Chapter 2

E-Commerce Business Models
Teaching Objectives

- Identify the key components of e-commerce business models.
- Describe the major B2C business models.
- Describe the major B2B business models.
- Explain the key business concepts and strategies applicable to e-commerce.
E-commerce Business Models

- **Business model (business process)**
  - Set of planned activities designed to result in a profit in a marketplace

- **Business plan**
  - Describes a firm’s business model

- **E-commerce business model**
  - A business model that aims to use and leverage the unique qualities of Internet and Web
Eight Key Elements of a Business Model

1. Value proposition
2. Revenue model
3. Market opportunity
4. Competitive environment
5. Competitive advantage
6. Market strategy
7. Organizational development
8. Management team
1. Value Proposition

“Why should the customer buy from you?”
- How a company’s product or service fulfills the needs of customers

Successful e-commerce value propositions:
- Personalization/customization
- Reduction of product search, price discovery costs
- Facilitation of transactions by managing product delivery
2. Revenue Model

“How will you earn money?”

Major types:

- Advertising revenue model

  - A company provides a forum for advertisements and receives fees from advertisers
  
  - For example, Google, Yahoo (video advertising)
2. Revenue Model (cont.)

- Subscription revenue model
  - A company offers its users content or services and charges a subscription fee for access to some or all of its offerings
  - For example, dating services (Match.com and eHarmony), video games (Xboxlive.com), music (Rhapsody.com)
2. Revenue Model (cont.)

✧ Transaction fee revenue model

■ A company receives a fee for enabling or executing a transaction

■ For example, eBay provides an online auction marketplace and receives a small transaction fee from a seller if the seller is successful in selling the item

✧ Sales revenue model

■ A company derives revenue by selling goods, information, or services
2. Revenue Model (cont.)

- Affiliate revenue model

A company steers business to an affiliate and receives a referral fee or percentage of the revenue from any resulting sales.
3. Market Opportunity

“What marketspace do you intend to serve and what is its size?”

- Marketspace: Area of actual or potential commercial value in which company intends to operate
- Realistic market opportunity: Defined by revenue potential in each market niche in which company hopes to compete

Market opportunity typically divided into smaller niches
4. Competitive Environment

“Who else occupies your intended marketspace?”

- Other companies selling similar products in the same marketspace
  - For example, Priceline and Travelocity, both of whom sell discount airline tickets online, are direct competitors because both companies sell identical products – cheap tickets

- Includes both direct and indirect competitors
  - For instance, automobile manufacturers and airline companies operate in different industries,
  - but they still compete indirectly because they offer consumers alternative means of transportation
5. Competitive Advantage

“What special advantages does your firm bring to the marketspace?”

- Is your product superior to or cheaper to produce than your competitors’?

Important concepts:

- Asymmetries
  - Exits whenever one participant in a market has more resources than other participants
  - For example, financial backing, knowledge, information, and power
5. Competitive Advantage (cont.)

- **First-mover advantage**
  - A competitive market advantage for a firm that results from being the first into a marketplace with a serviceable product or service
  - If first movers develop a loyal following or a unique interface that is difficult to imitate, they can sustain their first-mover advantage for long periods
  - For example, Amazon, eBay

- **Unfair competitive advantage**
  - Occurs when one firm develops an advantage based on a factor that other firms cannot purchase
  - For instance, a brand name (Coke) cannot be purchased and is in the sense an unfair advantage
5. Competitive Advantage (cont.)

❖ Leverage
   ■ When a company uses its competitive advantages to achieve more advantage in surrounding markets
   ■ For instance, Amazon’s move into the online grocery business leverages the company’s huge customer database and years of e-commerce experience

❖ Perfect markets
   ■ A market in which there are no competitive advantages or asymmetries because all firms have equal access to all the factors of production
   ■ However, real markets are imperfect, and asymmetries leading to competitive advantages do exist, at least in the short term
6. Market Strategy

“How do you plan to promote your products or services to attract your target audience?”

- The plan you put together that details how a company intends to enter market and attract customers

- For instance, Twitter and YouTube have a social network marketing strategy that encourages users to post their content on the sites for free, build personal profile pages, contact their friends, and build a community
7. Organizational Development

“What types of organizational structures within the firm are necessary to carry out the business plan?”

Plan describes how the company will organize the work that needs to be accomplished

- Typically, divided into functional departments (production, shipping, marketing, customer support, and finance)
- As company grows, hiring moves from generalists to specialists
7. Organizational Development (cont.)

- For instance, eBay founder Pierre Omidyar started an online auction site, according to some sources, to help his girlfriend trade ..................

- But within a few months the volume of business had far exceeded what he alone could handle

- So he began hiring people with more business experience to help out

- Soon the company had many employees, departments, and managers who were responsible for overseeing the various aspects of the organization
8. Management Team

“What kind of backgrounds should the company’s leaders have?”

Management team: employees of the company responsible for making the business model work

A strong management team:

- Can make the business model work
- Can give credibility to outside investors
- Has market-specific knowledge
- Has experience in implementing business plans
Categorizing E-commerce Business Models

- No one correct way
- Text categorizes according to:
  - E-commerce sector (e.g., B2B)
  - E-commerce technology (e.g., m-commerce)
- Similar business models appear in more than one sector
- Some companies use multiple business models (e.g., eBay: B2C+C2C)
B2C Business Models

- E-tailer
- Community provider (social network)
- Content provider
- Portal
- Transaction broker
- Market creator
- Service provider
B2C Models: E-tailer

- Online version of traditional retailer
- Revenue model: Sales of goods
- Variations:
  - Virtual merchant (online version of retail store)
  - Bricks-and-clicks (online distribution channel for a company that also has physical stores)
  - Catalog merchant (online version of direct mail catalog)
  - Manufacturer-direct (manufacturer uses online channel to sell direct to customer)

- Low barriers to entry
B2C Models: Community Provider

- Provide online environment (social network) where people with similar interests can transact, share content, and communicate
  - e.g., Facebook, LinkedIn, Twitter

- Revenue models:
  - Typically hybrid, combining advertising, subscriptions, sales, transaction fees, affiliate fees
B2C Models: Community Provider (cont.)

- Community sites such as iVillage make money through affiliate relationships with retailers and from advertising

- For instance, a parent might visit RightStart.com for tips on diapering a baby and be presented with a link to Huggies.com
  - If the parent clicks the link and then makes a purchase from Huggies.com
  - Rightstart gets a commission
B2C Models: Content Provider

- **Distributes information (digital) content on the Web**
  - News, music, video, text, artwork

- **Revenue models:**
  - Subscription; pay per download (micropayment); advertising; affiliate referral
  - For example, Harvard Business Review – charge customers for content downloads
B2C Business Models: Portal

- Gateways to the Internet
- Search plus an integrated package of content and services (news, e-mail, instant messaging, calendar, shopping)
  - For example, Yahoo, MSN and AOL
- Revenue models:
  - Advertising, referral fees, transaction fees, subscriptions
- Portals do not sell anything directly
B2C Models: Transaction Broker

- Site that processes transactions for consumers that are normally handled in person, by phone or by mail
- Process online transactions for consumers
  - Primary value proposition—saving time and money
- Revenue model:
  - Transaction fees
  - Transaction brokers make money each time a transaction occurs
- Industries using this model:
  - Financial services
  - Travel services
  - Job placement services
B2C Models: Market Creator

- Builds a digital environment where buyers and sellers can meet
  - Display products, search for products, and establish a price for products
- e.g., eBay
- Revenue model: Transaction fees
B2C Models: Service Provider

- **Online services**
  - e.g., Google—Google Maps, Gmail, etc.

- **Value proposition**
  - Valuable, convenient, time-saving, low-cost alternatives to traditional service providers

- **Revenue models:**
  - Sales of services, subscription fees, advertising, sales of marketing data
B2B Business Models

- **Net marketplaces**
  - E-distributor
  - E-procurement
  - Exchange
  - Industry consortium

- **Private industrial network**
B2B Models: E-distributor

- A company that supplies products and services directly to individual businesses

- Revenue model: Sales of goods

- e.g., Grainger.com (industrial equipment and tools), Partstore.com (a major online parts retailer Consumer Electronics)
B2B Models: E-procurement

- Creates and sells access to digital electronic markets
- **B2B service providers**: sells business services to other firms
- **Application service providers (ASPs)**: a company that sells access to Internet-based software applications to other companies
- **Revenue model**: Service fees
- **e.g., Ariba, PerfectCommerce**
B2B Models: Exchanges

- An independent digital electronic marketplace where suppliers and commercial purchasers can conduct transactions
  - The greater the number of sellers and buyers, the lower the sales cost and the higher the chances of making a sale
- Revenue model: Transaction, commission fees
- Create powerful competition between suppliers
B2B Models: Industry Consortia

- **Industry-owned vertical digital marketplace that serve specific industries**
  - Such as the automobile, aerospace, chemical

- **More successful than exchanges**
  - Sponsored by powerful industry players
  - Strengthen traditional purchasing behavior

- **Revenue model:** Transaction, commission fees

- **e.g., Exostar** (an online trading exchange for the aerospace and defense industry)
Private Industrial Networks

- Digital network
- Used to coordinate communication among firms engaged in business together
- The network is owned by a single large purchasing firm
- e.g., Walmart’s network for suppliers – monitor the sales of their goods, the status of shipments, and the actual inventory level of their goods
How the Internet and the Web Change Business

E-commerce changes industry structure by changing:

- Rivalry among existing competitors
- Barriers to entry
- Threat of new substitute products
- Strength of suppliers
- Bargaining power of buyers
How the Internet and the Web Change Business (cont.)

- Rivalry among existing competitors
  - Increase price competition
  - Expands the market

- Barriers to entry
  - Reduced barriers to entry in music

- Threat of new substitute products
  - Streaming video replaces DVDs
  - Cloud music replaces downloads
  - Online reservation replaces agents
How the Internet and the Web Change Business (cont.)

- **Bargaining power of suppliers**
  - Supplier power decreased in autos with online procurement systems
  - Supplier power increased in airline-owned online systems

- **Bargaining power of buyers**
  - Increased power of retail customers
  - Decreased power of wholesale buyers in hotel reservation
Firm Value Chains

- Activities that a firm engages in to create final products from raw inputs

- Effect of Internet:
  - Increases operational efficiency
  - Enables product differentiation

- For instance, Amazon uses the Internet to provide consumers with a much larger inventory of books to choose from, at a lower cost, than traditional book stores
  - Instantly available professional and consumer reviews
  - Information on buying patterns of other consumers
Business Strategy

Plan for achieving superior long-term returns on the capital invested in a business firm

Four generic strategies

- Differentiation
- Cost
- Scope
- Focus
Business Strategy (cont.)

- **Differentiation**
  - Refers to all the ways producers can make their products unique and different to distinguish them from those of competitors

- **Cost**
  - A business has discovered some unique set of business processes or resources that other firms cannot obtain in the market place (a cost advantage over competitors)
**Scope**

- A strategy to compete in all markets around the globe, rather than merely in local, regional, or national markets
- Yahoo, for instance, along with all of the other top 20 e-commerce sites, has readily attained a global presence using the Internet

**Focus**

- A strategy to compete within a narrow market segment or product segment
- For instance, L.L.Bean uses the Web to continue its historic focus on outdoor sports