

## Chapter 8

# Business Model Analysis



# Ch8. Business Model Analysis

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# Ch8. Business Model Analysis

## Short Description

- Business model analysis (BMA) provides the tools to quantify the relative strength of an organization's business model to generate economic rents from a product or service.
- Elements include:
  - the value proposition in the positions it adopts.
  - the market segments it chooses to serve or avoid.
  - its value chain and the resulting costs.
  - its revenue model and the resulting profit potential.
  - its position and strength in the larger upstream and downstream value network including competitors and complementors.
  - its competitive strategy/competitive advantage.



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## Background

- Business models have been since people first traded goods.
- Evolved from 'single-celled' shopkeeper model to 'multi-celled' organisms.
- Other innovations include:
  - 1950's McDonald's 'Speedy Service System'
  - 1960's Wal-Mart's branded quality products in small towns
  - 1970's 'category killers' Exp. Toy-R-Us
  - 1980's Dell's direct-to-market custom products
  - 1990's e-tailing Exp. Amazon and E-bay
  - Newest: VOIP threatening traditional phone line providers



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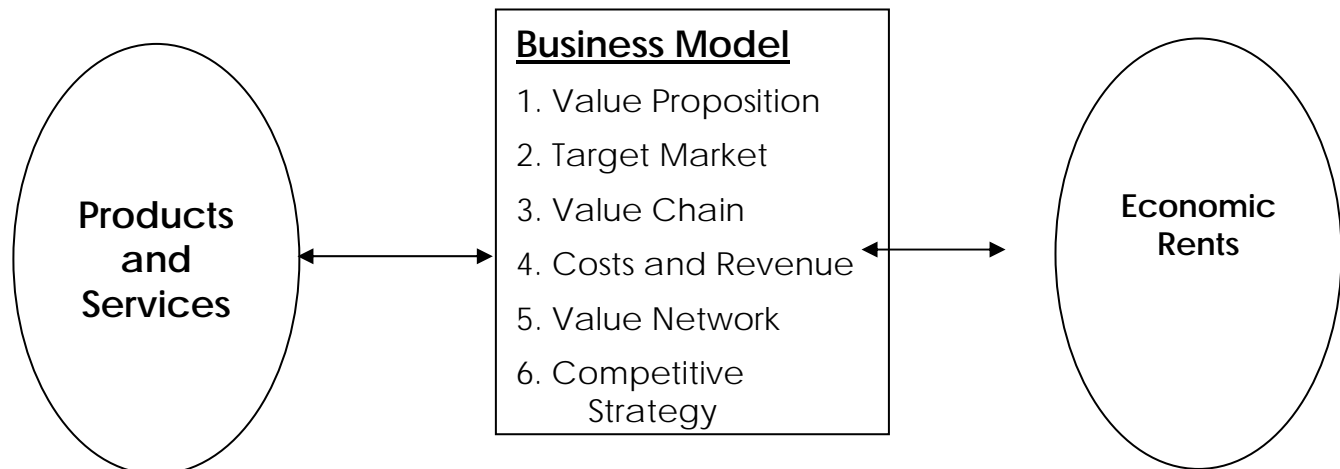
## Strategic Rationale and Implications

- There is no real consensus of what a business model and its components are.
- The purpose of every business is to satisfy a customer's need.
- A superior business model will allow the firm to maintain or gain a leadership position in its industry while an inferior model can spell disaster.
- **Analysis can answer the questions:**
  - Does the firm have a temporary or sustainable competitive advantage?
  - Does the model lends itself to delivering factors critical to the firm's success?

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## Strategic Rationale and Implications

- Chesborough and Rosenbloom (2002) proposed the definition of a business model as a link between products, services, and economic rents earned by the firm.
- They propose that a business model incorporates the following six elements:



Source: Adapted from Chesborough and Rosenbloom (2002), "The role of the business model in capturing value from innovation: evidence from Xerox Corporation's technology spin-off companies", *Industrial and Corporate Change*, Volume 11, Number 3, pp 529-55.



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## Strategic Rationale and Implications

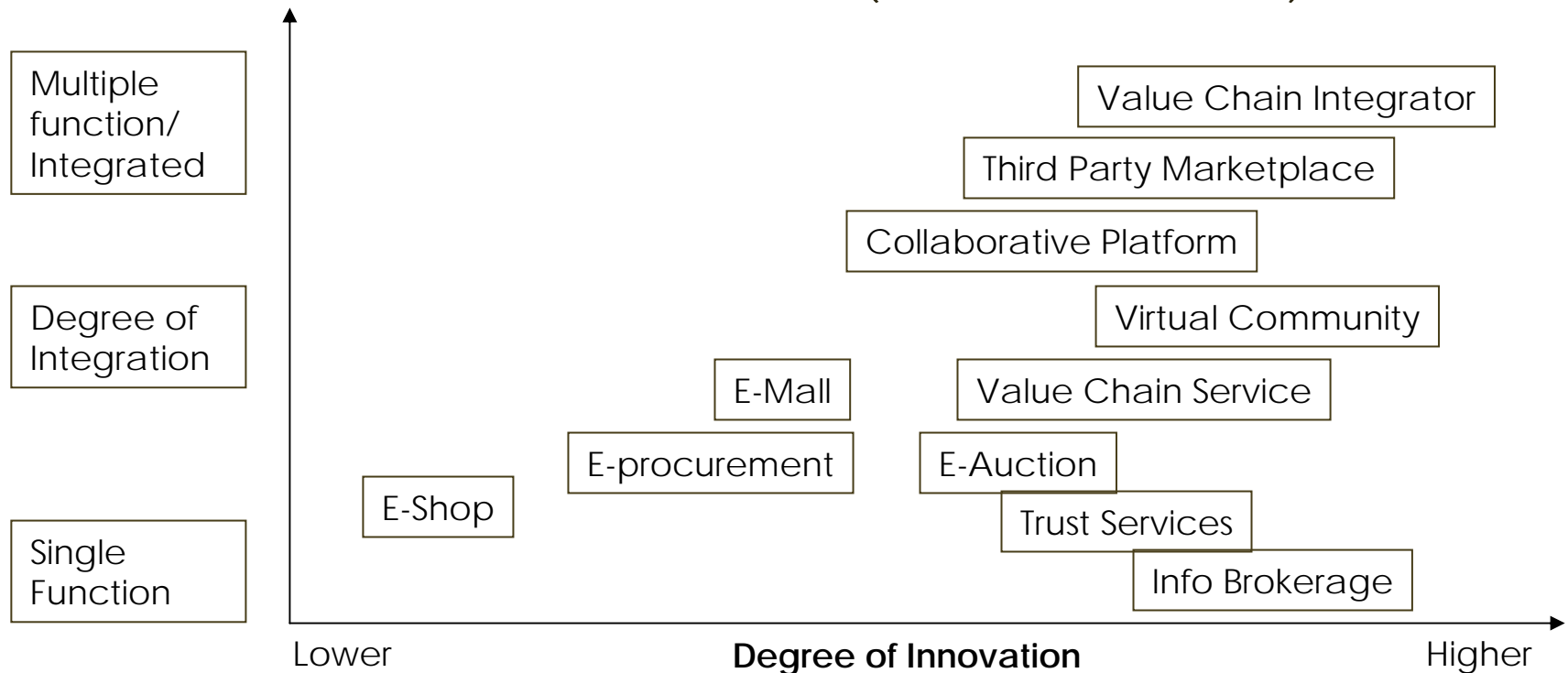
- Contrast Business Model and Strategy:

Business Model	Strategy
<ol style="list-style-type: none"><li>1. Focus on creating and capturing value.</li><li>2. Construct for converting product/service into economic value.</li><li>3. Requires knowledge of target market and value network.</li></ol>	<ol style="list-style-type: none"><li>1. Goes further to define how firm will create competitive advantage.</li><li>2. Considers how value will be delivered to shareholders.</li><li>3. Requires knowledge of broad environment firm operates in.</li></ol>

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## Strategic Rationale and Implications

- Classification of Business Models (Timmer's scheme)

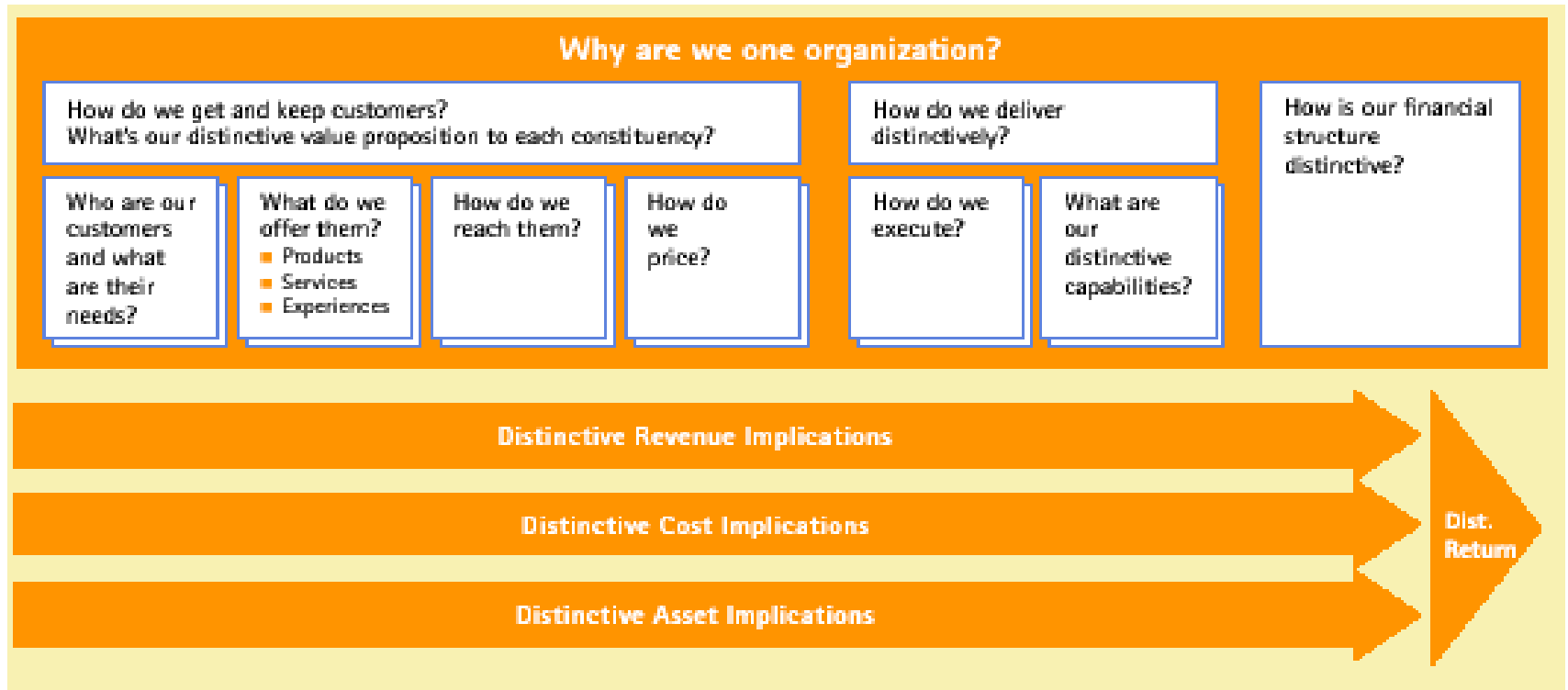




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## Strategic Rationale and Implications

- Classification of Business Models (Linder & Catrall's scheme)





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- **Strategic Rationale and Implications**
- BMA provides link between firm's prosperity, products & services.
- BMA provides a holistic framework to combine all the activities of the firm in the pursuit of competitive advantage.
- BMA can make it possible to deliver superior value propositions to the target market, and receive higher prices for the product or service delivered.
- The inability to adapt business models to changing competitive and macro-economic conditions can spell disaster for firms.
- For some firms new models must be created.



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## Strengths and Advantages

- BMA provides a comprehensive approach beyond strategic and operational effectiveness in describing why a firm is profitable or unprofitable.
- Allows a detailed understanding which makes it possible to modify part or all of a business model to create a competitive advantage.
- Delivers the ability to integrate the value delivery mechanism, charge superior prices which can lead to maximizing revenue and increased profitability.
- Can provide an impetus to innovate within the organization.



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## **Weaknesses and Limitations**

- Firms may become blind to rivals offering innovative solutions or to those companies that are not considered direct competitors.
- Technique will only be useful to a firm that has a market orientation.



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## Process for Applying the Technique

- **Step 1:** Articulate the Value Proposition
  - From the view of the customer and per segment.
  - May chose a low-cost, differentiated, or niche market.
- **Low-Cost Provider Strategy works best when:**
  - Price competition is especially vigorous,
  - Competitive products are essentially identical,
  - There are few ways to achieve product differentiation that are meaningful to buyers,
  - Buyers incur low switching costs, or
  - Where buyers are large and have significant power to bargain down prices.



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## Process for Applying the Technique

- **Step 1:** Articulate the Value Proposition Cont'd
- Differentiation allows a firm to command a premium price for its product and/or increase unit sales.
- Bases for differentiation that are difficult to imitate include:
  - **Brand name or reputation. (Coke)**
  - **Where the good or service is available, an extensive distribution network that makes the product widely available to customers.**
  - **Extreme positioning in levels of quality or delivery — a six-sigma or beyond level of quality.**



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## Process for Applying the Technique

- Many firms offer multiple products, services, or a combination.
- Are they operating in one business model or more?
  - Consider a bicycle shop, or GE.
- Consider value from customer's perspective.



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## Process for Applying the Technique

- **Step 2:** Specify the target segment
- Segments can be broken down by:
  - Psychographics, demographics, etc.
- Pursue a detailed analysis of each market segment.
  - Segment needs must be understood along with growth potential.
- Customer focus groups may be useful if needs are not understood.





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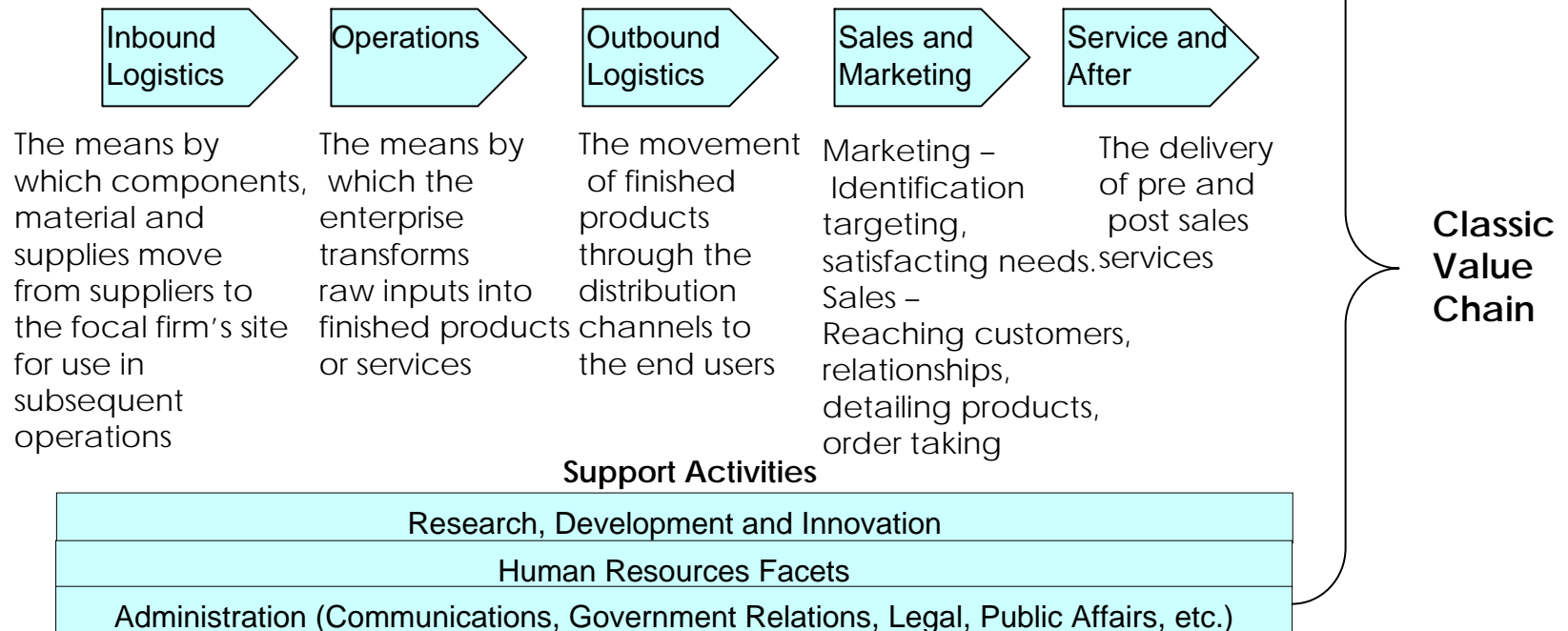
## Process for Applying the Technique

- **Step 3: Determine Competitors**
  - Firms serving the same customer segments, with the same product or service.
  - Firms that provide substitute products.
  - Companies that operate in niche markets.
  - Suppliers / customers that have forward or backward integration.
- Need to articulate the value propositions and the target markets of competitors.

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## Process for Applying the Technique

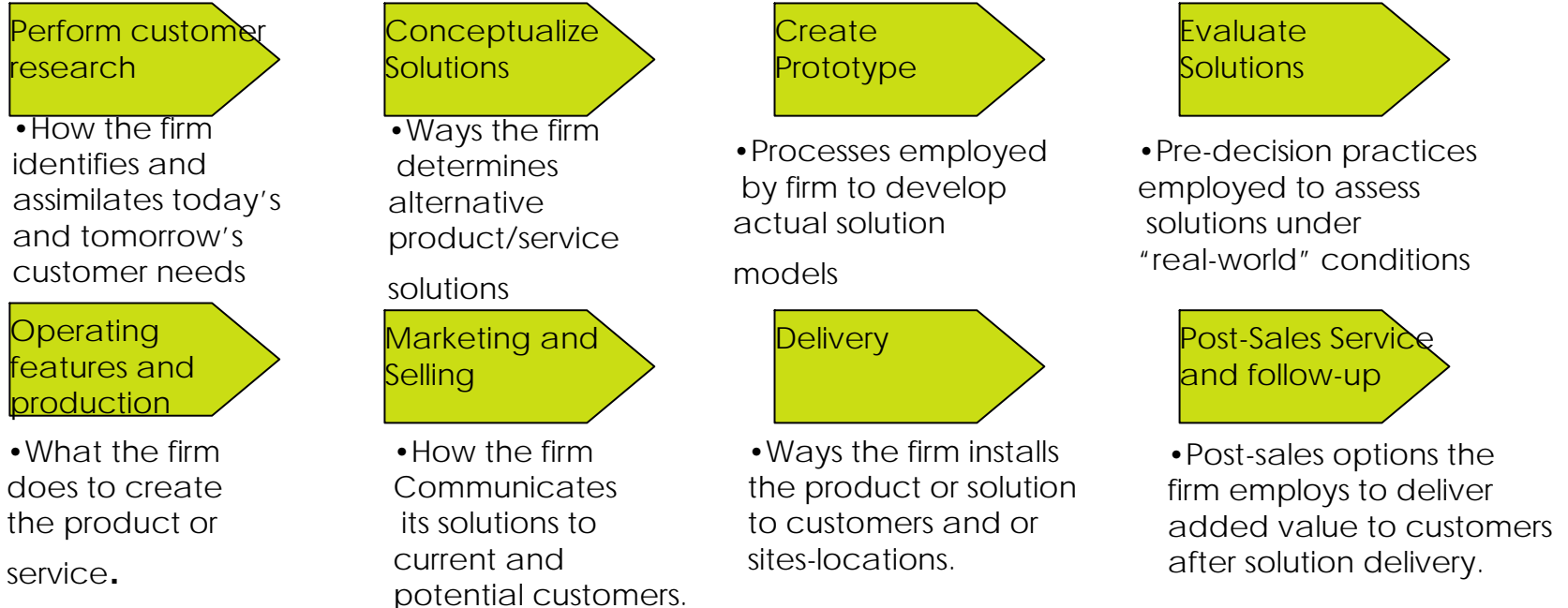
- Step 4: Evaluate Value Chain and Cost Model



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## Process for Applying the Technique

### • Step 4- Activity Value Chain is better suited for intangibles





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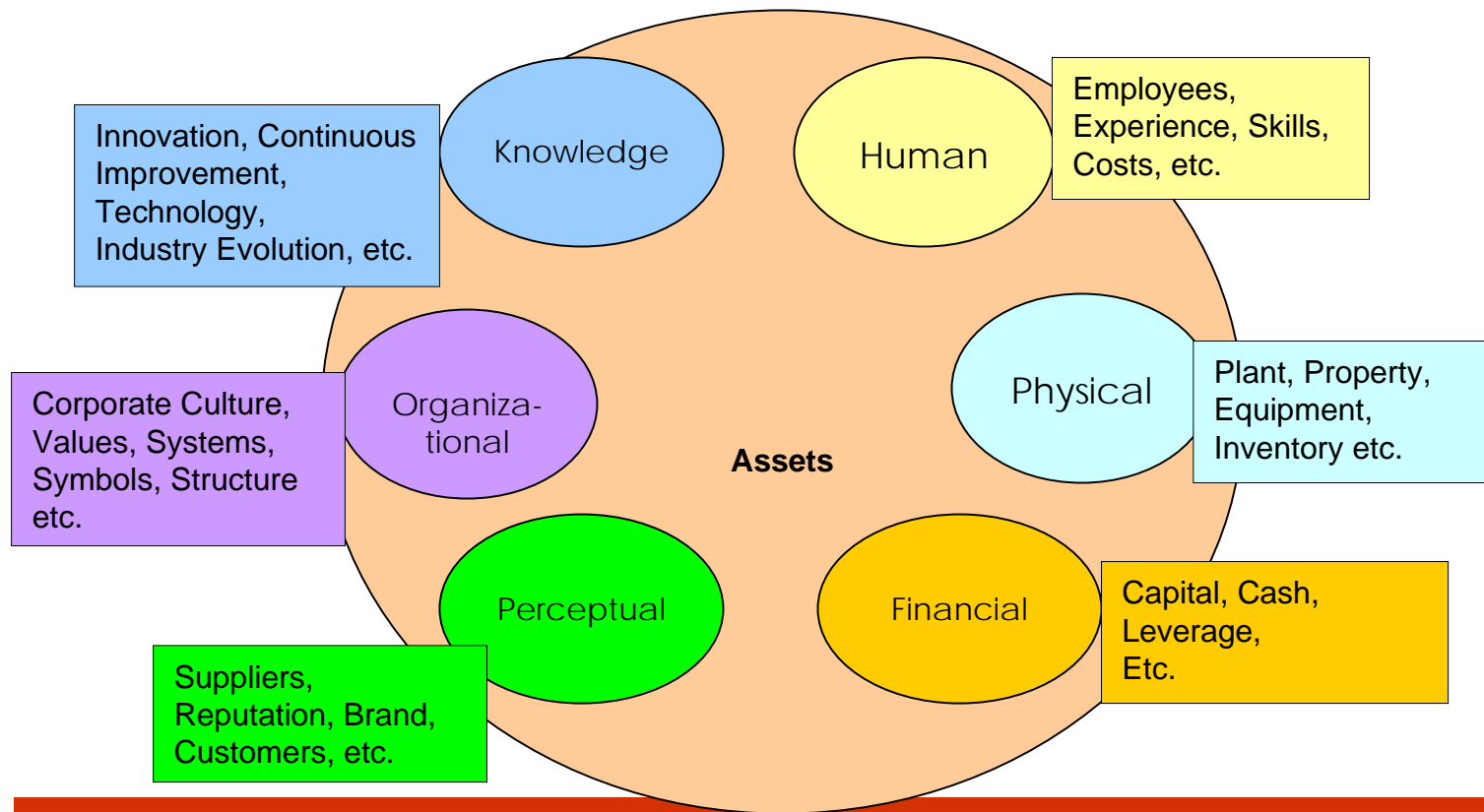
## Process for Applying the Technique

- **Step 4 Cont'd**
- Conduct one of the two value chains.
- Compare chains to direct competitors.
- Apply time dimension. (learning curve effects)
- Determine where competitive advantages lie.
- Determine which resources a firm is leveraging to deliver value.

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## Process for Applying the Technique

- Step 4 Cont'd: Evaluate 6 asset groups:





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## Process for Applying the Technique

- **Step 4 Cont'd**
- 6 asset groups may have the following attributes:
  - Availability
  - Specificity
  - Sustainability
  - Replicability
  - Substitutability



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## Process for Applying the Technique

- **Step 5: Evaluate the Value Network**

- Consider value firm can capture in extended value chain.
- Consider relative positioning.
- Analysis should include suppliers, customers, complementors and competitors.

- **Step 6: Determine Revenue Model for the Firm**

- Revenues must be greater than costs.
- Should describe revenue streams.
- Understand price w.r.t. competition, value, quality and service.
- Is revenue model superior to competition?



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## Process for Applying the Technique

- **Step 7: Determine Industry CSFs (Rockart)**
  - Specific industry characteristics.
  - Those arising from the chosen strategy of the business.
  - Environmental characteristics or those resulting from economic or technological change.
  - Those arising from the internal needs of the firm.
- Use tools like balanced scorecard, benchmarking, environmental analysis, industry structure analysis, internal analysis, competitor analysis, or using industry / business experts.





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## Process for Applying the Technique

- **Step 8: Analysis Grid for each element of Model**
- Goal is to detail where firm is capable of superior results.
- Rank each element from 1-5.

	Target Firm	Competitor A	Competitor B	Competitor C
Value Proposition	5	3	4	4
Targets Markets	4	5	3	3
VCA & Cost Model	3	3	5	5
Value Network	1	3	4	4
Revenue Model/profit	3	5	4	5
Strategy	3	4	2	2



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## Summary

- The strength of firm's business model will be determined by its ability to convert the product/service domain to economic rents for the firm.
- Value of this analysis lies in achieving a detailed understanding of the components of its business model and to make improvements in model design.
- Business models are not static constructs-- the analyst should generate both a current state and future state analysis.
- Review the analysis on a regular basis.



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## Case Study: Dell Computer & the Printer Market

- Value proposition — Dell is competing on price with limited high-end printers available to large business that allows centralized management. It does not provide large printers with robust duty cycles. Advantage HP.
- Target markets – The result of the value proposition and the product offering is that Dell's active market segment is the home consumer. In 2004 Dell sold some 31,000 laser printers compared to over 2,000,000 for HP. Advantage HP.
- Value chain analysis and cost structure — With Dell's value chain and cost structure and the complexity HP has in shipping product across the country for distribution, the advantage lies with Dell here.



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## Case Study Cont'd

- Value network — Dell purchases a number of its printers from Lexmark; however, both have a PC business, make storage devices, and consequently neither have an advantage.
- Revenue model — both companies use the razor and blades model, with neither having a significant advantage.
- Strategy — Dell has a sustainable competitive advantage with its revenue model, however this does not seem to be well aligned in printers with the CSFs for the industry. HP printers are readily available for demonstration at stores and to distributors. Printers, in fact, may not lend themselves to internet selling or distribution. Advantage HP.



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## Case Study Cont'd: Business Model Analysis Grid

- HP indeed has an overall advantage with its business model.
- Dell needs to seek a new value proposition, target market and strategy.

	Dell	HP
Value Proposition		
Targets Markets		
VCA & Cost Model		
Value Network		
Revenue Model/profit		
Strategy		

Darker = Superior



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## •FAROUT Summary

	1	2	3	4	5
F					
A					
R					
O					
U					
T					



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## Related Tools and Techniques

- Activity Value Chain Analysis
- Industry Analysis
- Competitor Profiling
- STEEP Analysis
- Competitor Segmentation Analysis
- Strategic Funds Programming
- Customer Value Analysis
- Strategic Group Maps



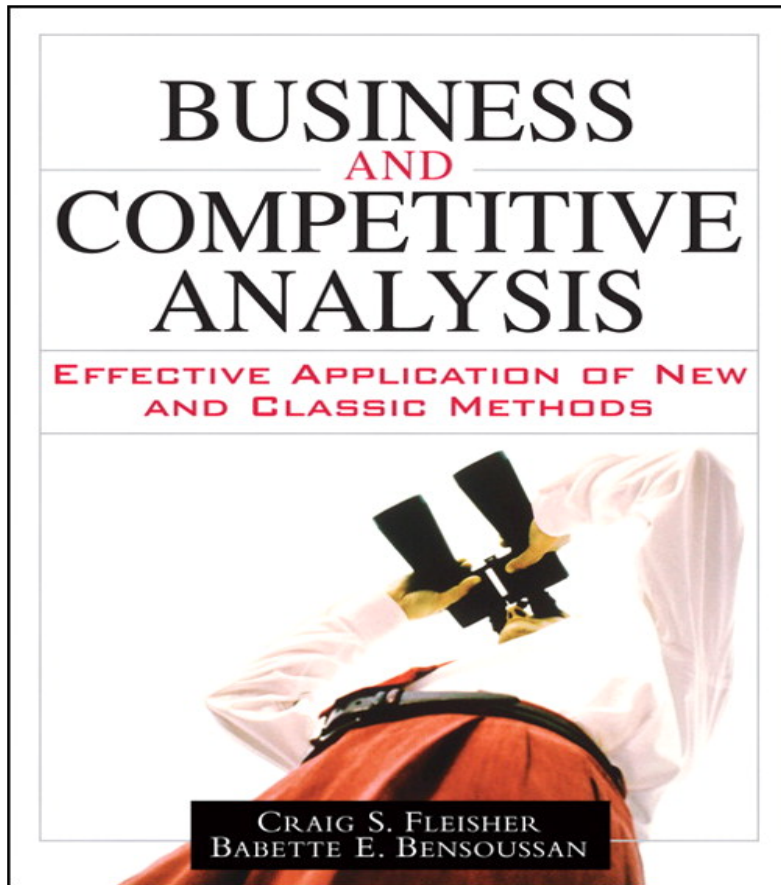
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## Related Tools and Techniques Cont'd

- Financial Ratio Analysis
- Value Chain Analysis
- Functional Capability & Resource Analysis
- Kano Model Analysis
- Quality Function Deployment



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For More About **Business Model Analysis** and 23 Other Useful Analysis Methods, see:

Fleisher, Craig S. and Babette E. Bensoussan

*Business and Competitive Analysis: Effective Application of New and Classic Methods*

**FT Press**  
FINANCIAL TIMES

Upper Saddle River, NJ  
2007