

# The big picture of business model design

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## **Whether you are an entrepreneur or a change manager, a well-designed business model is crucial to the success of your firm.**

Purposeful design, within and across a firm's boundaries, is the essence of a successful business model. In their working paper, "[Designing Your Future Business Model: An Activity System Perspective](#)," due to be published in the journal *Long Range Planning* as part of a special issue on business models, IESE's [Christoph Zott](#) and Wharton's Raphael Amit provide managers and entrepreneurs with a framework to show how this can be done.

To illustrate this wider perspective, the professors use the example of FriCSO, Inc., a young technology company, which has achieved a huge technological breakthrough in friction reduction. Given the huge benefits for a number of industries from this technological leap, success looks certain.

## **Options, options, options...**

However, before success comes, there are various options to consider. First and foremost is the decision of which business model to adopt in order to unlock the value potential of the new technology. Would you choose to commercialize the technological innovation as a machine manufacturer (a product-based business model), selling to original equipment manufacturers (OEM)? Or would you operate a factory that performs the surface treatment of moving parts for clients (a service-based business model)? Or would you go the pure R&D route, perhaps using licensing agreements to sell your know-how?

Each of these options involves a completely different activity system. Each also involves different interactions with third parties. On the performance side, each of these options will

affect the level of capital expenditure, the prices charged and the margins made.

## **Defining the concept of an activity system**

Key to understanding the concept of the business model as an activity system is the mutual interdependence of the firm and the players in its "ecosystem," such as customers, suppliers and competitors. By shaping the activities both within the firm and transactions with other players, managers can adapt to changes in the competitive environment over time. A successful business model, argue the professors, has to imply value creation for all parties involved, while keeping the focus on the firm.

The firm itself will perform some activities relevant to the business model; others will be carried out by suppliers, partners and/or customers. For example, if FriCSO adopted the business model of a machine manufacturer, it would choose OEM suppliers as its customers and other machine manufacturers as its competitors. If it adopted a technology-licensing model, it would choose both these parties as customers.

Obviously, the stronger the competition, the more difficult it is for the firm to secure its share of the value-creation pie - or, in the case of entrepreneurial firms, even to survive. The role of the revenue model is to help the firm secure its largest possible share. The revenue model complements a business model design, just as a pricing strategy complements product design.

## **Design elements**

To help design the business model, managers should address the following elements.

*Content:* What is the range of activities? For example, a bank decides, in addition to retail banking, to offer microcredit to capture a wider market. It would have to train top managers and hire new staff as well as linking this new activity to the existing system.

*Structure:* How are activities linked, and which ones are of core, support or peripheral importance? For example, IBM, following a crisis in the 1990s, switched its core activity from hardware supplier to service provider. It then harnessed its extensive experience to launch various new activities, including IT maintenance and consulting. Consequently, more than half of IBM's 2006 revenues came from these activities, which had been peripheral just 15 years earlier.

*Governance:* Who carries out these activities? Franchising is a possible approach to creating

value through appropriate governance. For example, the 7-Eleven chain used franchising as an authentic way to adapt to the highly regulated Japanese market in the 1970s.

## **NICE design themes**

Another way of approaching an activity-based business model is to view these elements as connected by key value-creating themes, such as the following, summarized under the acronym NICE.

*Novelty:* An example of this is Apple's development of the iPod and the related music download business iTunes. Apple used to be a producer of innovative hardware - personal computers. Today it is the first electronics company to have included music distribution as an activity (content novelty), linking it to the development of the iPod hardware and software (structure novelty) and digitizing it, pushing many aspects of legal music downloads to customers (governance novelty). Thus, Apple has successfully transferred its innovation from its products to its business model.

*Lock-In:* Business models can be designed to keep third parties on board as partners. For example, most of eBay's customers loyally perform many of the marketing and sales activities of the firm themselves, such as photographing items for sale in the online auctions. What keeps these customers coming back are the strong networking possibilities inherent in eBay's massive database and the time and effort they have already invested. The same principle applies to Facebook and other social networking sites.

*Complementarities:* These occur when activities bundled together create more value rather than if run separately. For example, in the commercial banking sector, a deposit activity is an important source of funding that complements banks' lending activity. In the recent liquidity squeeze, banks without access to these funds suffered severely.

*Efficiency:* Firms whose activities are geared toward increasing efficiency usually aim to reduce the costs of working with third parties. For example, the main firm may decide to integrate vertically into activities to avoid being held hostage by price rises.

The activity-based business model concept explored here highlights the importance of transactional relationships with third parties. Future research could build on this to focus on the growing importance of the social aspects of the relationships between the various players.

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