

STRATEGY & INNOVATION

Business Models

With Jimmy Wales

1. First Things First

A business model is a framework that defines how a company will create, capture and deliver value. It serves as a blueprint for how the organization operates and generates revenue.

The **value proposition** is a core component of a business model, serving as the foundation upon which the rest of the business model is built. It answers the critical question of *why* customers should choose a company's product or service over its competitors.

There are many kinds of business models, but one rule applies to all of them: they have to be built around the customer.

The only good business model is a customer-centric business model.

2. The Profit Equation

Profit represents the difference between the revenues earned by a business and the total costs and expenses incurred in generating those revenues.

Revenue is the total amount of money generated from the sale of goods or services. It does not include any deductions.

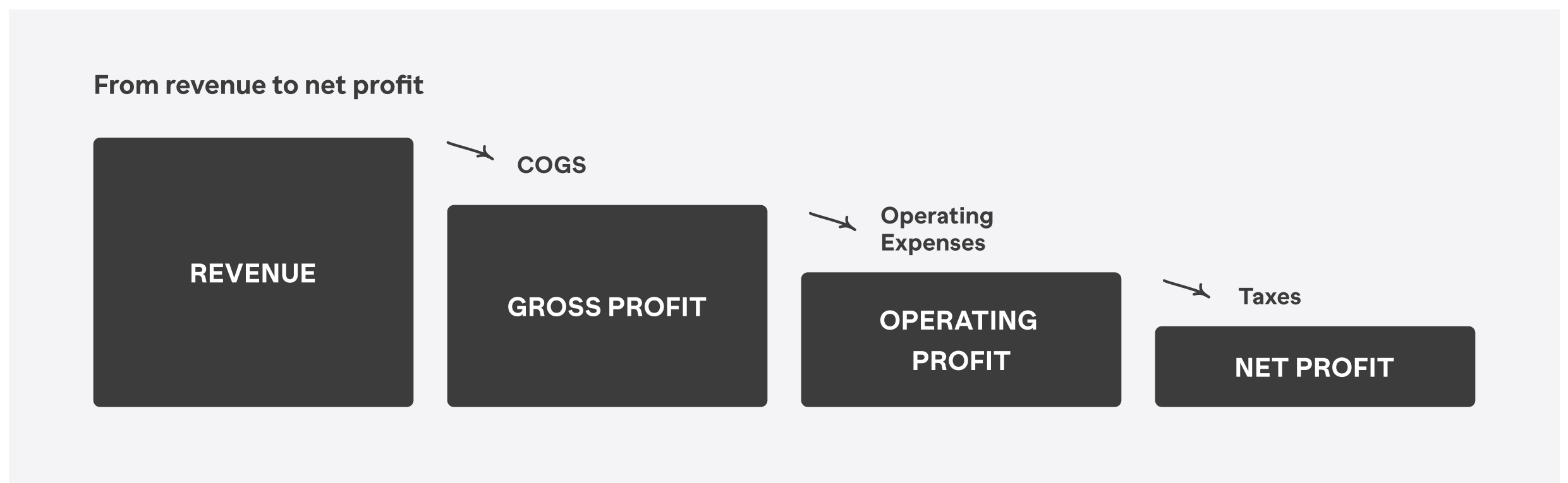
Costs are all the expenses incurred to produce the goods or services.

In its simplest form, the profit equation is:

$$\text{PROFIT} = \text{REVENUE} - \text{COSTS}$$

Costs can be further broken down into various categories:

- **Cost of goods sold (COGS)** refers to the direct costs of producing the goods sold by a company. This includes the cost of the materials and labor directly used to create the goods in question.
- **Operating expenses** include expenditures that are not directly tied to the production of goods or services. Examples include rent, utilities, insurance, and salaries of nonproduction employees.
- **Taxes and interests** are the final deductions made before reaching net profit.



3. Types of Business Models

There are many kinds of business models, and finding the right one is often one of the key early challenges faced by businesses. Looking at different options and proceeding by elimination is usually a helpful way for companies to narrow down their options.

Here is a comprehensive list of common business models.

Business Model Type	How it works	Example
BROKERAGE	Bring together buyers and sellers, charging a fee per transaction to one or another party.	<ul style="list-style-type: none"> • Century 21 • Orbitz
BUNDLING	Package related goods and services together.	<ul style="list-style-type: none"> • Fast-food value meals • iPod/iTunes
CELL PHONE	Charge different rates for discrete levels of a service.	<ul style="list-style-type: none"> • Sprint • Betterplace
CROWDSOURCING	Get a large group of people to contribute content for free in exchange for access to other people's content.	<ul style="list-style-type: none"> • Wikipedia • YouTube
DISINTERMEDIATION	Sell direct, sidestepping traditional middlemen.	<ul style="list-style-type: none"> • Dell • WebMD
FRACTIONALIZATION	Sell partial use of something.	<ul style="list-style-type: none"> • Times-shares
FREEMIUM	Offer basic services for free, charge for premium service.	<ul style="list-style-type: none"> • LinkedIn
LEASING	Rent, rather than sell, high-margin, high-priced products.	<ul style="list-style-type: none"> • Cars
NEGATIVE OPERATING CYCLE	Lower prices by receiving payment before delivering the offering.	<ul style="list-style-type: none"> • Amazon
PAY-AS-YOU-GO	Charge for real-time, metered usage.	<ul style="list-style-type: none"> • Electric companies
RAZOR/BLADES	Offer the high-margin razor below cost to increase volume sales of the low-margin razor blades.	<ul style="list-style-type: none"> • Printers and ink

Business Model Type	How it works	Example
PRODUCT TO SERVICE	Rather than sell a product, sell the service the product performs.	• Zipcar
SUBSCRIPTION	Charge a subscription fee to gain access to a service.	• Netflix

4. Deep Dive - The Subscription Business Model

Companies that operate on a subscription business model generate revenue by charging their customers a recurring fee—weekly, monthly, or yearly—for access to their products or services, instead of requiring a one-time purchase.

This approach prioritizes keeping existing customers over acquiring new ones, offering a more predictable revenue stream.

Key examples of subscription-based businesses include streaming services like Netflix and Spotify, software as a service (SaaS) platforms such as Microsoft and Salesforce, and content providers like the New York Times.

Adopting a subscription business model comes with benefits and drawbacks:

Advantages	Disadvantages
Predictable Revenue	Increasing competition
Stronger customer base & relationships	High cancellation rate
Improves profiling and targeting for customer acquisition and retention	Uncertain revenue in startup phase
Increased Customer Lifetime Value*	Constant need to provide new value

***Customer Lifetime Value (CLV)** is a metric that represents the total amount of revenue a business can reasonably expect from a single customer account throughout the business relationship. It factors in the customer's revenue contribution, the duration of the relationship, and the costs associated with serving the customer.

5. Deep Dive - The Freemium Business Model

The freemium business model provides basic services or products at no cost, while advanced features, functionalities, or content are available for a fee.

By eliminating the initial cost barrier, this model seeks to attract a broad user base, encouraging them to sample the service. The goal is for users to recognize the value of the premium offerings and decide to **upgrade to the paid version**.



Dropbox, an early adopter of the freemium business model, was established in 2007 as a cloud storage and file synchronization service.

Today, Dropbox boasts over 700 million users on its platform. Its free plan is straightforward and user-friendly, while the premium plan offers enhanced features, including additional storage space and advanced functionalities.

It's estimated that around 8.5% of Dropbox's user base opts for premium plans.

Dropbox's remarkable success can be attributed to its strategic focus on expanding its user base through the freemium business model.

There are numerous advantages and limitations to adopting a subscription business model:

Advantages	Disadvantages
Increased user base	Faster cash burn due to high maintenance costs
Ability to upsell	Low customer retention rate
Different revenue streams	Higher overhead costs
Barrier to competition	Requires a large user base

6. Deep Dive - The Online Marketplace Business Model

The marketplace business model creates a virtual space that connects buyers and sellers on a centralized platform, facilitating the purchase and sale of goods.

Businesses that use this model act as an intermediary, helping make communication and transactions smoother and more secure.



Airbnb, an early adopter of the marketplace business model, connects property owners with guests seeking accommodations. For each booking, Airbnb collects a service fee from both guests and property owners.

Here are some pros and cons of adopting an online marketplace business model:

Advantages	Disadvantages
<p>Scalability at a relatively low cost</p> <p>Multiple revenue streams (listing fees, commissions, advertising, etc)</p> <p>Network effects</p> <p>Community building</p>	<p>High initial investment</p> <p>Challenge of trust and safety</p> <p>Regulatory compliance</p> <p>Quality control</p> <p>Dispute resolution</p>

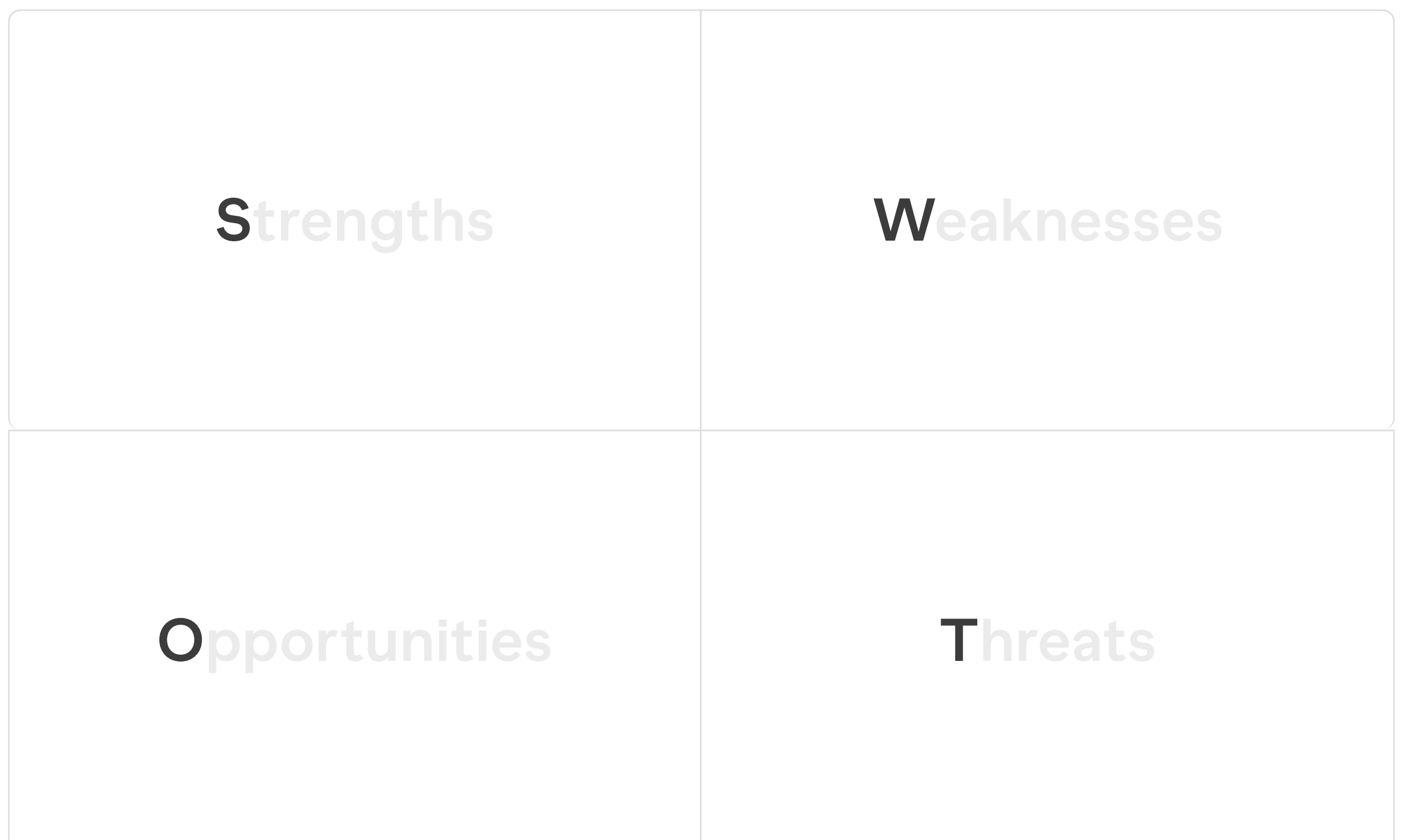
8. Evaluating the competitive environment: PESTEL & SWOT

Two useful business tools for evaluating a competitive environment are the PESTEL and SWOT analyses.

The SWOT analysis evaluates an organization's internal strengths and weaknesses, along with the opportunities and threats present in its external environment. SWOT stands for **Strengths, Weaknesses, Opportunities, and Threats**.

The PESTEL analysis helps identify the external forces impacting an organization, covering **Political, Economic, Social, Technological, Environmental, and Legal** factors.

These frameworks offer valuable insights into a company's position and capabilities, guiding strategic planning and decision-making.



Political

Economical

Social

Technological

Environmental

Legal

Key Takeaways



- A **business model** outlines how a company creates, delivers, and captures value, acting as a blueprint for operations and revenue generation.

- The success of any business hinges on its willingness and ability to **focus on the customer**.

- There exists a wide array of business models, from subscription services to freemium models. The key is to **explore various options**, assess them against your strengths and business objectives.

- Business models should evolve based on factors such as market demand, technological advancements, and changes in consumer behavior. **Flexibility and adaptability** are key to staying relevant.

- **Continuous innovation** in your business model can create a competitive edge, reduce barriers to entry, and increase customer lifetime value.

- Utilizing **PESTEL** and **SWOT** analyses can provide comprehensive insights into the internal and external factors affecting your business,
