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The power of business models☆

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Abstract Over the past few years, "business models" have surged into the management vocabulary. But, while it has become quite fashionable to discuss business models, there is still much confusion about what business models are and how they can be used. In fact, business models can serve a positive and powerful role in corporate management. While other authors have recently offered definitions of "business model," none appear to be generally accepted. This lack of consensus may in part be attributed to interest in the concept from a wide range of disciplines, all of which have found a connection to the term. To help managers better understand business models, this paper reviews the extant literature and identifies and classifies the components of business models cited therein. Components were classified into four primary categories: strategic choices, the value network, creating value, and capturing value. To address the absence of a generally accepted definition of a business model, a new definition that integrates and synthesizes the earlier work is offered. Based on the proposed definition, business models are then contrasted with strategy. Four problems associated with business models are also discussed.

1. Business Models

For many years, Sun Microsystems enjoyed considerable success by bucking the industry trend toward standardized chips and software (Tam, 2003). Sun made the strategic choice to offer more powerful and more expensive computer solutions based on proprietary hardware and software, which worked well as long as Sun was able to maintain a performance advantage. However, standardized chips eventually matched the performance of Sun's proprietary chips, and standardized software offered functionality similar to Sun's. As a result, Sun has seen its quarterly sales drop by more than 40% since their peak in 2001, and its stock price decline to under $4 per share from a high of over $60 per share.

In late 2002, after a probing meeting with the head of Sun's low-end server business, Sun's CEO agreed that the firm would add a line of cheaper servers based on Intel chips. This strategic choice

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marked a clear departure from Sun's existing business model, but there is no evidence that this change has helped the company's business. In fact, revenues for the quarter ending June 30, 2003 were down 13% from a year earlier. Indeed, one might reasonably conclude that Sun's "business model" was and remains broken. Certainly, the levels of misdirection and confusion in Sun's engineering and sales organizations, reported recently in the *Wall Street Journal*, suggest that, at a minimum, Sun is experiencing some problems communicating its new model internally.

Furthermore, there is little evidence that Sun executives considered issues of internal consistency as they reviewed alternative strategic choices. In particular, the choice to offer less expensive servers needs to be evaluated in terms of the added pressure this will place on Sun's more expensive hardware. In addition, a fundamental element of Sun's traditional strategy has been plowing a significant portion of revenue back into R&D in an effort to maintain its performance advantage. Making the strategic choice to offer less expensive solutions will likely have a significant impact on Sun's ability to maintain its current R&D funding levels, which in turn will have implications regarding its ability to compete on the basis of higher performing solutions.

It is hard to argue that there is a single "right" strategic answer for Sun. However, it is similarly difficult to believe that all of the cause-and-effect relationships within the new business model have been carefully considered. Based on media reports and customer complaints, it is fairly obvious that Sun's executives have not been successful in explaining their new model. While business models can be powerful tools for analyzing, implementing, and communicating strategic choices, there is no evidence that Sun has successfully harnessed that power.

Over the past few years, "business models" have surged into the management vocabulary. In the mid-1990s, "dot-com" firms pitched business models to attract funding. Now, companies of all sorts in virtually every industry rely on the concept as well; in fact, approximately 27% of Fortune 500 firms used the term in their 2001 annual reports. The media have certainly gotten on board also. Within major magazines and journals, only one article in 1990 used the term "business model" three times or more; by 2000, well over 500 articles fell into that category.

While it has become quite fashionable to discuss business models, many executives remain confused about how to use the concept. For example, in a recent Accenture study, in which one of the authors took part, 70 executives from 40 companies were interviewed regarding their company's core logic for creating and capturing value: the basis of a business model. Surprisingly, 62% had a difficult time describing succinctly how their own company made money (Linder & Cantrell, 2000), and it appears that Sun's executives may be similarly confused. Strategist Michael Porter (2000) has referred to the phrase "business model" as part of the "Internet's destructive lexicon"; we disagree. We believe that business models can in fact play a positive and powerful role in corporate management. Before exploring that role in more detail, it is first necessary to understand exactly what constitutes a business model.

2. Desperately seeking definition: Identity crisis of the business model

To be sure, many authors have offered definitions of the term "business model." Our own review of relevant literature uncovered 12 definitions in established publications during the years 1998—2002. None of these definitions, however, appears to have been accepted fully by the business community, and this may be due to emanation from so many different perspectives (i.e., e-business, strategy, technology, and information systems), with the viewpoint of each author driving term definition; by peering through different lenses, authors are seeing different things.

In fact, across these 12 definitions, one can find 42 different business model components: unique building blocks or elements. As Table 1 illustrates, some of these components appear in only one definition, but others are seen time and time again. To gain additional insight, we developed an affinity diagram (Pyzdek, 2003) to categorize the business model components that were cited twice or more (affinity diagrams are a popular "Six Sigma" tool for organizing ideas into categories based on their underlying similarity; affinity diagrams help to identify patterns and establish related groups that exist in qualitative datasets). The resulting affinity diagram (see Fig. 1) identified four major categories: strategic choices, creating value, capturing value, and the value network. To develop the affinity diagram shown in Fig. 1, two of the authors, along with a graduate student, worked independently to (a) cluster into categories the 20 business model components cited two or more times and (b) develop a descriptive name for each