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 on 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 firs-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)

BOEING

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)

Business Strategy (cont.)

- 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