

A business model is more than just a business plan. Avoid future headaches by reviewing the key elements of good business model design.

■ MY INSIGHT

A Model for Success



by David J. Teece

BUSINESS MODEL DESIGNS HAVE RECEIVED increasing attention in recent years. However, there are still too many entrepreneurs and managers who think that a business model is no more than a business plan. This can lead to a poor business model design that embeds future headaches deep in a company's strategy and brand.

For example, starting off by giving a product away in order to build a customer base may backfire because it can be difficult to charge for a product, such as news articles, once customers are accustomed to getting it for free.

The correct path depends on the nature of the product or service, how customers use it, how attached they become to it, and what substitutes are available. Getting the business model right as early as possible is, therefore, a crucial step for any new business, whether a startup or an established company launching a new product or service.

A good business model solves a problem for an identifiable group of potential customers who can support a price that will enable the business to cover all costs and leave a satisfactory profit. Sometimes, the problem to be solved is one that the user or innovator personally faces, but it can also emerge from market intelligence. The key elements of a business model are:

- **THE VALUE PROPOSITION:** the product or service, the user need it satisfies, and the identity of the initial and potential customer base.
- **THE REVENUE MODEL:** the pricing strategy, distribution channels and customer communication channels.
- **THE COST MODEL:** the necessary assets and capabilities, the operating structure and the partner network.

Business model design starts with choosing the technologies to be employed in the product or service. This choice should depend on which features are needed to help solve the problem faced by the identifiable group of users.

The choice of features, in turn, will determine what capabilities must be brought to bear. Those that are not already available in-house may need to be acquired or developed internally. If competitively supplied, their services can be contracted.

Once the product exists (in limited quantities, if non-digital), exploratory marketing efforts can determine whether customers find it as useful as expected. Customer

feedback is vital for determining the willingness to pay and the potential for market segmentation.

A typical decision at this stage is whether to start out targeting high-end users willing to pay a relatively high price or to pursue a larger pool of low-end users with a smaller profit margin. This choice has implications for the status of the emerging brand – or may be constrained by the status of an existing brand – and will be influenced by the presence or absence of network effects that reward whichever company expands its user network the fastest.

“ A business model is the basis on which a great business is built.”

As the revenue plan becomes clear, the cost structure may need to be adjusted to yield an acceptable profit. In the case of a high-end approach, the requirements in terms of usability and reliability are greater. Whatever the approach, access to information about suppliers and their costs is critical for capturing a high share of the value.

Unfortunately, no matter how good a business model is, it will eventually need to be modified in response to changes in technology, the customer base or competition. In fact, business model design is an ongoing process of review, frequent tweaking and periodic renovation.

To be successful in the long-term, the business model must also be complemented by good strategy, including differentiation from rivals and the creation of entry barriers, such as patents.

In the digital realm, it is relatively easy to pivot from an unsuccessful business model to a better one. Instagram, for example, started out as one feature of a smartphone app called Burbn that allowed users to leave location-specific messages. After a mixed reception, the founders discovered that photo-sharing seemed to be what most excited their users, leading to popularity and a \$1 billion sale to Facebook less than two years after launch.

The challenging endeavor of business model design provides the structure around which a great business can be built. Engaging in this process is an important step on the path to profits. ■

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