Types of Business Models

Business Models

- A business model may be defined as the manner in which a business organizes itself so as to achieve its objectives, which normally involves the generation of profits.
  - The way in which revenue is generated and the way in which costs are controlled or eliminated
- Traditional business models have evolved around a central product or service
  - E.g. Ford motor company in the text
  - This has continued even with the recent increase in service companies

Business Models

- Paul Timmers defined business model as:
  - “An architecture for the product, service and information flows, including a description of the various business actors and their roles; and
  - “A description of the potential benefits for the various business actors; and
  - “A description of the sources of revenues
  - Definition complicates the definition and makes it more dynamic
- “The method by which a firm builds and uses its resources to offer its customers better value than its competitors and to make money doing so.”
  \- Afuah and Tucci

Business Models

- Michael Porter
  - “ The essence of strategy is choosing to perform activities differently than rivals do”
  - Competitive strategy is about being different.
  - Deliberately choosing a different set of activities to deliver a unique mix of value
- Some definitions do not make a clear distinction between strategy and models

Internet Business Models

- Using the internet as a tool for implementing a business model
- New Business Models – MusicNet
  - Subscription service to download music

Generic Business Models on the Web

- Brokerage
- Advertising
- Infomediary
- Merchant
- Manufacturer
- Affiliate
- Community
- Subscription
- Utility
- See table 2.1 P.24

Brokerage

- Brokerage
  - Charge a fee for transactions enabled on their site
  - Also called market makers because they bring buyers and sellers together
  - Includes
    - Buy / Sell fulfillment sites – Financial brokerage, online travel agents
    - Market exchanges – B2B market exchanges
    - Business trading communities – B2B within an industry
    - Buyer aggregator – take advantage of volume buying
    - Distributors – B2B – broker facilitates transactions
    - Virtual malls – hosts online merchants

Brokerage

- Metamediaries – more service than a virtual mall but similar such as billing and collection (Amazon. COM)
- Auction brokers – conducts auctions like eBay. COM
- Reverse auction – prospective buyer enters an order for a good and a price – Priceline.COM
- Classifieds – provides classified ads like in newspapers
- Search agents – search internet for best price
- Bounty broker – offers a reward for finding a person or desired item

Generic Business Models

- Advertising
  - Must have a large enough volume
  - Can also create personalized portals
- Infomediary – free access if fill out survey
- Merchant – seller can be bricks and mortar or bricks and clicks
- Manufacturer – sell to market directly
- Affiliate – exchanging of banner ads
- Community – depend on user loyalty
- Subscription
- Utility – user pay site

Corporate Strategic Planning – Internet Strategy

- Is there a role for traditional corporate strategic planning?
- “launch and learn”
- For some, the corporate strategic plan is indistinguishable from the Internet strategy
- Treat the Internet strategy as a separate exercise?

The Components of an IT Strategic Plan (1)

- The Business Model to be used for the web
  - The Data Architecture - defines the data elements and location needed
  - The Application Architecture - structure of applications that is necessary
  - The Technology Architecture - the hardware, software and other infrastructure components

The Components of an IT Strategic Plan (2)

- The Migration Plan - process of determining how current data, application and technology architectures will be moved to the planned architectures
- The Tactical Plan - includes the funding and the detailed project management

Pitfalls in Internet Strategy

- Failure to link the Internet strategy to the general enterprise strategy
- Assuming that customers will come to a Website
- Inadequate resources
- Training/communication weaknesses

More Pitfalls

- Defining who will be responsible for the Website and who owns Internet projects
  - i.e. user department, the IS department, marketing, public relations, or a senior executive
- Balance of management/technical people on Web projects

Summary of Business Design

- Focus on customers
- Create value with continuous innovation
- Transform business processes into digital form
- Decentralize management but centralize coordination
- Create an e-business application architecture
- Integrate, but plan for continuous change

e-Business to Consider

- Dell

"Many of our competitors have tried to copy elements of the way we do business, with little success. In fact, we believe Dell is widening the fundamental advantages of our direct business model."

2000 Annual Report

Sales = $25,265,000,000 and rising

Why can other competitors not match Dell's performance?

A Business Model

- A business model is a group of shared or common characteristics, behaviors, and methods of doing business that enables a firm to generate profits through increasing revenues and reducing costs.

Business Models

Two categories of Internet businesses--pure-play vs. bricks-and-clicks:

Pure-play **businesses have an online presence only.**

Examples: Amazon.com, eBay, and Slate.com

Bricks-and-clicks **businesses combine a physical presence with an online presence.**

Examples: Barnes and Noble, Nordstrom, and the New York Times

Fundamental Models of e-Business

Business originating from...

And selling to...	Business	Consumers
Business	B2B	C2B
Consumers	B2C	C2C

Business-to-Business Model

- Many e-businesses can be distinguished from others simply by their customer focus.
- For instance, some firms use the Internet mainly to conduct business with other businesses. These firms are generally referred to as having a business-to-business (B2B) model.
- Currently, the vast majority of e-business is B2B in nature.

B2B Pure-Play Business Models

Business markets are unique in many ways:

- High value of purchases
- Large order size
- Items purchased
- Purchase specificity
- Team buying
- Use of buying specialists
- Special services required
- Team selling
- Vendor/value analysis
- Leasing
- Competitive bidding
- Derived demand
- Cyclical demand
- Number and location of buyers

B2B Pure-Play Business Models (continued)

EDI/Extranets:

EDI Systems

Created on a closed network—systems did not speak to one another.

Extranets

An intranet that is adapted so that external parties are provided varying degrees of access to information.

B2B Pure-Play Business Models (continued)

B2B marketplaces—net markets:

- Broadly described as all online marketplaces where buyers and sellers congregate to exchange goods and services for money.
- Net markets can be organized either horizontally or vertically.

B2B Pure-Play Business Models (continued)

Three types of net markets include:

1. ***Buy-centric markets*** are organized by large, influential buyers as a place where small and fragmented sellers can sell their goods.
2. ***Sell-centric markets*** are markets where one or more big sellers build a marketplace for small, fragmented buyers.
3. ***Neutral exchanges*** appear when both the sellers and the buyers are fragmented.

B2B Pure-Play Business Models (continued)

Why would an established business use net markets?

- Selection of buyers or sellers (global markets) is greater.
- Dynamic markets may be a great place to move inventory quickly.
- Efficient exchange process minimizes employee time.
- Prices are low due to expanded access to sellers.
- Some one-time deals are available only to online audiences.

B2B Pure-Play Business Models (continued)

Challenges faced by e-marketplaces:

- Building traffic is a big challenge for e-hubs.
- Competing e-marketplaces.
- Integrating other sales channels with e-marketplaces.

B2B Pure-Play Business Models (continued)

What separates the top B2B companies from the rest?

- A high number of buyers and sellers.
- A higher number of transactions even though the total value may be smaller.
- They are able to charge a higher transaction fee and earn more nontransaction revenue.
- They offer financial services, not content or advertising.

Business-to-Consumer Model

- In contrast to those firms using a B2B model, firms like Amazon and eBay are clearly focused on individual buyers and so are referred to as having a business-to-consumer (B2C) model.

B2C Pure-Play Business Models

Classifications:

- ***Direct sellers*** make money by selling products or services to consumers.
- ***Intermediaries*** facilitate transactions between buyers and sellers and receive a percentage of the value of each transaction.
- ***Advertising-based models*** have ad inventory on their site and sell it to interested parties.

B2C Pure-Play Business Models (continued)

Classifications: (continued)

- ***Community-based models*** allow users worldwide to interact with one another on the basis of interest areas.
- ***Fee-based models*** charge viewers a subscription fee to view content.

Business Models Examples

Merchant

Brokerage

Advertising

Mixed

Informediary

Subscription

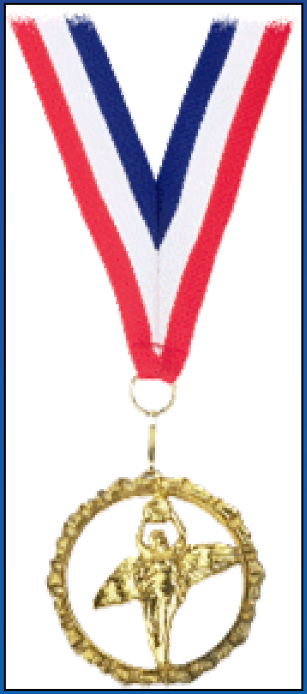
B2C Pure-Play Business Models (continued)

What separates the top B2C companies from the rest?

- The top performer had 3.2 times more unique visitors per month than the median.
- Conversion rate of new visitors was about twice the median.
- Revenue per transaction was about 2.5 times the median.

B2C Pure-Play Business Models (continued)

What separates the top B2C companies from the rest? (continued)



- Average gross margin was about three times the median.
- No significant differences in the number of transactions per customer and the visitor acquisition cost.

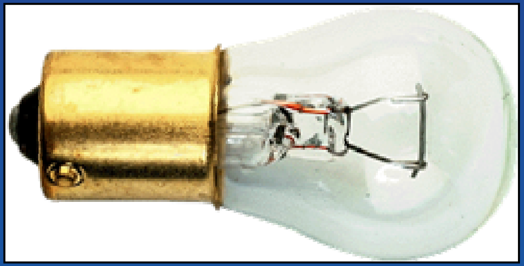
Consumer-to-Consumer Model

- Unlike the B2B and B2C models, which focus on business transactions and communications, the consumer-to-consumer (C2C) model involves the growing popular use of peer-to-peer (P2P) software that facilitates the exchange of data directly between individuals over the Internet.

Pure-Play C2B Business Models

Categories of C2B models include:

- ***Idea collectors*** are companies that are able to motivate consumers to submit product improvement ideas for money.



- ***Reverse auction*** companies allow consumers to submit binding bids for the purchase of products such as airline tickets.

Pure-Play C2B Business Models (continued)

Categories of C2B Models Include:

- ***Complaint centers*** allow individuals to post complaints about a business, view others' complaints about any given business, and interact directly with the business in question.
- ***Paid advertising models*** include companies that seek to pay consumers to view targeted ads.

The Bricks-and-Clicks Business Model

Advantages over other models:

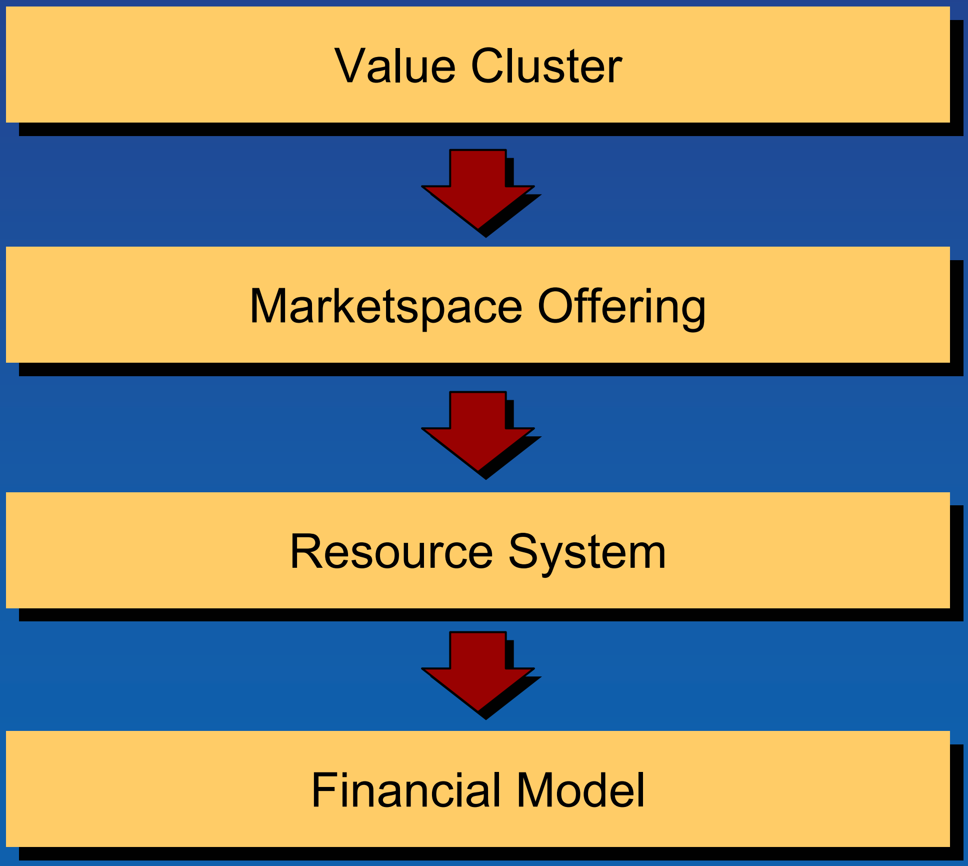
- For some product categories, individuals have to touch, feel, or try on a product before buying.
- Delivering products is a hassle for dot-coms.
- Product returns can be tricky.
- Salespeople can help customers by answering product questions, providing feedback, and suggesting other products.

The Bricks-and-Clicks Business Model (continued)

Organizing for Bricks-and-Clicks:

1. Spin off the online venture.
2. Create a strategic partnership.
3. Create a joint venture between a bricks-and-mortar store and an online company.
4. Integrate the online operation with the existing physical operation by creating a division within the company.

4 Main Components of a E-commerce Business Model



The Trend Toward E-Business

- Much more than a cool Web site!
- **E-commerce** – the part of e-business that the customer experiences directly
  - **B2B** (business-to-business)
  - **B2C** (business-to-consumer)
  - **C2C** (consumer-to-consumer)

Six Levels of E-Commerce

Marchak (2000)

- Level 1: minimal online presence – website only
- Level 2: Online catalog
- Level 3: Online order entry
- Level 4: Automated value chain – fully integrated with the enterprise system
- Level 5: Market site – allow customer to compare products among competitors
- Level 6: Super market site – Wide spectra of products are available

Key Issues in E-Business

There are many key issues in e-business, such as:

- Order fulfillment and accuracy of the order
- Knowing real-time inventory information

Internet-Enabled Enterprise Systems

- Enterprise system -> Web = Backend enterprise system + web applications
- So, intranet and extranet
- Then, more issues:
  - Customer relationship management
  - New business model
  - Security
  - Etc.

Customer Relationship Management (CRM)

- Why: The global marketplace and the growth of the Internet economy require that an organization have better understanding of customer requirements if it is going to keep them as customers
- What: CRM system involves the collection and recall of large amounts of customer information, including customer basic information plus historical information regarding sales, repair, payment, etc.
- How: Face-to-face, phone, the Internet

Sale Force Automation (SFA)

- Purpose: Sell more with less cost
- SFA is the integration of sales and marketing processes to generate a sale using less time and effort
- SFA must satisfy:
  - Fewer but more productive sale calls
  - Low communication costs
  - Low paperwork costs
  - Eliminate redundant data entry
  - Lower training costs
  - Reduce administrative costs

IT’s Role in CRM

- Customer data collection
- Customer data maintenance
- Customer data analysis and report

  “A 5% point increase in customer retention yields a profit, in net present value term, of between 20% and 125%” – Payne (2000)
- So, an organization needs:
  - Measurement of customer retention,
  - identification of root causes of defection and related key service issues,
  - the cost of acquisition,
  - the number of new customers acquired,
  - the profitability of retained customers,
  - corrective action to improve retention.
- With IT these requirements will be met.

Customer Experience Management (CEM)

- CEM: Obtaining customer's view of the system and system output
- Channels:
  - Survey by phone or mails
  - Web-based and email-based
- CEM reports the feedback results

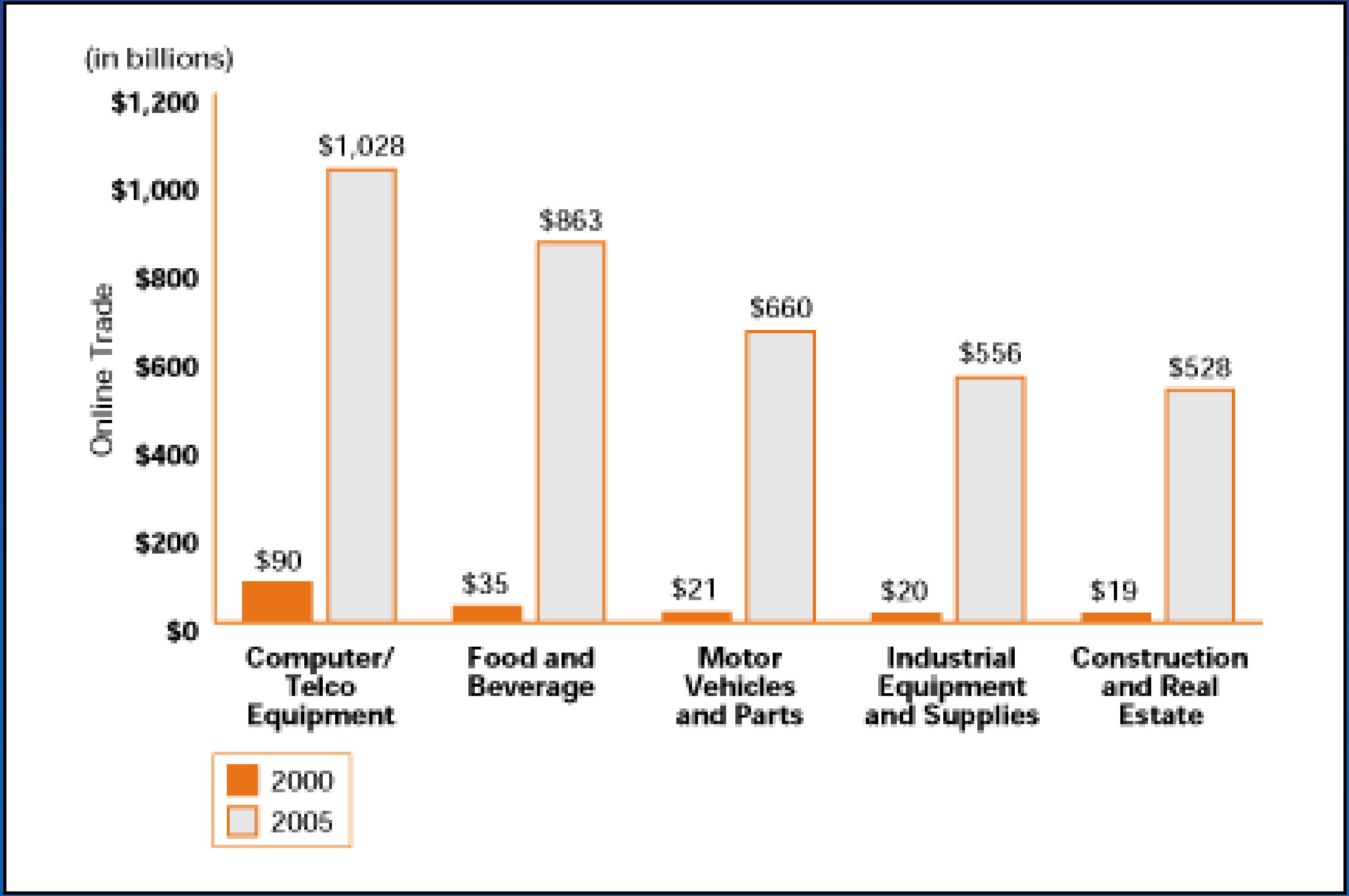
B2B E-commerce

Online B2B Growth

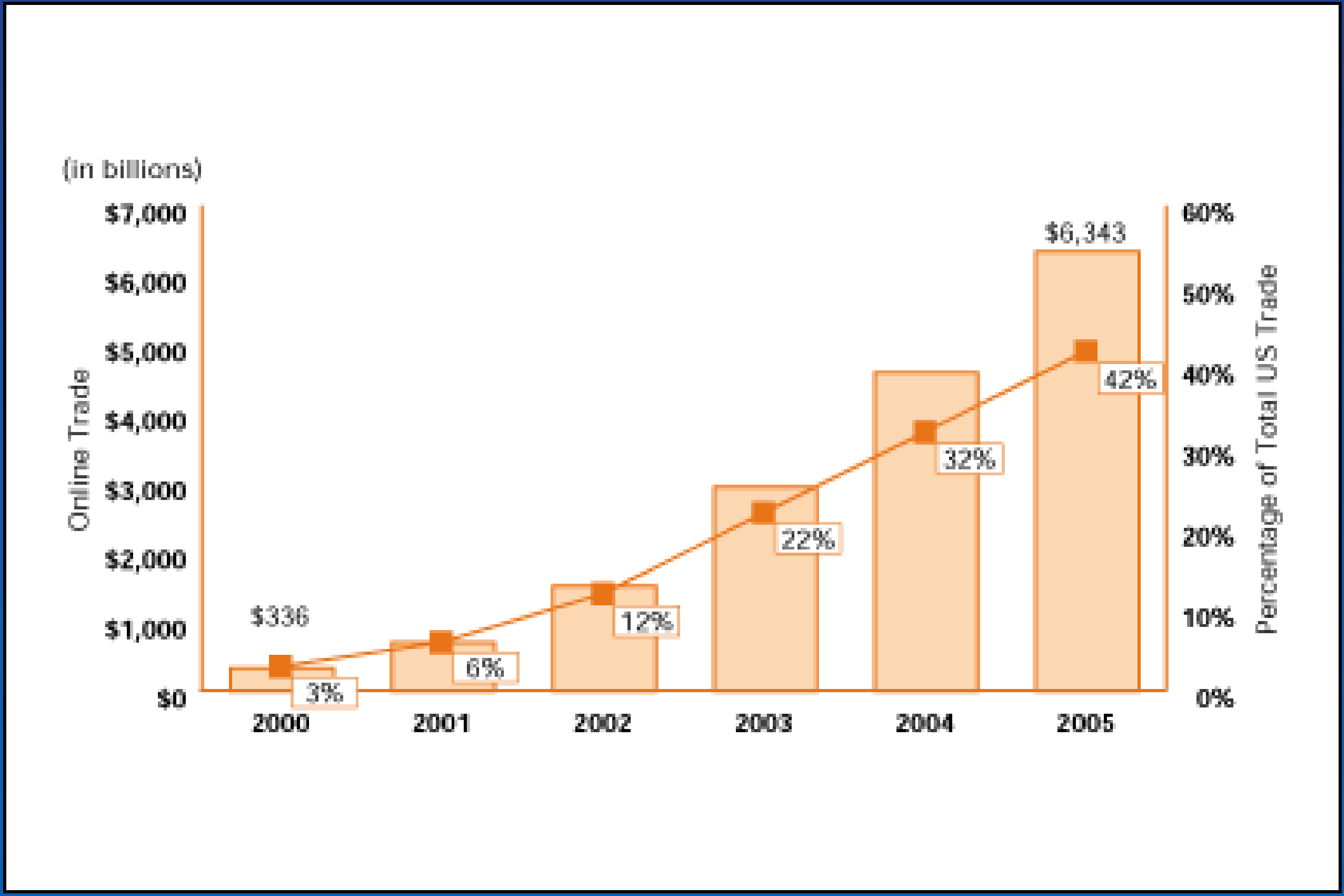
- Total US B2B non-service trade will rise from $11.5 trillion in 2000 to $15.1 trillion in 2005.
- The Internet's share of total US B2B trade will soar from 3% in 2000 to 42% in 2005.
- Internet trade will grow more than 20 times in five years from $336 billion in 2000 to $6.3 trillion in 2005.
- In 2004, online trade will represent over 50% of total B2B commerce.
- By 2005, Net Markets will account for 35% of B-to-B online commerce as compared to 2% in 2000.

B2B Trade Forecast

Online Trade Forecast: Top Five Industries



B-to-B Online Trade Forecast



B2B's Attributes

- Huge market opportunity
- Financially light business model
- Scalable
- Acquisition cost effect
- Sticky products
- Multiple revenue stream

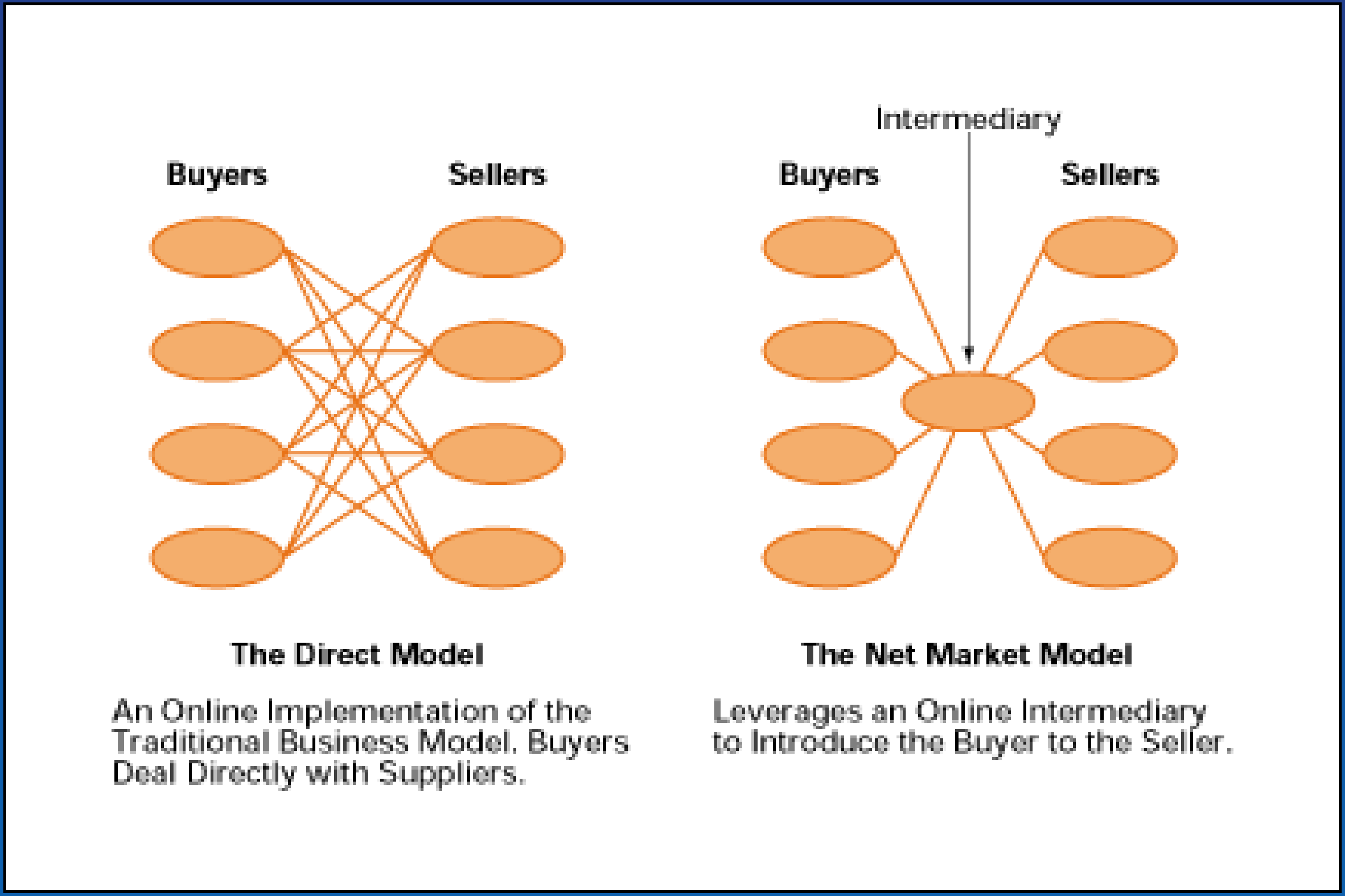
Five B2B Generations

- EDI (Buyer-centric)
- Storefronts (seller-side systems)
- Buyer-driven Procurement (Buyer-side systems)
- Net Markets, Independent or Coalition
- Hosted Private Market

Net Market (4th Generation)

- Net Markets are online intermediaries where many buyers and many sellers can congregate to trade. Net Markets essentially match buyers and sellers using a variety of market mechanisms including auctions, catalogs, and Nasdaq-like exchanges. The first Net Markets were independent entities, often funded by venture capital, which sought to be neutral intermediaries between buyers and sellers.

Net Market Model



Private B2B Marketplaces (5th Generation)

- The latest model to emerge has been that of private marketplaces, defined as areas within independent or coalition Net Markets in which specific buyers can interact and trade with designated sellers, or vice versa. Private marketplaces use the technology infrastructure of the Net Market to create essentially direct connections between buyers and sellers. This system saves infrastructure investments for buyers and suppliers and offers additional revenue sources for Net Markets.

Three B2B Ownership Models

- Third-party exchanges, e.g. Ventro and FreeMarket
- Consortia-led exchanges, e.g. Covisint
- Private/Proprietary exchanges, e.g. Dell
  - > 745 B2B exchanges have been announced in the first half year of 2000
  - 93% are of the third type

Business Models for B2B Intermediaries

- Catalog:
  - CommerceOne and GM’s TradeXchange
- Exchange:
  - Tradex
- Auction
  - FreeMarkets
- Negotiations

Case 1 - FreeMarkets Online Inc.

- Pre-select qualified suppliers
- Assess, evaluate & short list
- Conduct global online auctions
- Helping companies with RFQ for custom components
- 3000 companies from 45 countries participate in
- Operates about 70 different vertical industries
- $7 million in 1998 commissions

Case 2 - Aeroexchange

- A consortium for 13 airline companies
- offers airframe, avionics, maintenance services, and general goods and services
- With web-based applications

Case 3 - Covisint

- Created by Ford, GM and DiamlerChrysler
- For trading automobile related goods and services
- Attracts 20+ buyers and suppliers, such as Nissan, Renault and BASF.

Case 4 - DELL

- Michael Dell started his computer business in 1984
- Dell Computer's growth
  - 1985 – $6 million
  - 1990 - $500 million
  - 1993 - +40%, but faced operating loss
  - 1996 - $7.8 billion
- Dell's direct sell (started in 1997)
  - Order-shipping process 36 hrs vs. regular 75-100 days
  - Reduced suppliers from 204 in 1992 to 47
  - 13-day inventory
  - Cash flow cycle reduced to 24 hrs comparing to Gateway 16.5 days and Compaq 35 days.
  - Direct monitor shipping from suppliers

Dell Computer

- Business insight:
  - Sell directly to customers
    - Decide how much to produce based on demand estimates & contracts $\Leftrightarrow$ produce on demand
- What makes this approach possible?
  - Outsourcing
    - Negative holding costs!
  - Mass customization
    - Powerful order fulfillment system

Start-ups

Knowledge-based stock information service

- TradeTrek.com
  - started in 1998 with a seed capital $100,000
  - now expanded to Taiwan and Hong Kong
  - available cash $6 Million now
  - first dividend 33% of the initial investment

B2B Company example

- eAnyway and eMobile
  - Headquartered in San Diago
  - Produce OEM cellular phones
  - Started in June 2000 with the initial investment $300 million

Efficiencies of B2B Electronic Marketplaces

- A survey conducted in spring 2000:
  - Only 1% companies are conducting e-business through their websites.
  - 80% B2B processes are still manual, and 20% considered automated are actually not yet.

B2B Efficiencies

- Administration costs
- Search costs
- New markets
- Maverick purchasing (buying occurs outside the normal channel)
- Joint purchasing
- System integration (with the legacy system)
- Supply chain management (from push marketing to pull marketing)
- Collaboration (Outsourcing product design), joint channel of distribution
- Middlemen (the new service particularly for small business)

Questions