Case Studies on

Business Models – Vol. I

Edited by

R. Muthukumar

Icfai Business School Case Development Centre

Icfai Books

71, Nagarjuna Hills, Punjagutta, Hyderabad – 500082

Icfai Books
71, Nagarjuna Hills,
Punjagutta, Hyderabad – 500082
Andhra Pradesh, INDIA
Phone: 91 - 40 - 23435387/91, Fax: 91 - 40 - 23435386
e-mail: icfaibooks@icfai.org, ibscdc@icfai.org
Website: www.books.iupindia.org, www.ibscdc.org

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Editorial Team: K Ramanathan and Deepa Verma

Visualiser and Designer: Cherukuri Chinna Mabu

OVERVIEW

Business model is a buzzword that everybody used during the dotcom boom. Poor business models were attributed for the downfall of many dotcoms. To differentiate the winners from the losers, it is important to describe and evaluate companies' business models.[1] However, the business model dates back to the earliest days of business; it merely describes the way in which a company makes money.

A business model describes what and how a firm will do, to build and capture wealth for stakeholders. Effective business models operationalize good strategies — turning position and fit into wealth: By efficiently (profitably) transforming inputs into something that customers value enough to pay for repeatedly.

To put it simply, the business model is how the company makes money. This is a plan implemented by a company to generate revenue and make a profit from operations. The model includes the components and functions of the business, as well as the revenues it generates and the expenses it incurs. It also explains the sources of the company's revenues, how much these sources pay and how often. For instance, a restaurant's business model is to make money by cooking and serving food to hungry customers. A website's business model might be little complex, as there are many ways in which these types of companies can generate revenue. For example, some make money by providing a free service and then selling advertising to other companies, while others might sell a product or service directly to online customers.

According to IBM's global study on CEOs in 2007[2], companies are responding to challenges through increased focus on business model innovation. The business models will determine the strategies' failure and success. Products and services can be copied, but the business model is the differentiator. CEOs believe that greatest focus is on business model innovation, which is where the greatest benefits lie. Business model innovators expand margins (Exhibit I).

Business model innovation can be defined along three dimensions[3]:

- Industry model innovation: Innovating the 'industry value chain' by moving into new industries, redefining existing industries or creating entirely new ones, also by identifying/leveraging unique assets. For example, Apple transformed the music industry through a new way of connecting hardware with software to download music with iPods/iTunes product & service combination. Dell redefined the PC value chain and industry model by using a direct to customer sales model
- Revenue model innovation: Innovating how we generate revenue through offering reconfiguration (product/service/value mix) and pricing models. For example, Gillette

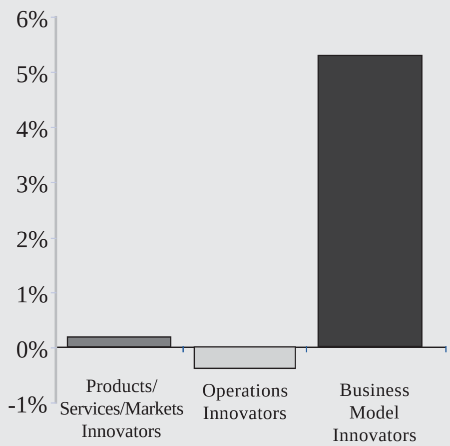
[1] McClure Ben, "Getting To Know Business Models", http://www.investopedia.com/articles/fundamental/04/033104.asp

[2] Edward H.B. Giesen, et al., "Business Model Innovation Competing through innovative business models", *The Global CEO Study 2006: Expanding the Innovation Horizon*, June 2007

[3] Ibid.

Exhibit I
Operating Margin Growth in Excess of Peers

(Compound annual growth rate over 5 years)



Source: Edward H.B. Giesen, et al., "Business Model Innovation Competing through innovative business models", *The Global CEO Study 2006: Expanding the Innovation Horizon*, June 2007

innovated the pricing model by giving away razors and making money on the blades. Netflix shifted the revenue model from product /rental based to a subscription based annuity model. Cirque du Soleil reconfigured offering and value elements to transform the circus experience

- Enterprise model innovation: Innovating the role we play in the value chain by changing our extended enterprise and networks with employees, suppliers, customers, and others, including capability/asset configuration. Zara's Fast Fashion model is supported by a highly integrated business model along its value chain. Bharti created a highly specialized Telco business model by focusing only on its key differentiators – marketing, sales and distribution – and partnering for everything else. P&G's innovative R&D collaboration model "connect & develop", sourcing over 50% of ideas externally

Moreover, as industries change, companies cannot always stick to the same business model. We can witness the same from Kodak and the fast-changing camera business. Traditional film cameras generated a lot of revenues for the company, as users have to buy film rolls frequently to take pictures and then spend even more getting the pictures developed. But new digital cameras do away with film sales and processing fees. In response, Kodak has had to create a new business model. The company has established digital printing centers, where users can have their digital camera pictures printed on genuine Kodak paper. The business model that was once based on film sales and processing has become a model based primarily on photograph printing.

So how do we know whether a business model is any good? When business models do not work, it is because they do not make sense and/or add up to profits.The airline industry is a good place to find business models that stopped making sense. For years, major carriers like American, Delta and Continental built their businesses around a 'hub-and-spoke' system, in which all flights routed through a handful of big city airports. By ensuring that seats were filled, the business model produced big profits for airlines. But it turned out that competitive carriers like Southwest and JetBlue could shuttle planes between smaller centres at a lower cost - in part because of lower labor costs, but also because they avoided some of the operational inefficiencies that occur in the hub-and-spoke structure. As competitive carriers drew away more customers, the old carriers were left to support their large, extended networks with fewer passengers. To fill seats, the airlines had to offer more and deeper discounts. No longer able to produce profits, the hub-and-spoke model no longer made sense.

Similar example of business models that failed can be US automakers. In 2003, to compete against foreign manufacturers, Ford, Chrysler and General Motors offered customers such deep discounts and interest-free financing that they effectively sold vehicles for less than it cost to make them. That dynamic squeezed all the profits out of Ford's US operations and threatened to do the same for Chrysler and GM. To remain viable, the big automakers had to revamp their business models.

This book entails the business models adopted by various companies and benefits they got out of it.