

Social Innovation

Unit 7: Business Models

This unit is focused on understanding the concepts of business model. To do so, we will look at the meaning of business model, different types of business model, elements of business model and its advantages and disadvantages.

The objectives of this unit is

- to understand the concept of business model
- to be able to integrate these concepts into practice
- to learn about the different types of business model
- to look at the tools used for business model

The term “business model” often appears to encompass everything from, among others, strategy, economic model, and revenue model. Although several papers have critically examined certain aspects of business models (Casadesus-Masanell and Ricart, 2010, Morris et al., 2005, Zott and Amit, 2008, Zott et al., 2011).

Understanding how business works and how value is created for different stakeholders has become the grail quest of management scholars in recent years. Millions of dollars were raised to fund flawed “business models” during the dot-com era (Shafer et al., 2005).

Business model' is a term often used to describe the key components of a given business. It is particularly popular among e-businesses and within research on e-businesses (Timmers, 1998; Afuah & Tucci, 2001; Amit & Zott, 2001; Applegate, 2001; Cheng et al., 2001; Rayport & Jaworski, 2001; Weill & Vitale, 2001). Business models are even subject to patent law, for example, Amazon.com has a patent for *one-click purchase* (Rappa, 2002).

A business model is a conceptual tool containing a set of objects, concepts and their relationships with the objective to express the business logic of a specific firm. Therefore we must consider which concepts and relationships allow a simplified description and representation of what value is provided to customers, how this is done and with which financial consequences (Osterwalder, A., Pigneur, Y., & Tucci, C. , 2005).

A business model is

- Articulates the value proposition (i.e., the value created for users by an offering based on technology);
- Identifies a market segment and specify the revenue generation mechanism (i.e., users to whom technology is useful and for what purpose);
- Defines the structure of the value chain required to create and distribute the offering and complementary assets needed to support position in the chain;
- Details the revenue mechanism(s) by which the firm will be paid for the offering;
- Estimates the cost structure and profit potential (given value proposition and value chain structure);

- Describes the position of the firm within the value network linking suppliers and customers (incl. identifying potential complementors and competitors); and
- Formulates the competitive strategy by which the innovating firm will gain and hold advantage over rivals.

There are certain elements of a winning business model and they are

- Target the *average* consumer (rather than the *early adopters*) by emphasizing different product attributes to those that the pioneers focus on. In particular, instead of emphasizing the functionality of the product, emphasize low prices that help grow the market;
- Create alliances with key suppliers and producers of complementary goods, so as to control key inputs and the provision of complementary goods;
- Protect the market by exploiting first mover advantages
- Support low prices by driving down costs. To do so, the winning firms build market share quickly so as to enjoy economies of scale and learning benefits. This can be achieved by creating bandwagon effects;
- Reduce customer risk through branding and communication. The winning firms help build as big a consensus as possible across consumers to broaden the initial installed base and widen the ultimate market;
- Build the distribution that can serve the mass market.

There are also certain components of a business model. They are

- Everything it takes to make something: design, raw materials, manufacturing, labor, and so on.
- Everything it takes to sell that thing: marketing, distribution, delivering a service, and processing the sale.
- How and what the customer pays: pricing strategy, payment methods, payment timing, and so on.

The advantages of business model are

- A good business models gives the company a competitive edge in the industry.
- A strong business model provides the company good reputation in the market place encouraging the investors to remain invested in the company.
- Making the business model strong leads to an ongoing business profit leading to increase in cash reserve and new investments.
- Proven business model brings a financial stability in the organization.

The disadvantages of business model are

- Once a business model is created, then it restricts to implement new ideas for the product.
- Creating a business model is time consuming as lot of factors needs to be considered.
- There might be a chance that business model may turn out to be inaccurate.

We can conclude that business models are important since it helps us understand the business itself. It also leads to recognition and awareness. Every business model is different in one way or another. There are tools we can use to identify a business model and we will look at the tool is next unit.

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