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Business Model Generation

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An amazing crowd of 470 practitioners from 45 countries

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— Alex, Yves, Alan, Tim, and Patrick

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~~*A Handbook for Visionaries, Game Changers, and Challengers*~~

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Def_ Business Model

A business model describes the rationale of how an organization creates, delivers, and captures value

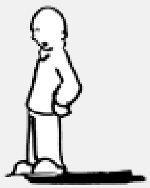
The starting point for any good discussion, meeting, or workshop on business model innovation should be a shared understanding of what a business model actually is. We need a business model concept that everybody understands: one that facilitates description and discussion. We need to start from the same point and talk about the same thing. The challenge is that the concept must be simple, relevant, and intuitively understandable, while not oversimplifying the complexities of how enterprises function.

In the following pages we offer a concept that allows you to describe and think through the business model of your organization, your competitors, or any other enterprise. This concept has been applied and tested around the world and is already used in organizations such as IBM, Ericsson, Deloitte, the Public Works and Government Services of Canada, and many more.

This concept can become a shared language that allows you to easily describe and manipulate business models to create new strategic alternatives. Without such a shared language it is difficult to systematically challenge assumptions about one's business model and innovate successfully.

We believe a business model can best be described through nine basic building blocks that show the logic of how a company intends to make money. The nine blocks cover the four main areas of a business: customers, offer, infrastructure, and financial viability. The business model is like a blueprint for a strategy to be implemented through organizational structures, processes, and systems.

The 9 Building Blocks



CS

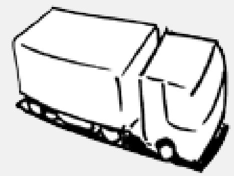
1 Customer Segments

An organization serves one or several Customer Segments.

VP

2 Value Propositions

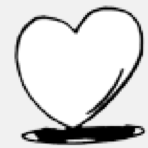
It seeks to solve customer problems and satisfy customer needs with value propositions.



CH

3 Channels

Value propositions are delivered to customers through communication, distribution, and sales Channels.



CR

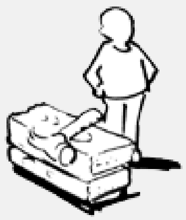
4 Customer Relationships

Customer relationships are established and maintained with each Customer Segment.

R$

5 **Revenue Streams**

Revenue streams result from value propositions successfully offered to customers.



KR

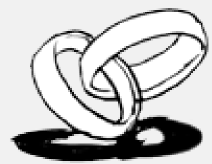
6 **Key Resources**

Key resources are the assets required to offer and deliver the previously described elements…

KA

7 **Key Activities**

…by performing a number of Key Activities.



KP

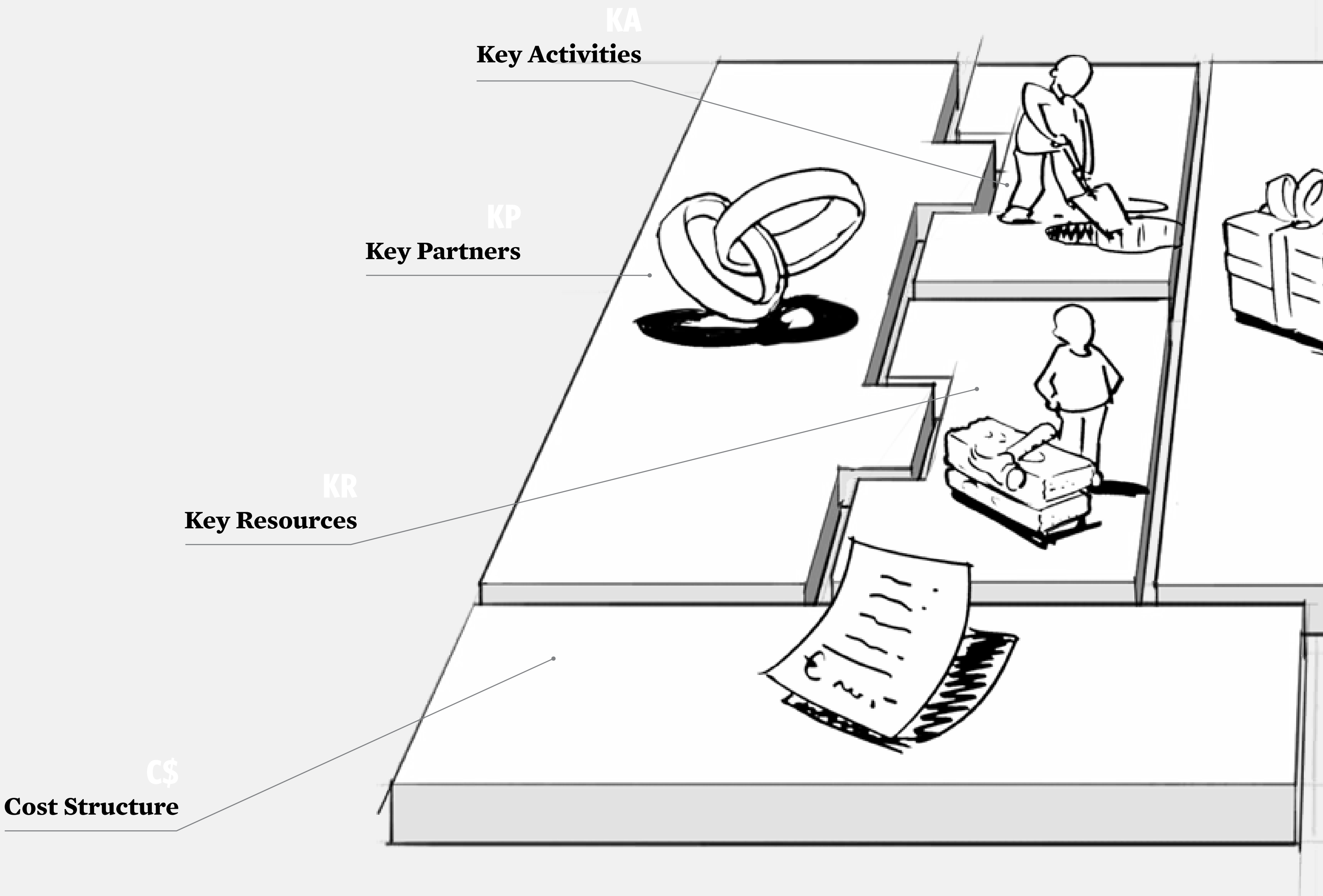
8 **Key Partnerships**

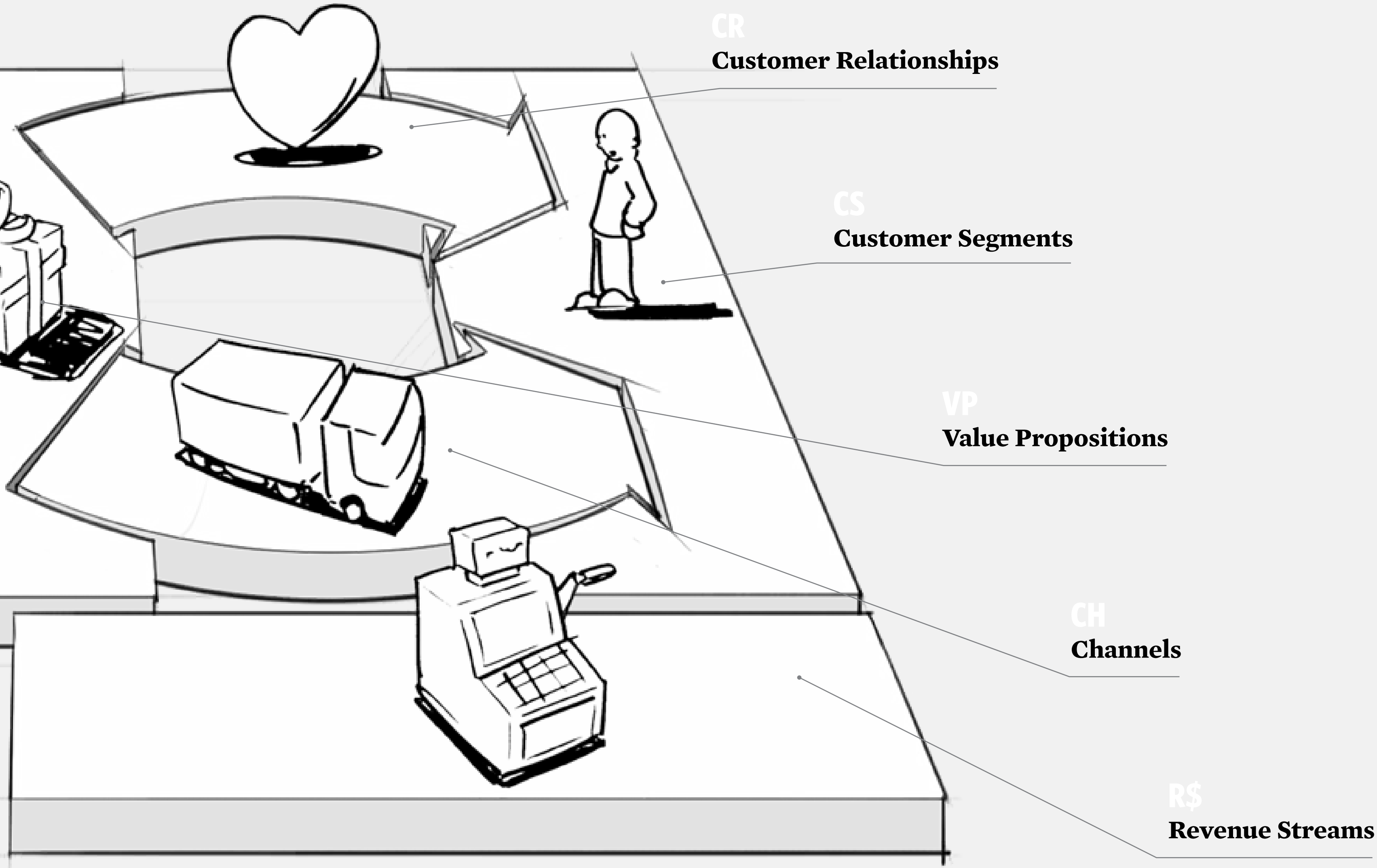
Some activities are outsourced and some resources are acquired outside the enterprise.

C$

9 **Cost Structure**

The business model elements result in the cost structure.


KA
Key Activities
KP
Key Partners
KR
Key Resources
C$
Cost Structure


CR
Customer Relationships
CS
Customer Segments
VP
Value Propositions
CH
Channels
R$
Revenue Streams

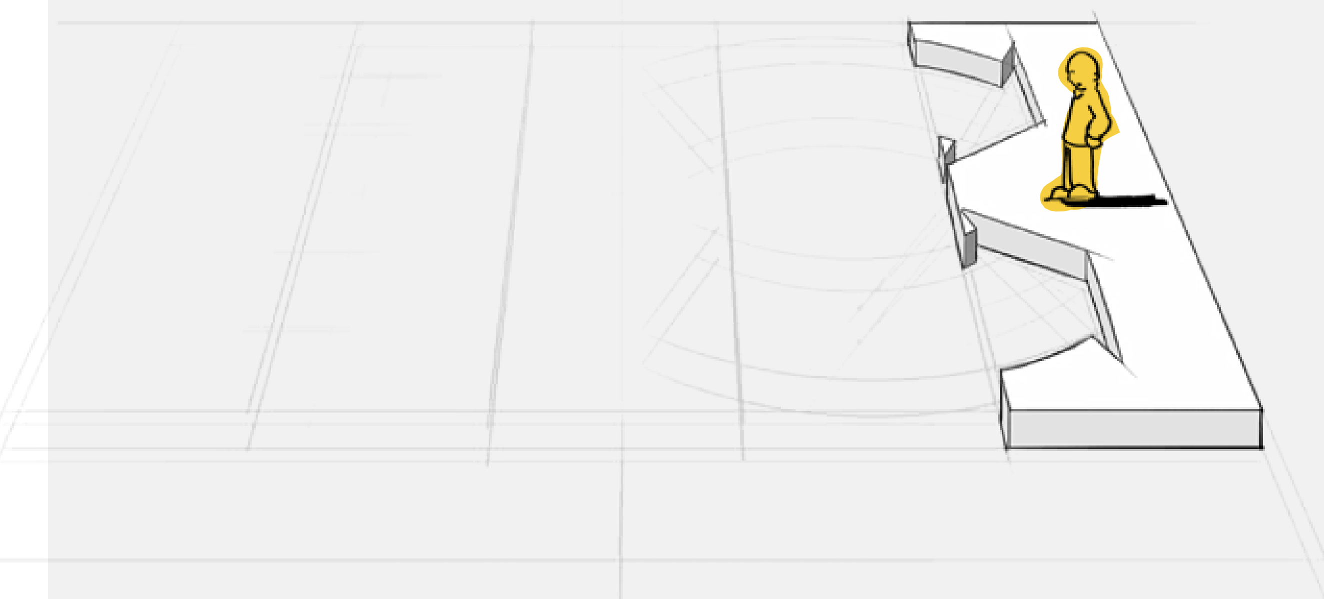
1

Customer Segments

The Customer Segments Building Block defines the different groups of people or organizations an enterprise aims to reach and serve

Customers comprise the heart of any business model. Without (profitable) customers, no company can survive for long. In order to better satisfy customers, a company may group them into distinct segments with common needs, common behaviors, or other attributes. A business model may define one or several large or small Customer Segments. An organization must make a conscious decision about which segments to serve and which segments to ignore. Once this decision is made, a business model can be carefully designed around a strong understanding of specific customer needs.

Customer groups represent separate segments if:
- *Their needs require and justify a distinct offer*
- *They are reached through different Distribution Channels*
- *They require different types of relationships*
- *They have substantially different profitabilities*
- *They are willing to pay for different aspects of the offer*



For whom are we creating value?
Who are our most important customers?

There are different types of Customer Segments. Here are some examples:

Mass market

Business models focused on mass markets don't distinguish between different Customer Segments. The Value Propositions, Distribution Channels, and Customer Relationships all focus on one large group of customers with broadly similar needs and problems. This type of business model is often found in the consumer electronics sector.

Niche market

Business models targeting niche markets cater to specific, specialized Customer Segments. The Value Propositions, Distribution Channels, and Customer Relationships are all tailored to the specific requirements of a niche market. Such business models are often found in supplier-buyer relationships. For example, many car part manufacturers depend heavily on purchases from major automobile manufacturers.

Segmented

Some business models distinguish between market segments with slightly different needs and problems. The retail arm of a bank like Credit Suisse, for example, may distinguish between a large group of customers, each possessing assets of up to U.S. $100,000, and a smaller group of affluent clients, each of whose net worth exceeds U.S. $500,000. Both segments have similar but varying needs and problems. This has implications for the other building blocks of Credit Suisse's business model, such as the Value Proposition, Distribution Channels, Customer Relationships, and Revenue streams. Consider Micro Precision Systems, which specializes in providing outsourced micromechanical design and manufacturing solutions. It serves three different Customer Segments — the watch industry, the medical industry, and the industrial automation sector — and offers each slightly different Value Propositions.

Diversified

An organization with a diversified customer business model serves two unrelated Customer Segments with very different needs and problems. For example, in 2006 Amazon.com decided to diversify its retail business by selling "cloud computing" services: online storage space and on-demand server usage. Thus it started catering to a totally different Customer Segment — Web companies — with a totally different Value Proposition. The strategic rationale behind this diversification can be found in Amazon.com's powerful IT infrastructure, which can be shared by its retail sales operations and the new cloud computing service unit.

Multi-sided platforms (or multi-sided markets)

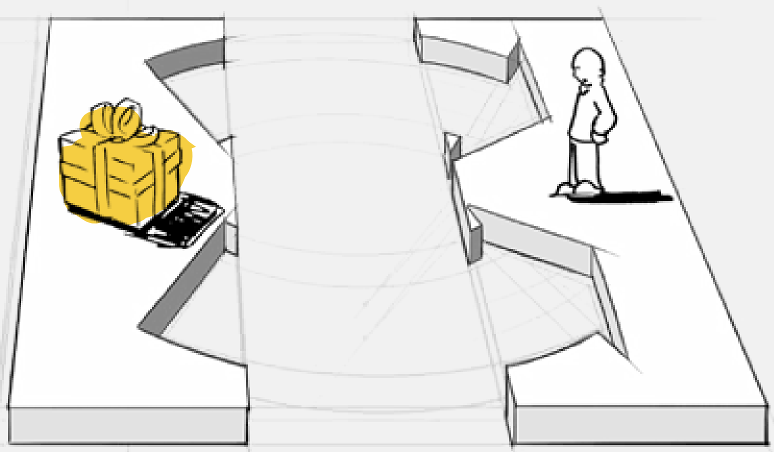
Some organizations serve two or more interdependent Customer Segments. A credit card company, for example, needs a large base of credit card holders and a large base of merchants who accept those credit cards. Similarly, an enterprise offering a free newspaper needs a large reader base to attract advertisers. On the other hand, it also needs advertisers to finance production and distribution. Both segments are required to make the business model work (read more about multi-sided platforms on p. 76).

2 *Value Propositions*

The Value Propositions Building Block describes the bundle of products and services that create value for a specific Customer Segment

The Value Proposition is the reason why customers turn to one company over another. It solves a customer problem or satisfies a customer need. Each Value Proposition consists of a selected bundle of products and/or services that caters to the requirements of a specific Customer Segment. In this sense, the Value Proposition is an aggregation, or bundle, of benefits that a company offers customers.

Some Value Propositions may be innovative and represent a new or disruptive offer. Others may be similar to existing market offers, but with added features and attributes.



What value do we deliver to the customer? Which one of our customer's problems are we helping to solve? Which customer needs are we satisfying? What bundles of products and services are we offering to each Customer Segment?

A Value Proposition creates value for a Customer Segment through a distinct mix of elements catering to that segment's needs. Values may be quantitative (e.g. price, speed of service) or qualitative (e.g. design, customer experience).

Elements from the following non-exhaustive list can contribute to customer value creation.

Newness

Some Value Propositions satisfy an entirely new set of needs that customers previously didn't perceive because there was no similar offering. This is often, but not always, technology related. Cell phones, for instance, created a whole new industry around mobile telecommunication. On the other hand, products such as ethical investment funds have little to do with new technology.

Performance

Improving product or service performance has traditionally been a common way to create value. The PC sector has traditionally relied on this factor by bringing more powerful machines to market. But improved performance has its limits. In recent years, for example, faster PCs, more disk storage space, and better graphics have failed to produce corresponding growth in customer demand.

Customization

Tailoring products and services to the specific needs of individual customers or Customer Segments creates value. In recent years, the concepts of mass customization and customer co-creation have gained importance. This approach allows for customized products and services, while still taking advantage of economies of scale.

"Getting the job done"

Value can be created simply by helping a customer get certain jobs done. Rolls-Royce understands this very well: its airline customers rely entirely on Rolls-Royce to manufacture and service their jet engines. This arrangement allows customers to focus on running their airlines. In return, the airlines pay Rolls- Royce a fee for every hour an engine runs.

Design

Design is an important but difficult element to measure. A product may stand out because of superior design. In the fashion and consumer electronics industries, design can be a particularly important part of the Value Proposition.

Brand/status

Customers may find value in the simple act of using and displaying a specific brand. Wearing a Rolex watch signifies wealth, for example. On the other end of the spectrum, skateboarders may wear the latest "underground" brands to show that they are "in."

Price

Offering similar value at a lower price is a common way to satisfy the needs of price-sensitive Customer Segments. But low-price Value Propositions have important implications for the rest of a business model. No frills airlines, such as Southwest, easyJet, and Ryanair have designed entire business models specifically to enable low cost air travel. Another example of a price-based Value Proposition can be seen in the Nano, a new car designed and manufactured by the Indian conglomerate Tata. Its surprisingly low price makes the automobile affordable to a whole new segment of the Indian population. Increasingly, free offers are starting to permeate various industries. Free offers range from free newspapers to free e-mail, free mobile phone services, and more (see p. 88 for more on FREE).

Cost reduction

Helping customers reduce costs is an important way to create value. Salesforce.com, for example, sells a hosted Customer Relationship management (CRM) application. This relieves buyers from the expense and trouble of having to buy, install, and manage CRM software themselves.

Risk reduction

Customers value reducing the risks they incur when purchasing products or services. For a used car buyer, a one-year service guarantee reduces the risk of post-purchase breakdowns and repairs. A service-level guarantee partially reduces the risk undertaken by a purchaser of outsourced IT services.

Accessibility

Making products and services available to customers who previously lacked access to them is another way to create value. This can result from business model innovation, new technologies, or a combination of both. NetJets, for instance, popularized the concept of fractional private jet ownership. Using an innovative business model, NetJets offers individuals and corporations access to private jets, a service previously unaffordable to most customers. Mutual funds provide another example of value creation through increased accessibility. This innovative financial product made it possible even for those with modest wealth to build diversified investment portfolios.

Convenience/usability

Making things more convenient or easier to use can create substantial value. With iPod and iTunes, Apple offered customers unprecedented convenience searching, buying, downloading, and listening to digital music. It now dominates the market.

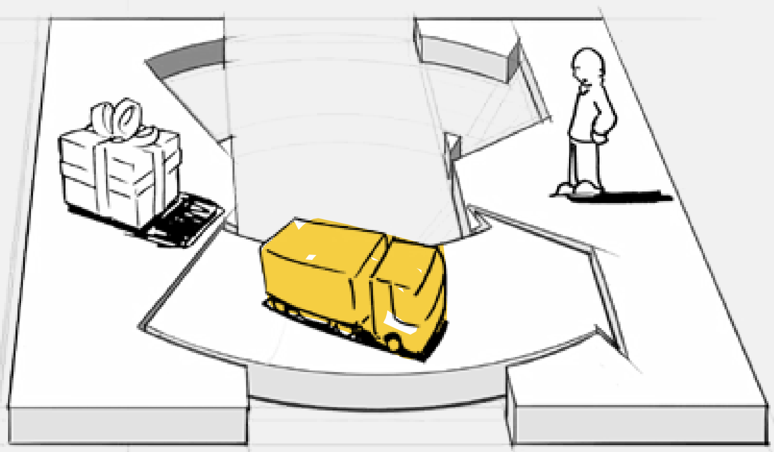
3

Channels

The Channels Building Block describes how a company communicates with and reaches its Customer Segments to deliver a Value Proposition

Communication, distribution, and sales Channels comprise a company's interface with customers. Channels are customer touch points that play an important role in the customer experience. Channels serve several functions, including:

- *Raising awareness among customers about a company's products and services*
- *Helping customers evaluate a company's Value Proposition*
- *Allowing customers to purchase specific products and services*
- *Delivering a Value Proposition to customers*
- *Providing post-purchase customer support*



Through which Channels do our Customer Segments want to be reached? How are we reaching them now? How are our Channels integrated? Which ones work best? Which ones are most cost-efficient? How are we integrating them with customer routines?

Channels have five distinct phases. Each channel can cover some or all of these phases. We can distinguish between direct Channels and indirect ones, as well as between owned Channels and partner Channels.

Finding the right mix of Channels to satisfy how customers want to be reached is crucial in bringing a Value Proposition to market. An organization can choose between reaching its customers through its own Channels, through partner Channels, or through a mix of both. Owned Channels can be direct, such as an in-house sales force or a Web site, or they can be indirect, such as retail stores owned or operated by the organization. Partner Channels are indirect and span a whole range of options, such as wholesale distribution, retail, or partner-owned Web sites.

Partner Channels lead to lower margins, but they allow an organization to expand its reach and benefit from partner strengths. Owned Channels and particularly direct ones have higher margins, but can be costly to put in place and to operate. The trick is to find the right balance between the different types of Channels, to integrate them in a way to create a great customer experience, and to maximize revenues.

<table>
<tr><th colspan="3">Channel Types</th><th colspan="5">Channel Phases</th></tr>
<tr><td rowspan="3">Own</td><td rowspan="2">Direct</td><td>Sales force</td><td rowspan="5">1. Awareness
How do we raise awareness about our company's products and services?</td><td rowspan="5">2. Evaluation
How do we help customers evaluate our organization's Value Proposition?</td><td rowspan="5">3. Purchase
How do we allow customers to purchase specific products and services?</td><td rowspan="5">4. Delivery
How do we deliver a Value Proposition to customers?</td><td rowspan="5">5. After sales
How do we provide post-purchase customer support?</td></tr>
<tr><td>Web sales</td></tr>
<tr><td rowspan="3">Indirect</td><td>Own stores</td></tr>
<tr><td rowspan="2">Partner</td><td>Partner stores</td></tr>
<tr><td>Wholesaler</td></tr>
</table>

Customer Relationships

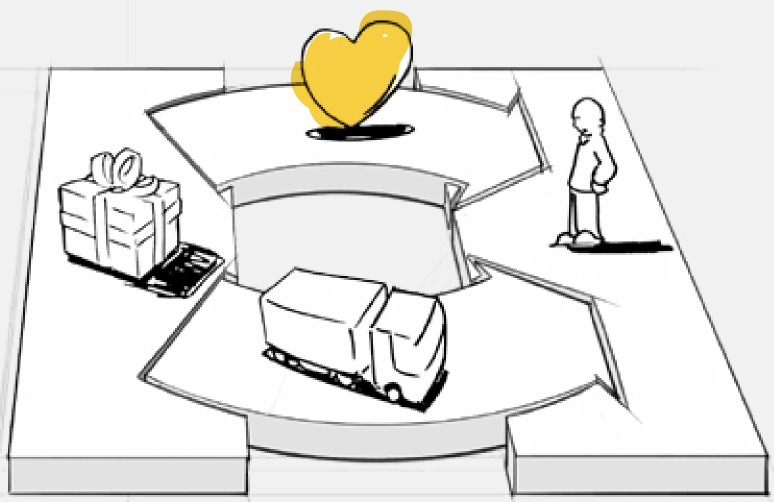
The Customer Relationships Building Block describes the types of relationships a company establishes with specific Customer Segments

A company should clarify the type of relationship it wants to establish with each Customer Segment. Relationships can range from personal to automated. Customer relationships may be driven by the following motivations:

- *Customer acquisition*
- *Customer retention*
- *Boosting sales (upselling)*

In the early days, for example, mobile network operator Customer Relationships were driven by aggressive acquisition strategies involving free mobile phones. When the market became saturated, operators switched to focusing on customer retention and increasing average revenue per customer.

The Customer Relationships called for by a company's business model deeply influence the overall customer experience.



What type of relationship does each of our Customer Segments expect us to establish and maintain with them? Which ones have we established? How costly are they? How are they integrated with the rest of our business model?

We can distinguish between several categories of Customer Relationships, which may co-exist in a company's relationship with a particular Customer Segment:

Personal assistance
This relationship is based on human interaction. The customer can communicate with a real customer representative to get help during the sales process or after the purchase is complete. This may happen on-site at the point of sale, through call centers, by e-mail, or through other means.

Dedicated personal assistance
This relationship involves dedicating a customer representative specifically to an individual client. It represents the deepest and most intimate type of relationship and normally develops over a long period of time. In private banking services, for example, dedicated bankers serve high net worth individuals. Similar relationships can be found in other businesses in the form of key account managers who maintain personal relationships with important customers.

Self-service
In this type of relationship, a company maintains no direct relationship with customers. It provides all the necessary means for customers to help themselves.

Automated services
This type of relationship mixes a more sophisticated form of customer self-service with automated processes. For example, personal online profiles give customers access to customized services. Automated services can recognize individual customers and their characteristics, and offer information related to orders or transactions. At their best, automated services can stimulate a personal relationship (e.g. offering book or movie recommendations).

Communities
Increasingly, companies are utilizing user communities to become more involved with customers/prospects and to facilitate connections between community members. Many companies maintain online communities that allow users to exchange knowledge and solve each other's problems. Communities can also help companies better understand their customers. Pharmaceutical giant GlaxoSmithKline launched a private online community when it introduced *alli*, a new prescription-free weight-loss product.

GlaxoSmithKline wanted to increase its understanding of the challenges faced by overweight adults, and thereby learn to better manage customer expectations.

Co-creation
More companies are going beyond the traditional customer-vendor relationship to co-create value with customers. Amazon.com invites customers to write reviews and thus create value for other book lovers. Some companies engage customers to assist with the design of new and innovative products. Others, such as YouTube.com, solicit customers to create content for public consumption.

R$

5

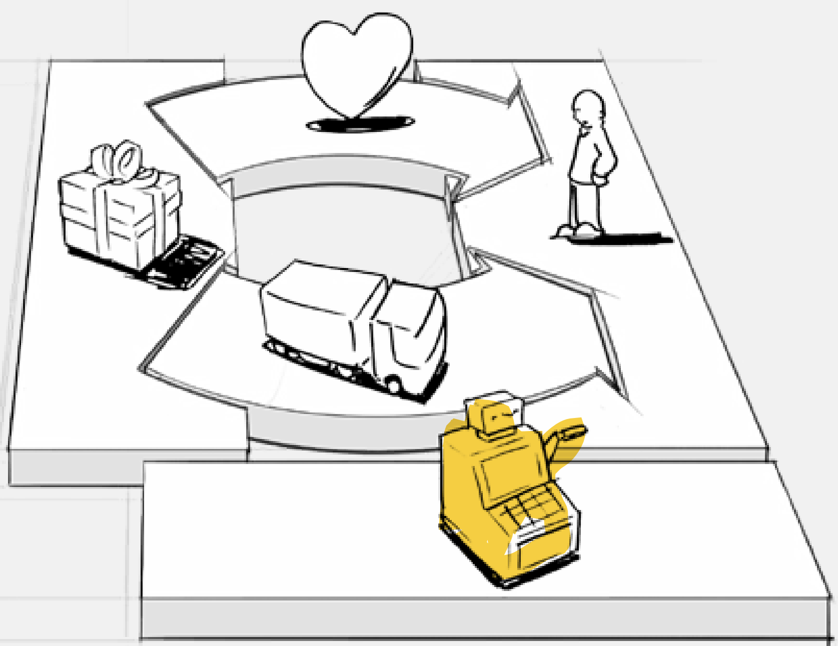
Revenue Streams

The Revenue Streams Building Block represents the cash a company generates from each Customer Segment (costs must be subtracted from revenues to create earnings)

If customers comprise the heart of a business model, Revenue Streams are its arteries. A company must ask itself, For what value is each Customer Segment truly willing to pay? Successfully answering that question allows the firm to generate one or more Revenue Streams from each Customer Segment. Each Revenue Stream may have different pricing mechanisms, such as fixed list prices, bargaining, auctioning, market dependent, volume dependent, or yield management.

A business model can involve two different types of Revenue Streams:

- *Transaction revenues resulting from one-time customer payments*
- *Recurring revenues resulting from ongoing payments to either deliver a Value Proposition to customers or provide post-purchase customer support*



For what value are our customers really willing to pay? For what do they currently pay? How are they currently paying? How would they prefer to pay? How much does each Revenue Stream contribute to overall revenues?

There are several ways to generate Revenue Streams:

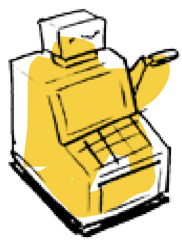
Asset sale
The most widely understood Revenue Stream derives from selling ownership rights to a physical product. Amazon.com sells books, music, consumer electronics, and more online. Fiat sells automobiles, which buyers are free to drive, resell, or even destroy.

Usage fee
This Revenue Stream is generated by the use of a particular service. The more a service is used, the more the customer pays. A telecom operator may charge customers for the number of minutes spent on the phone. A hotel charges customers for the number of nights rooms are used. A package delivery service charges customers for the delivery of a parcel from one location to another.

Subscription fees
This Revenue Stream is generated by selling continuous access to a service. A gym sells its members monthly or yearly subscriptions in exchange for access to its exercise facilities. World of Warcraft Online, a Web-based computer game, allows users to play its online game in exchange for a monthly subscription fee. Nokia's Comes with Music service gives users access to a music library for a subscription fee.

Lending/Renting/Leasing
This Revenue Stream is created by temporarily granting someone the exclusive right to use a particular asset for a fixed period in return for a fee. For the lender this provides the advantage of recurring revenues. Renters or lessees, on the other hand, enjoy the benefits of incurring expenses for only a limited time rather than bearing the full costs of ownership. Zipcar.com provides a good illustration. The company allows customers to rent cars by the hour in North American cities. Zipcar.com's service has led many people to decide to rent rather than purchase automobiles.

Licensing
This Revenue Stream is generated by giving customers permission to use protected intellectual property in exchange for licensing fees. Licensing allows rights-holders to generate revenues from their property without having to manufacture a product or commercialize a service. Licensing is common in the media industry, where content owners retain copyright while selling usage licenses to third parties. Similarly, in technology sectors patentholders grant other companies the right to use a patented technology in return for a license fee.



Brokerage fees

This Revenue Stream derives from intermediation services performed on behalf of two or more parties. Credit card providers, for example, earn revenues by taking a percentage of the value of each sales transaction executed between credit card merchants and customers. Brokers and real estate agents earn a commission each time they successfully match a buyer and seller.

Advertising

This Revenue Stream results from fees for advertising a particular product, service, or brand. Traditionally, the media industry and event organizers relied heavily on revenues from advertising. In recent years other sectors, including software and services, have started relying more heavily on advertising revenues.

Each Revenue Stream might have different pricing mechanisms. The type of pricing mechanism chosen can make a big difference in terms of revenues generated. There are two main types of pricing mechanism: fixed and dynamic pricing.

Pricing Mechanisms

Fixed "Menu" Pricing Predefined prices are based on static variables		Dynamic Pricing Prices change based on market conditions	
List price	Fixed prices for individual products, services, or other Value Propositions	*Negotiation (bargaining)*	Price negotiated between two or more partners depending on negotiation power and/or negotiation skills
Product feature dependent	Price depends on the number or quality of Value Proposition features	*Yield management*	Price depends on inventory and time of purchase (normally used for perishable resources such as hotel rooms or airline seats)
Customer segment dependent	Price depends on the type and characteristic of a Customer Segment	*Real-time-market*	Price is established dynamically based on supply and demand
Volume dependent	Price as a function of the quantity purchased	*Auctions*	Price determined by outcome of competitive bidding

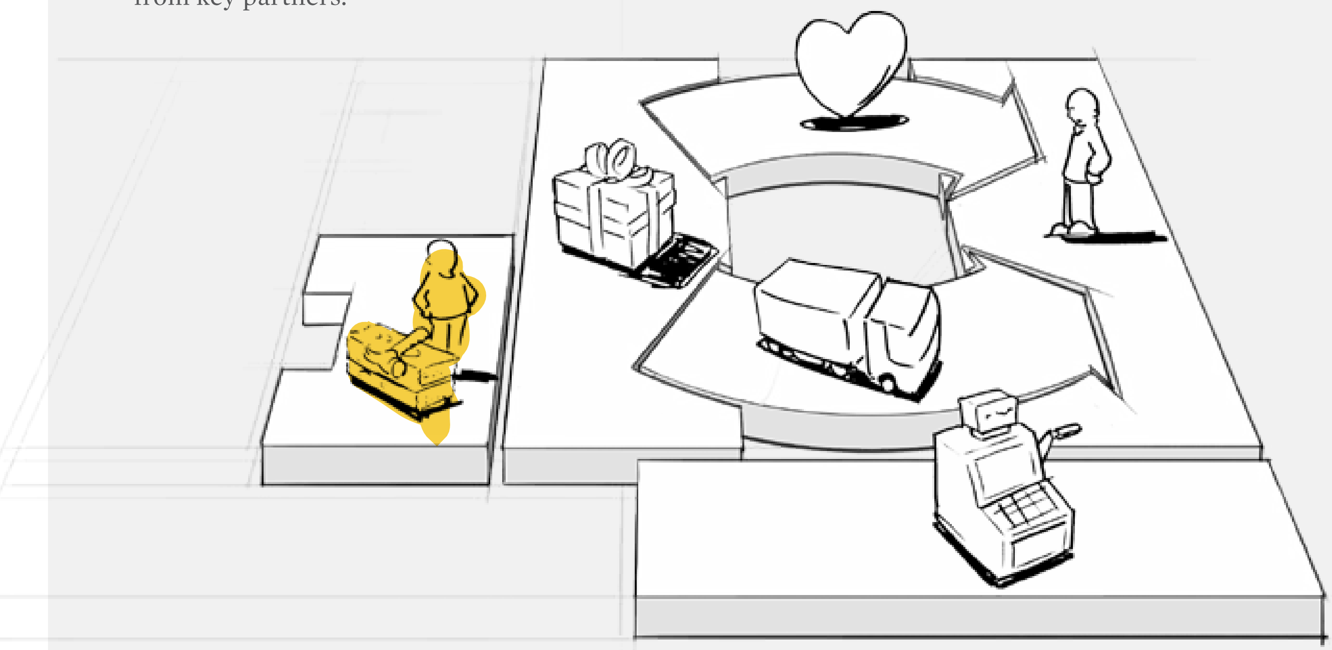
6

Key Resources

The Key Resources Building Block describes the most important assets required to make a business model work

Every business model requires Key Resources. These resources allow an enterprise to create and offer a Value Proposition, reach markets, maintain relationships with Customer Segments, and earn revenues. Different Key Resources are needed depending on the type of business model. A microchip manufacturer requires capital-intensive production facilities, whereas a microchip designer focuses more on human resources.

Key resources can be physical, financial, intellectual, or human. Key resources can be owned or leased by the company or acquired from key partners.



What Key Resources do our Value Propositions require? Our Distribution Channels? Customer Relationships? Revenue Streams?

Key Resources can be categorized as follows:

Physical
This category includes physical assets such as manufacturing facilities, buildings, vehicles, machines, systems, point-of-sales systems, and distribution networks. Retailers like Wal-Mart and Amazon.com rely heavily on physical resources, which are often capital-intensive. The former has an enormous global network of stores and related logistics infrastructure. The latter has an extensive IT, warehouse, and logistics infrastructure.

Intellectual
Intellectual resources such as brands, proprietary knowledge, patents and copyrights, partnerships, and customer databases are increasingly important components of a strong business model. Intellectual resources are difficult to develop but when successfully created may offer substantial value. Consumer goods companies such as Nike and Sony rely heavily on brand as a Key Resource. Microsoft and SAP depend on software and related intellectual property developed over many years. Qualcomm, a designer and supplier of chipsets for broadband mobile devices, built its business model around patented microchip designs that earn the company substantial licensing fees.

Human
Every enterprise requires human resources, but people are particularly prominent in certain business models. For example, human resources are crucial in knowledge-intensive and creative industries. A pharmaceutical company such as Novartis, for example, relies heavily on human resources: its business model is predicated on an army of experienced scientists and a large and skilled sales force.

Financial
Some business models call for financial resources and/or financial guarantees, such as cash, lines of credit, or a stock option pool for hiring key employees. Ericsson, the telecom manufacturer, provides an example of financial resource leverage within a business model. Ericsson may opt to borrow funds from banks and capital markets, then use a portion of the proceeds to provide vendor financing to equipment customers, thus ensuring that orders are placed with Ericsson rather than competitors.

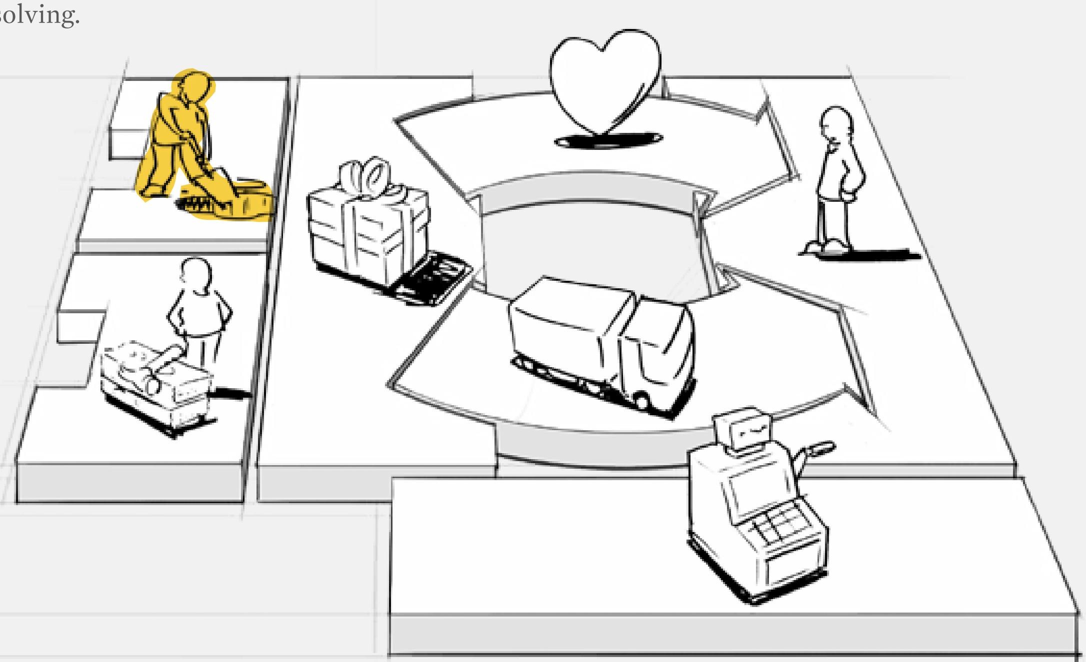
7

Key Activities

The Key Activities Building Block describes the most important things a company must do to make its business model work

Every business model calls for a number of Key Activities. These are the most important actions a company must take to operate successfully. Like Key Resources, they are required to create and offer a Value Proposition, reach markets, maintain Customer Relationships, and earn revenues. And like Key Resources, Key Activities differ depending on business model type. For software maker Microsoft, Key Activities include software development.

For PC manufacturer Dell, Key Activities include supply chain management. For consultancy McKinsey, Key Activities include problem solving.



What Key Activities do our Value Propositions require? Our Distribution Channels? Customer Relationships? Revenue streams?

Key Activities can be categorized as follows:

Production
These activities relate to designing, making, and delivering a product in substantial quantities and/or of superior quality. Production activity dominates the business models of manufacturing firms.

Problem solving
Key Activities of this type relate to coming up with new solutions to individual customer problems. The operations of consultancies, hospitals, and other service organizations are typically dominated by problem solving activities. Their business models call for activities such as knowledge management and continuous training.

Platform/network
Business models designed with a platform as a Key Resource are dominated by platform or network-related Key Activities. Networks, matchmaking platforms, software, and even brands can function as a platform. eBay's business model requires that the company continually develop and maintain its platform: the Web site at eBay.com. Visa's business model requires activities related to its Visa® credit card transaction platform for merchants, customers, and banks. Microsoft's business model requires managing the interface between other vendors' software and its Windows® operating system platform. Key Activities in this category relate to platform management, service provisioning, and platform promotion.

KP

8

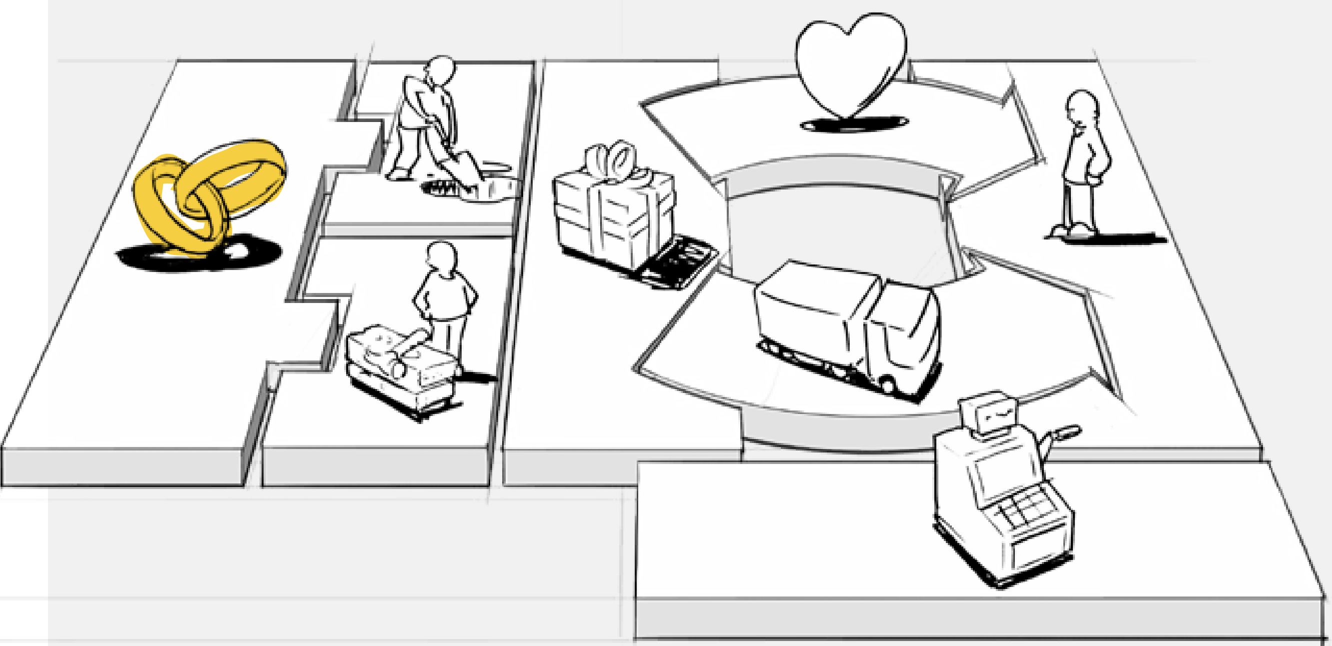
Key Partnerships

The Key Partnerships Building Block describes the network of suppliers and partners that make the business model work

Companies forge partnerships for many reasons, and partnerships are becoming a cornerstone of many business models. Companies create alliances to optimize their business models, reduce risk, or acquire resources.

We can distinguish between four different types of partnerships:

- *Strategic alliances between non-competitors*
- *Coopetition: strategic partnerships between competitors*
- *Joint ventures to develop new businesses*
- *Buyer-supplier relationships to assure reliable supplies*



Who are our Key Partners? Who are our key suppliers? Which Key Resources are we acquiring from partners? Which Key Activities do partners perform?

It can be useful to distinguish between three motivations for creating partnerships:

Optimization and economy of scale
The most basic form of partnership or buyer-supplier relationship is designed to optimize the allocation of resources and activities. It is illogical for a company to own all resources or perform every activity by itself. Optimization and economy of scale partnerships are usually formed to reduce costs, and often involve outsourcing or sharing infrastructure.

Reduction of risk and uncertainty
Partnerships can help reduce risk in a competitive environment characterized by uncertainty. It is not unusual for competitors to form a strategic alliance in one area while competing in another. Blu-ray, for example, is an optical disc format jointly developed by a group of the world's leading consumer electronics, personal computer, and media manufacturers. The group cooperated to bring Blu-ray technology to market, yet individual members compete in selling their own Blu-ray products.

Acquisition of particular resources and activities
Few companies own all the resources or perform all the activities described by their business models. Rather, they extend their own capabilities by relying on other firms to furnish particular resources or perform certain activities. Such partnerships can be motivated by needs to acquire knowledge, licenses, or access to customers. A mobile phone manufacturer, for example, may license an operating system for its handsets rather than developing one in-house. An insurer may choose to rely on independent brokers to sell its policies rather than develop its own sales force.

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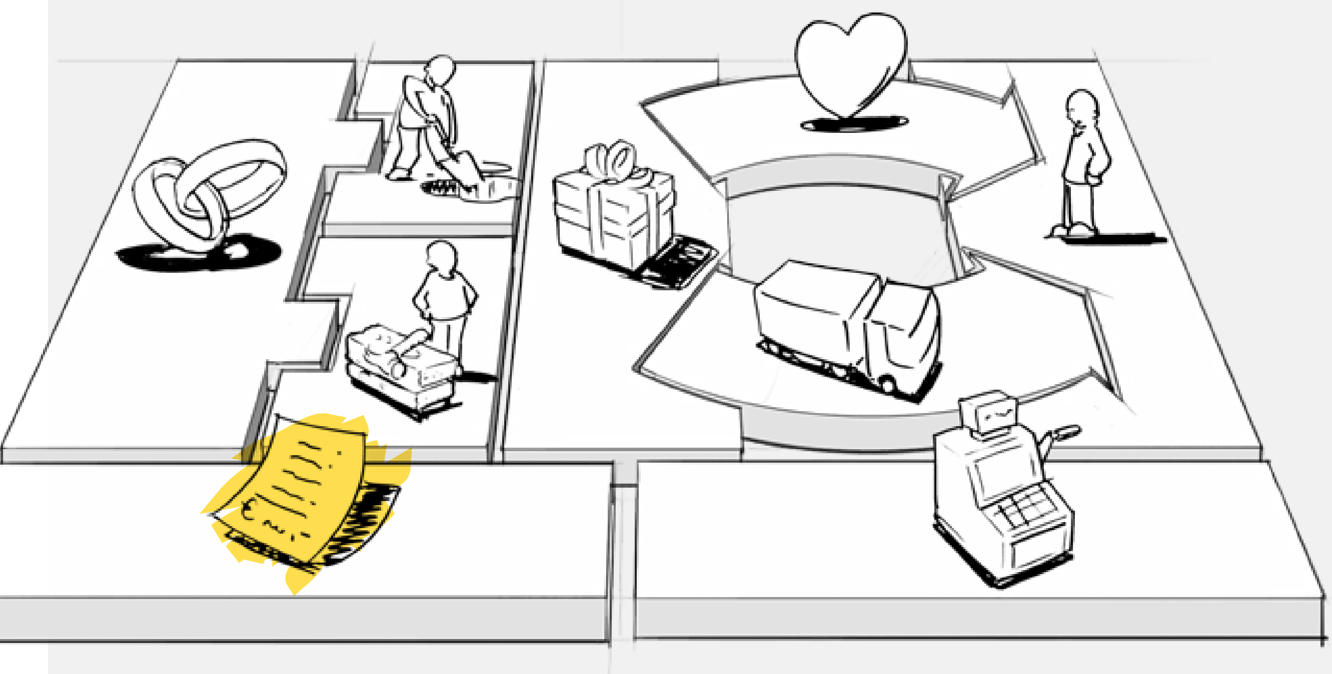
Cost Structure

The Cost Structure describes all costs incurred to operate a business model

This building block describes the most important costs incurred while operating under a particular business model. Creating and delivering value, maintaining Customer Relationships, and generating revenue all incur costs. Such costs can be calculated relatively easily after defining Key Resources, Key Activities, and Key Partnerships. Some business models, though, are more cost-driven than others. So-called "no frills" airlines, for instance, have built business models entirely around low Cost Structures.



What are the most important costs inherent in our business model? Which Key Resources are most expensive? Which Key Activities are most expensive?

Naturally enough, costs should be minimized in every business model. But low Cost Structures are more important to some business models than to others. Therefore it can be useful to distinguish between two broad classes of business model Cost Structures: cost-driven and value-driven (many business models fall in between these two extremes):

Cost-driven
Cost-driven business models focus on minimizing costs wherever possible. This approach aims at creating and maintaining the leanest possible Cost Structure, using low price Value Propositions, maximum automation, and extensive outsourcing. No frills airlines, such as Southwest, easyJet, and Ryanair typify cost-driven business models.

Value-driven
Some companies are less concerned with the cost implications of a particular business model design, and instead focus on value creation. Premium Value Propositions and a high degree of personalized service usually characterize value-driven business models. Luxury hotels, with their lavish facilities and exclusive services, fall into this category.

Cost Structures can have the following characteristics:

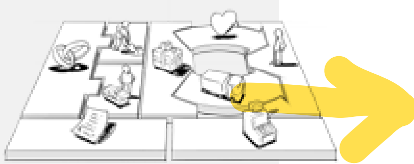
Fixed costs
Costs that remain the same despite the volume of goods or services produced. Examples include salaries, rents, and physical manufacturing facilities. Some businesses, such as manufacturing companies, are characterized by a high proportion of fixed costs.

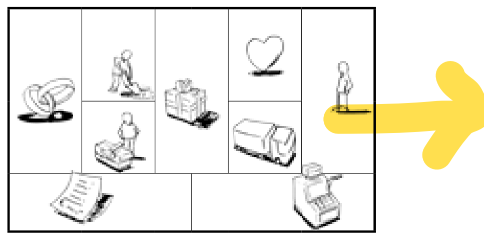
Variable costs
Costs that vary proportionally with the volume of goods or services produced. Some businesses, such as music festivals, are characterized by a high proportion of variable costs.

Economies of scale
Cost advantages that a business enjoys as its output expands. Larger companies, for instance, benefit from lower bulk purchase rates. This and other factors cause average cost per unit to fall as output rises.

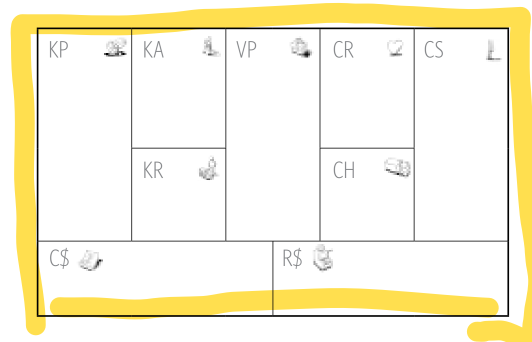
Economies of scope
Cost advantages that a business enjoys due to a larger scope of operations. In a large enterprise, for example, the same marketing activities or Distribution Channels may support multiple products.

The nine business model Building Blocks form the basis for a handy tool, which we call the *Business Model Canvas.*





The Business Model Canvas



This tool resembles a painter's canvas — preformatted with the nine blocks — which allows you to paint pictures of new or existing business models. ***The Business Model Canvas works best when printed out on a large surface so groups of people can jointly start sketching and discussing business model elements*** with Post-it® notes or board markers. It is a hands-on tool that fosters understanding, discussion, creativity, and analysis.

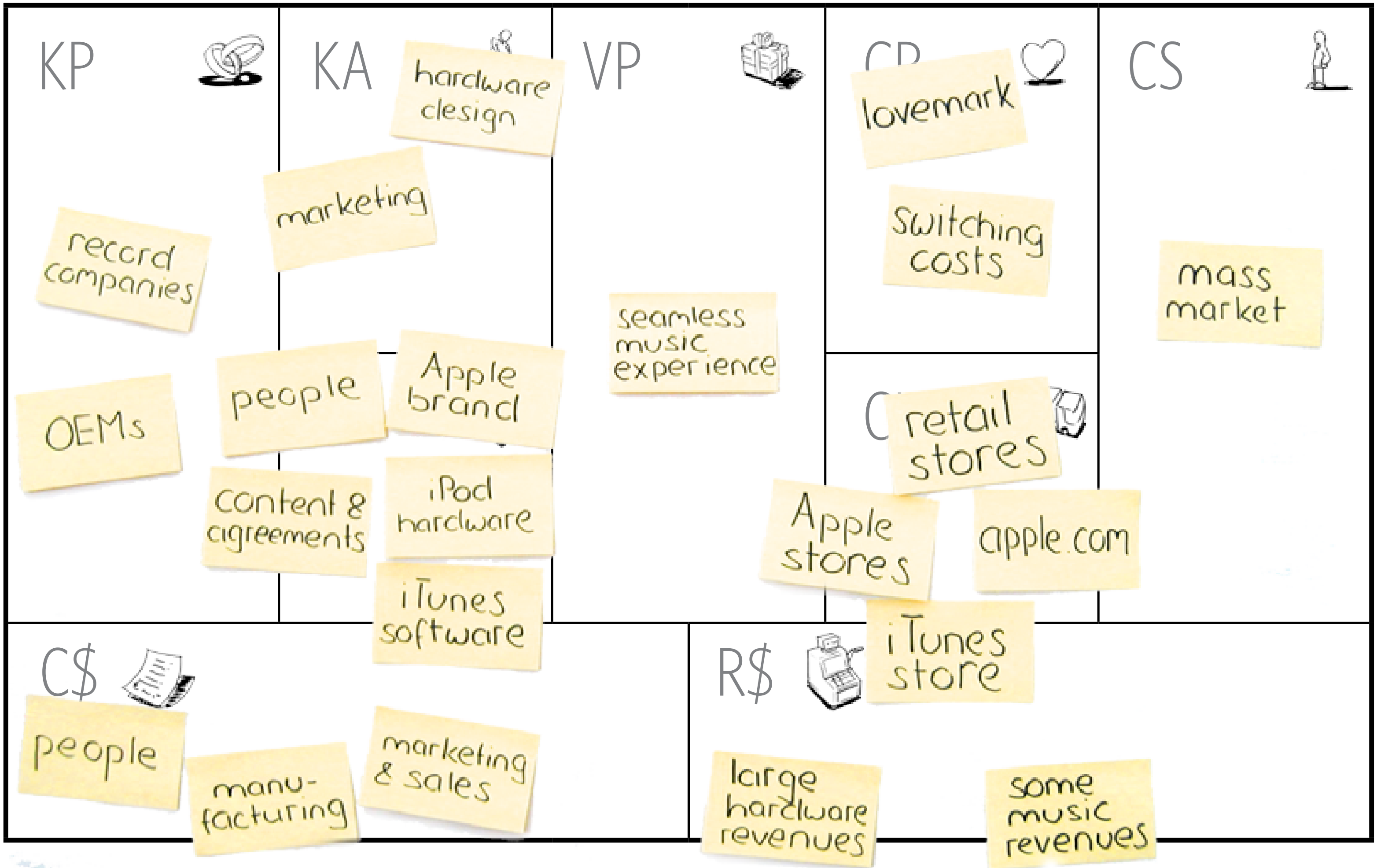

COST STRUCTURE

The Business Model Canvas

Key Partners	Key Activities	Value Proposition	Customer Relationships	Customer Segments
	Key Resources		Channels	

Cost Structure	Revenue Streams


① PLOT THE CANVAS ON A POSTER
② PUT THE POSTER ON THE WALL
③ SKETCH OUT YOUR BUSINESS MODEL


KP
record companies
OEMs
KA
hardware design
marketing
people
Apple brand
content & agreements
iPod hardware
iTunes software
VP
seamless music experience
lovemark
switching costs
retail stores
Apple stores
apple.com
iTunes store
CS
mass market
C$
people
manu-facturing
marketing & sales
R$
large hardware revenues
some music revenues

Example: Apple iPod/iTunes Business Model

In 2001 Apple launched its iconic iPod brand of portable media player. The device works in conjunction with iTunes software that enables users to transfer music and other content from the iPod to a computer. The software also provides a seamless connection to Apple's online store so users can purchase and download content.

This potent combination of device, software, and online store quickly disrupted the music industry and gave Apple a dominant market position. Yet Apple was not the first company to bring a portable media player to market. Competitors such as Diamond Multimedia, with its Rio brand of portable media players, were successful until they were outpaced by Apple.

How did Apple achieve such dominance? Because it competed with a better business model. On the one hand it offered users a seamless music experience by combining its distinctively designed iPod devices with iTunes software and the iTunes online store. Apple's Value Proposition is to allow customers to easily search, buy, and enjoy digital music. On the other hand, to make this Value Proposition possible, Apple had to negotiate deals with all the major record companies to create the world's largest online music library.

The twist? Apple earns most of its music-related revenues from selling iPods, while using integration with the online music store to protect itself from competitors.

Production and Logistics

Anything beyond content creation is outsourced to readily available service providers.

Differentiation

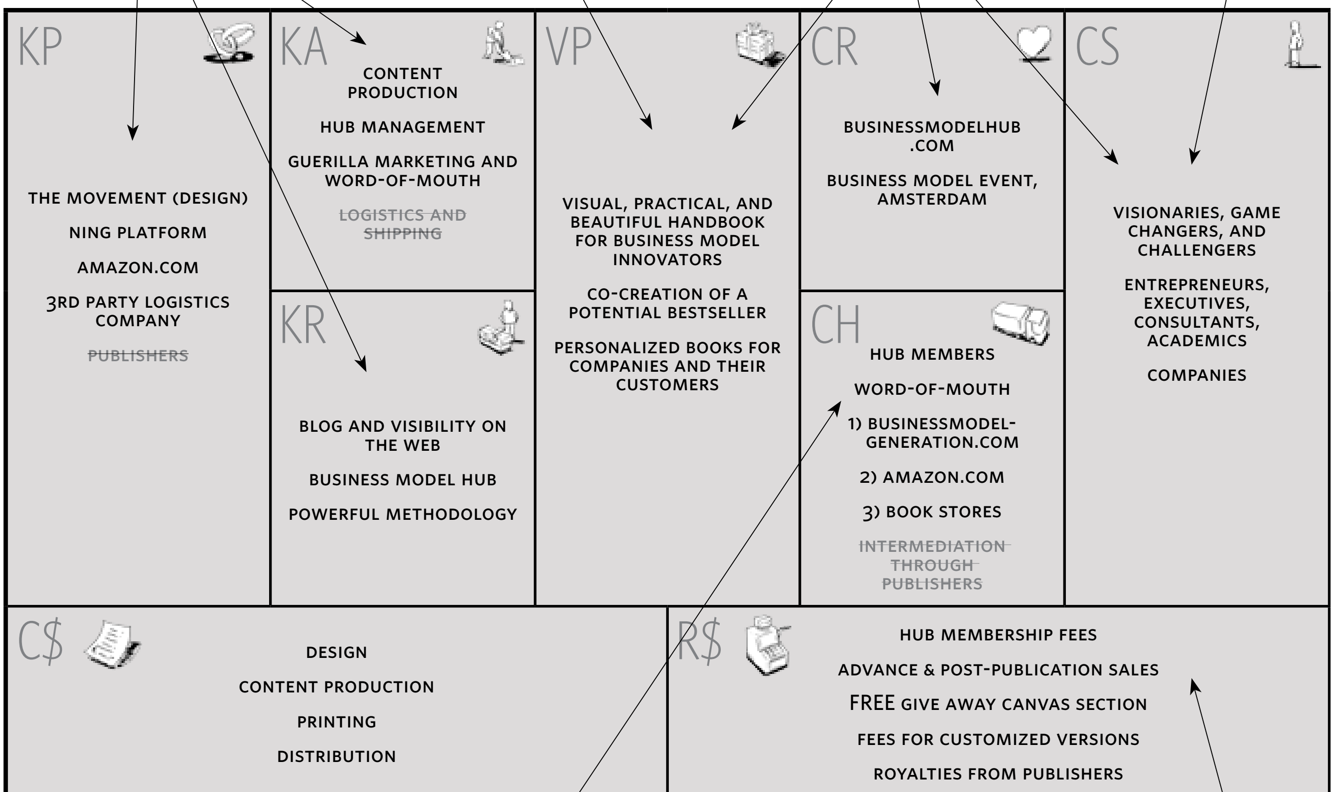
An entirely different format, business model, and story for the book makes it stand out in a crowded market.

Community

The book is co-created with practitioners from around the world who feel ownership thanks to attribution as contributing co-authors.

Buyers

Paying customers are not only readers, but co-creators and companies that want customized books for their employees and clients.



THE CANVAS OF *BUSINESS MODEL GENERATION*

Reach

A mix of direct and indirect Channels and a phased approach optimizes reach and margins. The story of the book lends itself well to viral marketing and word-of-mouth promotion.

Revenues

The book was financed through advanced sales and fees paid by co-creators. Additional revenues come from customized versions for companies and their clients.

Alex Osterwalder, Author

Dr. Osterwalder is an author, speaker, and adviser on the topic of business model innovation. His practical approach to designing innovative business models, developed together with Dr. Yves Pigneur, is practiced in multiple industries throughout the world by companies including 3M, Ericsson, Capgemini, Deloitte, Telenor, and many others. Previously he helped build and sell a strategic consulting firm, participated in the development of a Thailand-based global nonprofit organization combating HIV/AIDS and malaria, and did research at the University of Lausanne, Switzerland.

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Alan is a big scale thinker who loves the details just as much. He's a co-founder at the aptly named change agency: The Movement. There he works with inspired clients to blend community knowledge, business logic, and design thinking. The resulting strategy, communications, and interactive projects feel like artifacts from the future but always connect to the people of today. Why? Because he designs like he gives a damn — every project, every day.

Tim Clark, Editor & Contributing Co-Author

A teacher, writer, and speaker in the field of entrepreneurship, Tim's perspective is informed by his experience founding and selling a marketing research consultancy that served firms such as Amazon.com, Bertelsmann, General Motors, LVMH, and PeopleSoft. Business model thinking is key to his *Entrepreneurship for Everyone* approach to personal and professional learning, and central to his doctoral work on international business model portability. *Business Model Generation* is his fourth book.

Patrick van der Pijl, Producer

Patrick van der Pijl is the founder of Business Models, Inc., an international business model consultancy. Patrick helps organizations, entrepreneurs, and management teams discover new ways of doing business by envisioning, evaluating, and implementing new business models. Patrick helps clients succeed through intensive workshops, training courses, and coaching.

Business Model Generation *is a practical, inspiring handbook for anyone striving to improve a business model — or craft a new one.*

CHANGE THE WAY YOU THINK ABOUT BUSINESS MODELS
Business Model Generation will teach you powerful and practical innovation techniques used today by leading companies worldwide. You will learn how to systematically understand, design, and implement a new business model — or analyze and renovate an old one.

CO-CREATED BY 470 STRATEGY PRACTITIONERS
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Business Model Generation is for those ready to abandon outmoded thinking and embrace new, innovative models of value creation: executives, consultants, entrepreneurs — and leaders of all organizations.

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