LOG206: E-Business

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Notes

Module 2: Business models for e-commerce

Business model

One of the major characteristics of digital technologies is that they facilitate the creation of new business models. Business models refers to the logic of the company—how it creates, delivers and captures value in a marketplace. That is, a set of planned business elements designed to result in profit in a marketplace. In other words, it is "the story that explains how an enterprise works". A good business model answers the following questions:

- Who is the customer?
- What does the customer value?
- How do we make money in this business?
- How can we deliver value to customers efficiently?

> **Business model** refers to the logic of the company—how it creates, delivers and captures value in a marketplace processes with online and traditional

Different companies have different Business models. Some are simple and others are complex. A good business model remains essential to every successful organization, whether it's a new venture or an established player. The irony about the concept of business models is that when used correctly, it actually forces managers to think rigorously about their businesses.

Business model canvas

The business model canvas — as opposed to the traditional, intricate business plan — helps organizations conduct structured, tangible, and strategic conversations around new businesses or existing ones. Leading global companies like GE, P&G, and Nestlé use the canvas to manage strategy or create new growth engines, while start-ups use it in their search for the right business model. The canvas's main objective is to help companies move beyond product-centric thinking and towards business model thinking. As a planning tool, a business model canvas focuses attention on how all the elements of the system fit into a working whole.

The nine building blocks of business model canvas

Business model canvas is comprised of 9 building blocks. The 9 building blocks represent different components, players and functional correlation among these. Each of these nine components contains a series of hypotheses about your business model that you need to test.

When managers operate consciously from a model of how the entire business system will work, every decision, initiative, and measurement provides valuable feedback. The buildings blocks are:

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. 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

Key question for this block is "who do you sell to, who do you help?" That is:

- What groups of customers are you providing value for?
- What are your customers' characteristics and personas?
- How would you describe your different customer groups?

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 innovation. Others may be similar to existing market offers, but with added features and attributes.
Key question for this block is "what are your promises to your customers?" That is:

- What problems do your customers have and how are you solving them?
- How does your product or service meet the needs of your customers?
- What value do you deliver to your customer segments?
- What do you offer that is unique, and why will your customers prefer your solutions to alternatives that might be available?

Value proposition canvas

Value proposition canvas is a simple tool that quickly gets you to the 'minimum viable clarity' required to start building and testing. It includes elements from behavioural psychology and design thinking. It has three main parts as explained below.

Product profile

This part considers three elements, namely product features, benefits and experience. Each is explained herein below.

Features – A feature is a factual description of how your product works. The features are the functioning attributes of your product. The features also provide the 'reasons to believe'.

Benefits – A benefit is what your product does for the customer. The benefits are the ways that the features make your customer's life easier by increasing pleasure or decreasing pain. The benefits of your product are the core of your value proposition. The best way to list out the benefits of your product is to imagine all the ways that your product makes your customer's life better.

Experience – The product experience is the way that owning your product makes the customer feel. It's the sum total of the combined features and benefits. Product experience is different to features and benefits because it's more about the emotional reasons why people buy your product. The product experience is the kernel that will help identify the market positioning and brand essence that is usually built out of the value proposition.

Customer profile

The customer section draws on nuero-lingusitic programming and psychology research into motivation. It includes:

Wants – The emotional drivers of decision making are things that we want to be, do or have. Our wants are usually conscious (but aspirational) thoughts about how we'd like to improve our lives. They sometimes seem like daydreams but they can be powerful motivators of action. The wants speak more to the pull of our hearts and our emotions. I may need a car to get from A to B, but I want a BMW.

Needs – The customer's needs are the rational things that the customer needs to get done. Interestingly, needs are not always conscious. Customers can have needs that they may not know about yet. Designers call these "latent needs". The best example is that none of us knew that we needed a portable music player until we saw an iPod for the first time (we also then suddenly wanted an iPod rather than any other perfectly good music player). The needs speak more to the pull of our heads and rational motivations.

Fears – The dark side of making a decision is that it carries fear. Fear of making a mistake, fear of missing out, fear of loss and dozens of other related fears. Fears can be a strong driver of purchasing behaviour and can be the hidden source of wants and needs. Customer fears are often the secret reason that no one is buying your widget. For any product there is a secret "pain of switching“. Even if your product is better than the competition, it might not be a big enough improvement to overcome the inertia of the status quo.

Substitutes

Substitutes – These aren’t the obvious competitors, instead look for the existing coping behaviours. This is on the canvas because it forces us to recognise that our customers are real people with daily lives who have made it this far in life without our product. No matter how much better your product is than the competition, if it isn’t better than the existing solutions then you don’t have a real world value proposition.

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 touch points that play an important 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

Key question for this block is “how do you reach your customers?” That is:

- What are the most effective methods to reach your customers?
- What are the channels you use to communicate, sell and service your customers?
- How do you manage the customer journey from awareness raising to completing a sale?

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 establish with each Customer Segment. Relationships can range from personal to automated. Customer relationships may be driven by the following motivations:

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

In the early days, for example, mobile network operator Customer Relationships were driven by aggressive acquisition strategies involving free mobile phones. When the market became saturated, operators switched to focusing on customer retention and increasing average revenue per customer. The Customer Relationships called for by a company’s business model deeply influence the overall customer experience.

Key question for this block is “how do you interact with your customers?” That is:

- How will communicate with your customers (face-to-face or remotely)?
- How will you manage customer acquisition, convincing your customers to select your products or services over that of others available?
- Can you retain customers and how will you do this?
- Can you offer added value and upsell to your customers?

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 truly 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.
A business model can involve two different types of Revenue Streams:

- Transaction revenues resulting from one-time customer payments
- Recurring revenues resulting from ongoing payments to either deliver a Value Proposition to customers or provide post-purchase customer support

Key question for this block is “how much income will your customers generate?” That is:

- What sources of income do you have?
- What’s your pricing strategy?
- Do different customer segments generate different levels of income?
- Do you have a mix of customer segments that drive different revenues for your business?

6. Key Resources

The Key Resources Building Block describes the most important assets required to make a business model work. Every business model requires Key Resources. These resources allow an enterprise to create and deliver 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.

Key question for this block is “what resources do you need to create and deliver your value proposition?” That is:

- What physical resources will you need now and in the future?
- Which digital assets do you need?
- What human resources do you need now and in the future?

- What financial resources will you need? This might include lines of credit, working capital, and access to finance?

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.

Key question for this block is "what tasks are key to the success of your business?" That is:

- What are the key actions and activities that will enable you to deliver your value proposition?
- What processes will ensure your business runs efficiently?
- How will you manage research and development, production, marketing, sales, customer service, finance and administration?

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:

- Strategic alliances between non-competitors
- Coopetition: strategic partnerships between competitors
- Joint ventures to develop new businesses
- Buyer-supplier relationships to assure reliable supplies

Key question for this block is "what partnership are critical to your business?" That is:

- Who are your key partners, suppliers or collaborators?
- What key activities do they perform?
- What key resources do they provide/deliver?
- How will you manage these relationships?

9. Cost Structure

The Cost Structure describes all costs incurred to operate a business. This building block describes the most important 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.

Key question for this block is “what will it cost to launch and maintain your business?” That is:

- What costs will you incur at each stage of the business; for example creating marketing collateral, acquiring users/customers, building a team, managing partnerships, fulfilling distribution?
- Which key activities represent the biggest cost to your business?
- Are these costs fixed or variable?
- What economies of scale can you hope to achieve?

Two tests for business model for feasibility

A successful business must be viable and feasible. Considering our definition of BMs as creating, delivering and capturing value, a viable BM provides benefits for both the customer and provider of a product or service. Feasibility relates to the question if a BM can actually be implemented and deployed in practice. To be viable and feasible a business model must pass two tests: the narrative test and the numbers test.

1. The narrative test

The business model tells a logical story explaining who your customers are, what they value, and how you will make money providing them that value. The story’s plot may turn on one of two links in the generic business value chain:

- making something that satisfies an unmet need; for example LinkedIn enables professionals to build and manage their identities; create and leverage their professional networks; and gain the knowledge they need to be more successful in their careers, across multiple screens and devices"

- selling something in innovative ways; for example Kolonial.no and other online grocers allow individuals and businesses to buy groceries and grocery products online

- Example of a company that failed the narrative test: Priceline Webhouse Club

2. **The numbers test (the P&L doesn't add up)**

The business model's story must tie assumptions about customers to sound economics – the revenues obtained must justify the costs involved. For example currently almost all Norwegian online grocery companies are not making profit. Two reasons are critical: firstly, the number of consumers buying groceries online in Norway has not reached the critical mass. Secondly, the grocery industry has very thin margins. As such, the revenues obtained by e-grocers can hardly cover the marketing, technology and delivery costs. The future of e-grocers in Norway depends largely on change of customers habits in favour of purchasing groceries online and reduction in marketing, technology and delivery costs.

Critical mass means adequate number of users that makes a service economically viable

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