Chapter 6

Developing an Effective Business Model

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Chapter Objectives
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1. Describe a business model.
2. Explain business model innovation.
3. Discuss the importance of having a clearly articulated business model.
4. Discuss the concept of the value chain.
5. Identify a business model’s two potential fatal flaws.

Chapter Objectives
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6. Identify a business model’s four major components.
7. Explain the meaning of the term business concept blind spot.
8. Define the term core competency and describe its importance.
9. Explain the concept of supply chain management.
10. Explain the concept of fulfillment and support.

What is a Business Model?

- Model
  - A model is a plan or diagram that’s used to make or describe something.
- Business Model
  - A firm’s business model is its plan or diagram for how it competes, uses its resources, structures its relationships, interfaces with customers, and creates value to sustain itself on the basis of the profits it generates.
  - The term “business model” is used to include all the activities that define how a firm competes in the marketplace.

Dell’s Business Model
1 of 2

- Beyond Its Own Boundaries
  - It’s important to understand that a firm’s business model takes it beyond its own boundaries.
  - Almost all firms partner with others to make their business models work.
  - In Dell’s case, it needs the cooperation of its suppliers, customers, and many others to make its business model work.

Dell’s Business Model
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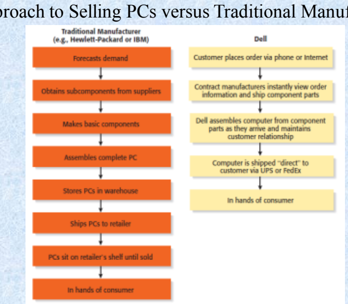
Dell’s Approach to Selling PCs versus Traditional Manufacturers



The Importance of Business Models

Having a clearly articulated business model is important because it does the following:

- Serves as an ongoing extension of feasibility analysis. A business model continually asks the question, “Does this business make sense?”
- Focuses attention on how all the elements of a business fit together and constitute a working whole.
- Describes why the network of participants needed to make a business idea viable are willing to work together.
- Articulates a company’s core logic to all stakeholders, including the firm’s employees.

Diversity of Business Models

Diversity or Variety in Business Models

- There is no standard business model for an industry or for a target market within an industry.
- However, over time, the most successful business models in an industry predominate.
- There are always opportunities for business model innovation.

How Business Models Emerge
1 of 3

- The Value Chain
  - The value chain is the string of activities that moves a product from the raw material stage, through manufacturing and distribution, and ultimately to the end user.
  - By studying a product’s or service’s value chain, an organization can identify ways to create additional value and assess whether it has the means to do so.
  - Value chain analysis is also helpful in identifying opportunities for new businesses and in understanding how business models emerge.

How Business Models Emerge
2 of 3

The Value Chain

How Business Models Emerge
3 of 3

- The Value Chain (continued)
  - Entrepreneurs look at the value chain of a product or a service to pinpoint where the value chain can be made more effective or to spot where additional “value” can be added.
  - This type of analysis may focus on:
    - A single primary activity such as marketing and sales.
    - The interface between one stage of the value chain and another, such as the interface between operations and outgoing logistics.
    - One of the support activities, such as human resource management.

Potential Fatal Flaws in Business Models

- Fatal Flaws
  - Two fatal flaws can render a business model untenable from the beginning:
    - A complete misread of the customer
    - Utterly unsound economics

Components of a Business Model

Four Components of a Business Model

Core Strategy	Strategic Resources	Partnership Network	Customer Interface
• Business mission • Product/market scope • Basis for differentiation	• Core competencies • Strategic assets	• Suppliers • Partners • Other key relationships	• Target customer • Fulfillment and support • Pricing structure

Core Strategy
1 of 3

- Core Strategy
  - The first component of a business model is the core strategy, which describes how a firm competes relative to its competitors.
- Primary Elements of Core Strategy
  - Mission statement
  - Product/market scope
  - Basis for differentiation

Core Strategy
2 of 3

Primary Elements of Core Strategy

Mission Statement	A firm's mission, or mission statement, describes why it exists and what its business model is supposed to accomplish.
Product/Market Scope	A company's product/market scope defines the products and markets on which it will concentrate.

Core Strategy
3 of 3

Primary Elements of Core Strategy

Basis of Differentiation	It is important that a new venture differentiate itself from its competitors in some way that is important to its customers. If a new firm's products or services aren't different from those of its competitors, why should anyone try them?

Strategic Resources
1 of 3

- Strategic Resources
  - A firm is not able to implement a strategy without resources, so the resources a firm has affect its business model substantially.
    - For a new venture, its strategic resources may initially be limited to the competencies of its founders, the opportunity they have identified, and the unique way they plan to serve their market.
  - The two most important strategic resources are:
    - A firm's core competencies
    - Strategic assets

Strategic Resources
2 of 3

Primary Elements of Strategic Resources

Core Competencies	A core competency is a resource or capability that serves as a source of a firm's competitive advantage. Examples include Sony's competence in miniaturization and Dell's competence in supply chain management.
Strategic Assets	Strategic assets are anything rare and valuable that a firm owns. They include plant and equipment, location, brands, patents, customer data, a highly qualified staff, and distinctive partnerships.

Strategic Resources
3 of 3

- Importance of Strategic Resources
  - New ventures ultimately try to combine their core competencies and strategic assets to create a sustainable competitive advantage.
  - This factor is one that investors pay close attention to when evaluating a business.
  - A sustainable competitive advantage is achieved by implementing a value-creating strategy that is unique and not easy to imitate.
  - This type of advantage is achievable when a firm has strategic resources and the ability to use them.

Partnership Network
1 of 3

- Partnership Network
  - A firm's partnership network is the third component of a business model. New ventures, in particular, typically do not have the resources to perform key roles.
  - In most cases, a business does not want to do everything itself because the majority of tasks needed to build a product or deliver a service are not core to a company's competitive advantage.
  - A firm's partnership network includes:
    - Suppliers
    - Other key relationships

Partnership Network
2 of 3

Primary Elements of Partnership Network

Suppliers	A supplier is a company that provides parts or services to another company. Intel is Dell's primary suppler for computer chips, for example.
Other Key Relationships	Firms partner with other companies to make their business models work. An entrepreneur's ability to launch a firm that achieves a competitive advantage may hinge as much on the skills of the partners as on the skills within the firm itself.

Partnership Network
3 of 3

The Most Common Types of Business Partnerships

Table 6.4 The Most Common Types of Business Partnerships

Partnership Form	Description
Joint venture	An entity created by two or more firms pooling a portion of their resources to create a separate, jointly owned organization
Network	A hub-and-wheel configuration with a local firm at the hub organizing the interdependencies of a complex array of firms
Consortia	A group of organizations with similar needs that band together to create a new entity to address those needs
Strategic alliance	An arrangement between two or more firms that establishes an exchange relationship but has no joint ownership involved
Trade associations	Organizations (typically nonprofit) that are formed by firms in the same industry to collect and disseminate trade information, offer legal and technical advice, furnish industry-related training, and provide a platform for collective lobbying

Customer Interface
1 of 3

- Customer Interface
  - The way a firm interacts with its customer hinges on how it chooses to compete.
    - For example, Amazon.com sells books over the Internet while Barnes & Noble sells through its traditional bookstores and online.
  - The three elements of a company's customer interface are:
    - Target customer
    - Fulfillment and support
    - Pricing model

Customer Interface
2 of 3

Primary Elements of Customer Interface

Target Market	A firm's target market is the limited group of individuals or businesses that it goes after or tries to appeal to.
Fulfillment and Support	Fulfillment and support describes the way a firm's product or service reaches its customers. It also refers to the channels a company uses and what level of customer support it provides.

Customer Interface

3 of 3

Primary Elements of Customer Interface

Pricing Structure	The third element of a company's customer interface is its pricing structure. Pricing models vary, depending on a firm's target market and its pricing philosophy.

Recap: The Importance of Business Models

- Business Models
  - It is very useful for a new venture to look at itself in a holistic manner and understand that it must construct an effective "business model" to be successful.
  - Everyone that does business with a firm, from its customers to its partners, does so on a voluntary basis. As a result, a firm must motivate its customers and its partners to play along.
  - Close attention to each of the primary elements of a firm's business model is essential for a new venture's success.