your company will follow this business model. It should include your customers, your product or service, how you intend to deliver, your strategy for growth and the qualitative aspects of doing your business. All the pieces have to come together like a jigsaw puzzle in your business model.

4. Business Model Concepts

Many scientific authors split a business model in partial models to approach single elements of a business model. Wirtz 2001 describes an integrated business model consisting of the sub-models: value proposition model, value creation model, procurement model, market model, capital model and distribution model. The sub-models are subdivided where applicable.

4.1. Business Model according to Wirtz 2001

Source: http://www.itbusinessmodels.org/?q=content/about-business-models

 Value Proposition Model: A value proposition is based upon the Demander-Model. The goal is to create a customer-specific value proposition to reach the optimal demand-offering-combination. It can be seen from a customer’s perspective and is often reduced to an offering via a product or service. Anders Sundelin defines the value proposition as "how value is bundled and offered to potential value recipients". Value-bundles might relate to reduced costs, access to exclusive information, providing jobs etc.

- Value Creation Model: The value creation model is described as the combination of goods and services to create a value proposition. The main interest lies in the economic relations rather than in the technical value creation.
- Procurement Model: The procurement model specifies the type and amount of resources and where to buy them. This model also depends on the structure of the supplier-market and how they compete with each other
- Market Model: A market model defines the actors and structure of the surrounding markets of the company. Wirtz differentiates between demanders and competitors in this segment. This demand-model aims at providing the basis for doing market-segmentation to create an appropriate marketing mix.
- Capital Model: This model provides information about the financial resources of a company. This includes two sub-models.

The Financing-Model which specifies the sources of capital for the value creation (e.g. venture capital funding) whereas the Receipt-Model gives an overview about the different sources of receipt.

- Distribution-Model: The Distribution-Model provides information about the distribution channels. Whereas tangible goods require physical shipments, intangible goods and services can be distinguished between online and offline distribution.

5. Defining Your Business Model

Developing the right product is hard, but what is harder is building a good business model. It is simply the nuts and bolts of how a business plans to generate revenue and profits. It details the long-term strategy and day-to-day operations. A business model is not something you build from the ground up. When management-types ask about a business model — as in, "So what's your business model?" they really want an answer to a much more direct and basic question: "How do you plan to make money?"

Behind that question is a lineup of other questions:

- Who is your target customer?
- What customer problem or challenge do you solve?
- What value do you deliver?
- How will you reach, acquire and keep customers?
- How will you define and differentiate your offering?
- How will you generate revenue?
- What is your cost structure?
- What is your profit margin?

With the answers to these questions, you will be able to gain a better understanding of how to structure your business model. In addition, it may be also helpful to research other businesses that are similar to yours and see how they have structured their operations. This will help you choose the right business model for your business and also suggest avenues you can take to differentiate your business from other competitors.

Some business models are as old as the marketplace itself; others are as new as the Internet. Some have weathered the test of time; others are almost experimental. The simplest model involves creating a product and selling it directly to customers. Other models involve selling wholesale to retailers, selling through distributors, licensing products to other companies, selling online, selling through auctions and countless other alternatives. No one-size-fits-all solution exists. In fact, most companies use some combination of business models to arrive at a unique model. It is often used to explain the business and its activities to investors, banks or employees.

6. Some Well-Known Business Models

The following are some examples of business models that are used by various businesses. The list is by no means exhaustive (business models evolve constantly).

- Advertising model

The advertising model became popular with the growth of radio and TV where the TV stations earned revenue indirectly from people looking to promote services to the audience they attracted, rather than the consumers paying radio and TV stations for the consumption of their TV programmes, here the person receiving the value is not the one paying the revenues. Broadcast television is perhaps the best example. TV is free, but advertising pays for delivery. The advertising business model has become more sophisticated as the world has transitioned from print to online. An advertising business model is sometimes combined with a crowdsourcing model where you get your content for free from users instead of paying content creators to develop content.

Advertising business model examples CBS, The New York Times, YouTube

- Crowdsourcing

If you can bring together a large number of people to contribute content to your site, then you are crowdsourcing. Crowdsourcing business models are most frequently paired with advertising models to generate revenue, but there are many other iterations of the model. Threadless, for example, lets designers submit t-shirt designs and gives the designers a percentage of sales. Companies that are trying to solve difficult problems often publish their problems openly for anyone to try and solve. Successful solutions get rewards and the company can then grow its business. The key to a successful crowdsourcing business is providing the right rewards to entice the “crowd” while also enabling you to build a viable business.

Crowdsourcing business model examples Kickstarter, Patreon

- The Affiliate model

An affiliate is simply someone who helps sell a product in return for commission. However they may never actually take ownership of the product (or even handle it). They simply get rewarded for referring customers to a retailer when they make a sale. Again this business model has been a huge success given the ease with which the Internet facilitates it. The affiliate model uses links embedded in content instead of visual advertisements that are easily identifiable. For example, if you run a book review website, you could embed affiliate links to Amazon within your reviews that allow people to buy the book you are reviewing. Amazon will pay you a small commission for every sale that you refer to them.

Affiliate business model examples TheWireCutter.com, TopTenReviews.com

- Brokerage

Brokerage businesses connect buyers and sellers and help facilitate a transaction. They charge a fee for each transaction to either the buyer or the seller and sometimes both. One of the most common brokerage businesses is a real estate agency, but there are many other types of brokerages such as freight brokers and brokers who help construction companies find buyers for scrap that they excavate from new foundations.

Brokerage business model examples ReMax, RoadRunner Transportation Systems

- Bundling model

The bundling business model involves companies selling two or more products together as a single unit, often for a lower price than they would charge selling the products separately. This type of business model allows companies to generate a greater volume of sales and perhaps market products or services that are more difficult to sell. However, profit margins often shrink since businesses sell the products for less.

Examples: Businesses that use the bundling model include Adobe Creative Suite and Burger King, as well as other fast-food companies that offer value meals or deals.

- The Bait and Hook model

This is essentially the razor blade analogy, where disproportionate amounts of the value are captured on components, refills and the like. The mobile phone business also grew rapidly on the back of this model as handsets were often supplied free of charge when you signed up for a contract. The philosophy behind this business model is very simple, first lure in customers for something at cheap or free price and once they are hooked then start charging for that product or its accessories.

Examples: A time management consultant offering a training program including day planners that must be re-ordered; a web designer providing proprietary modules under a license that must be renewed annually.

- The Franchise model

Opening a franchise is essentially buying a working business model in a particular industry. For the franchisor, the franchise is an alternative to building 'chain stores' to distribute goods and avoid investment and liability over a chain. The franchisee pays royalties for the privilege and gets access to a winning recipe, a support network and an established brand. Some franchise business models are McDonald’s, VLCC, Shahnaz Hussein, Biotique and Habibs, and Pizza Hut.

- The Freemium model

Freemium is not the same as a free trial where customers only get access to a product or service for a limited period of time. Instead, freemium models allow for unlimited use of basic features for free and only charge customers who want access to more advanced functionality. Freemium is based on the concept of versioning an offering of the business where the basic free version is used as lowest possible barrier of adoption of the offering by the end-customer and hence create a large customer base for the business; and convert a part of this customer-base into paying customers who are willing to pay the premium for advanced special version of the offering.

In process, the paying premium customers cross-subsidize the free customers and form the core revenue stream of the business required to cover the cost of acquiring and servicing both free and premium customers. Many of these offerings have similar cost structures where the marginal cost of serving an additional customer tends towards zero. The core free offering then acts as a gateway to the paid service.

Freemium business model examples MailChimp, Evernote, LinkedIn

- The Pay as You Go model

With this model actual usage is metered and you pay on the basis of what you consume. Instead of pre-purchasing a certain amount of something, such as electricity or cell phone minutes, customers get charged for actual usage at the end of a billing period. Some mobile phone contracts operate on this basis i.e. the user can buy a phone card which gives them credit. Each call is metered and the credit is reduced as the ‘minutes’ are consumed (in contrast to subscription models where you pay a monthly fee for calls).

- Subscription Model

Subscription business models are becoming more and more common. In this business model, consumers get charged a subscription fee to get access to a service. The aim is to secure the customer on a long term contract so that they are consuming your product or service well into the future. Given that the cost of customer acquisition can be high, retaining customers is a primary goal for most businesses. While magazine and newspaper subscriptions have been around for a long time, the model has now spread to software and online services and is even showing up in service industries. Subscription business model examples Netflix, Salesforce, Comcast

Spotify is a music streaming platform that gives users access to a large catalog of music. It uses a freemium revenue model that offers a basic, limited, ad-supported service for free and an unlimited premium service for a subscription fee. Its main revenue source comes from users upgrading to a premium subscription.

- Bricks and Clicks Business Model

Business model by which a company integrates both offline (bricks) and online (clicks) presences. One example of the bricks-and-clicks model is when a chain of stores allows the user to order products online, but lets them pick up their order at a local store. For example, an electronics store may allow the user to order online, but pick up their order immediately at a local store. Conversely, a furniture store may have displays at a local store from which a customer can order an item electronically for delivery.

- No Frills Business Model

The term no frills are used to describe a service were the non-essential features are removed to reduce costs and pass on the saving to the customers. Most common example of a no frills service is the introduction of low cost airlines. No frill airlines operate with a single economy class and save money by not printing tickets instead issuing customers a reference number to use at check in. Complimentary drinks are not served on board, instead a paid for trolley service is provided. Thus making it possible to offer faultless service at a reduced price by removing unnecessary extras.

Example Jet Airways launched a new all-economy, low-cost service, Jet Konnect.

- Razor blade

The razor blade business model is named after the product that essentially invented the model: sell a durable product below cost to increase volume sales of a high-margin, disposable component of that product. This is why razor blade companies practically give away the razor handle, assuming that you'll continue to buy a large volume of blades over the long term. The goal is to tie a customer into a system, ensuring that there are many additional, ongoing purchases over time.

Razorblade business model examples Gillette, Inkjet printers, Xbox, Amazon's Kindle

- Reverse razor blade

Flipping the razor blade model around, you can offer a high-margin product and promote sales of a low-margin companion product. Similar to the razor blade model, customers are often choosing to join an ecosystem of products. But, unlike the razor blade model, the initial purchase is the big sale where a company makes most of its money. The add-ons are just there to keep customers using the initially expensive product.

- Concierge/customization

Some businesses take existing products or services and add a custom element to the transaction that makes every sale unique for the given customer. For example, custom travel agents who book trips and experiences for wealthy clients. You can also find customization happening at a larger scale with products like Nike's custom sneakers.

Customization business model examples NIKEiD, Journy

- Disintermediation

If you want to make and sell something in stores, you typically work through a series of middlemen to get your product from the factory to the store shelf. Disintermediation is when you sidestep everyone in the supply chain and sell directly to consumers, allowing you to potentially lower costs to your customers and have a direct relationship with them as well.

Disintermediation business model examples Casper, Dell, Apple

- Leasing

Leasing might seem similar to fractionalization, but they are actually very different. In fractionalization, you are selling perpetual access to part of something. Leasing, on the other hand, is like renting. At the end of a lease agreement, a customer needs to return the product that they were renting from you. Leasing is most commonly used for high-priced products where customers may not be able to afford a full purchase but could instead afford to rent the product for a while.

Leasing business model examples Cars, DirectCapital

7. CEO's Role in Business Model Reinvention

Why do established corporations struggle to find the next big thing before new competitors do? The simple explanation is that many companies become too focused on executing today's business model and forget that business models are perishable. Success today does not guarantee success tomorrow.

Transform Your Organization with the Three-Box Approach

To assess your company's vulnerability, try this diagnostic method: On separate index sheet, write down all the important initiatives undertaken in your organization. Then make three boxes and label them

"Box 1: Manage the Present,"

"Box 2: Selectively Forget the Past," and

"Box 3: Create the Future."

Then, imagine your industry in the next five, ten or even twenty years, as far as you can reasonably foresee. Consider all the factors of change your industry faces-technology, customer demographics, regulation, globalization and so on. Keeping those forces in mind put your organization's initiatives in the appropriate boxes:

Those intended to improve today's business performance in Box 1.

Those aimed at stopping some underperforming products and services, obsolete policies and practices, outdated assumptions and mind-sets in Box 2. And

Those that prepare your organization for the long term in Box 3.

For companies to endure, they must get the forces of preservation (box 1), destruction (box 2), and creation (box 3) in the right balance. Striking that balance is the CEO's most important task, but most companies favor box 1. Forces of preservation reign supreme. Forces of destruction and creation are overshadowed, outmatched and out of luck.

To win both today and tomorrow. CEO's must function in all the three boxes simultaneously and understand that boxes two and three are not about what business will be doing in future , next ten-twenty years but it is about the preparation of what they must do today, it is a matter of balancing resources across the three boxes. The CEO must know exactly what to destroy and what to create.

8. Conclusion

With all of these different types of business models, how do you choose the right one for your small business? At the end of the day, there is no absolute answer to this question Not all business models work equally well, of course; good ones share certain characteristics, like - Those being aligned with the Companies Goal. Should be self reinforcing and Must be Robust. A good business model should be able to sustain its effectiveness over time by defending the threats like Imitation of the business model and Substitution of the product/services which can decrease the value the customer perceives. However most of the companies create and evaluate business models in isolation, without considering how they will interact with the rivals' business models. This narrow approach leads to failures. Making a right choice, companies can strengthen their Business Models. Virtuous cycles weaken competitor's virtuous cycle and turn competitors into complimentary players. This is not a strategy or a tactics but using models to gain competitive advantage, by putting the time and effort into outlining your business model, you take the necessary steps to set your business up for growth and success in the future.

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