

# BUSINESS MODELS: STRUCTURE & DYNAMICS

A model & simulation driven approach

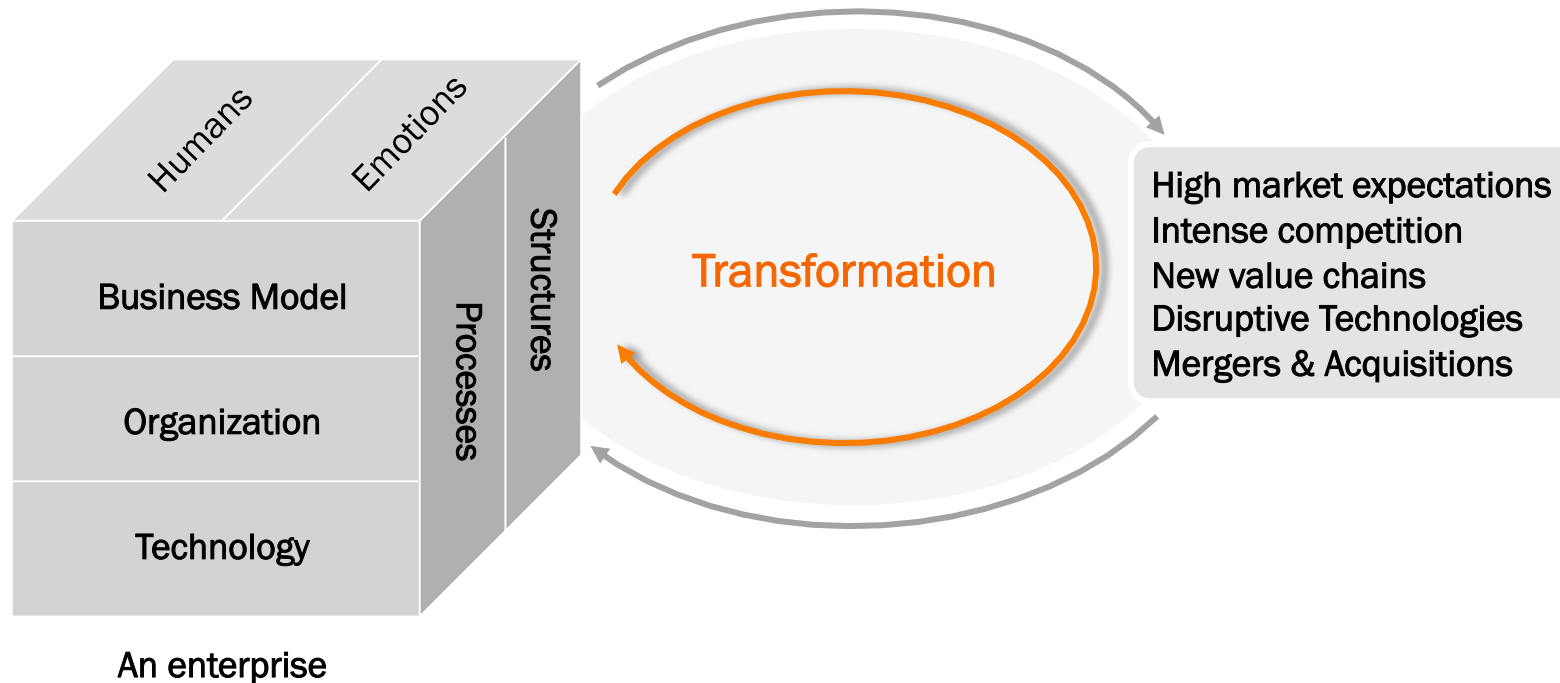
isee User Conference 2010 – Making Connections

Dr. Oliver Grasl, 5. October 2010

The business model concept  
What business models are not about  
A business model construction kit  
Business model blueprints  
Case Study: Dynamics of a professional service firm

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# STANDING STILL IS NOT AN OPTION



External drivers (such as market expectations, competition, new technologies) force enterprises to implement changes to their business models and operations – standing still is not an option.

# IMPORTANT STRATEGIC QUESTIONS

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- How do we shape strategic initiatives within our firm?
- How do we position our firm towards our stakeholders?
- How do we create value for our stakeholders?
- How will we change our firm by implementing strategic initiatives?
- How shall we monitor and assess the progress of our strategic initiatives?

Müller-Stewens/Lechner 2005

# BUSINESS MODEL ENGINEERING FOCUSES ON VALUE CREATION

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- How do we position our firm towards our stakeholders?
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- How will we change our firm by implementing strategic initiatives?
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Müller-Stewens/Lechner 2005

Business models address the question of value creation, or:  
"How do we make money in this business?"

# GENERAL DEFINITION OF BUSINESS MODEL

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*A firm's business model shows how it creates value for all the parties within its value network (customers, shareholders, business partners) by defining its value logic and showing which products and services are exchanged between these parties.*

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Magretta 2002, Timmers 1998,  
Zott/Amit 2007

## WHY BUSINESS MODELS ARE IMPORTANT

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*“ In future **business model innovation** will be the key to generating new wealth: Competition no longer takes place between companies and products, but between business models. ”*

Hamel 2000

*“ In future **business model innovation** will be more important for business success than product innovation. ”*

Kagermann/  
Österle 2006

# WHY IS BUSINESS MODEL ENGINEERING HARD?

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- The business model concept is a fairly fuzzy concept that is not used consistently.
- It hard to evaluate business models quantitatively, because many assumptions are not made explicit.
- Business is not static, but highly dynamic – it is difficult to make quantitative predictions about dynamic systems using simple calculations.
- The ownership of the business model and the value creation policies within an enterprise is often unclear – nobody feels responsible for the “big picture”.

Grasl 2008

# WHY IS BUSINESS MODEL ENGINEERING USEFUL?

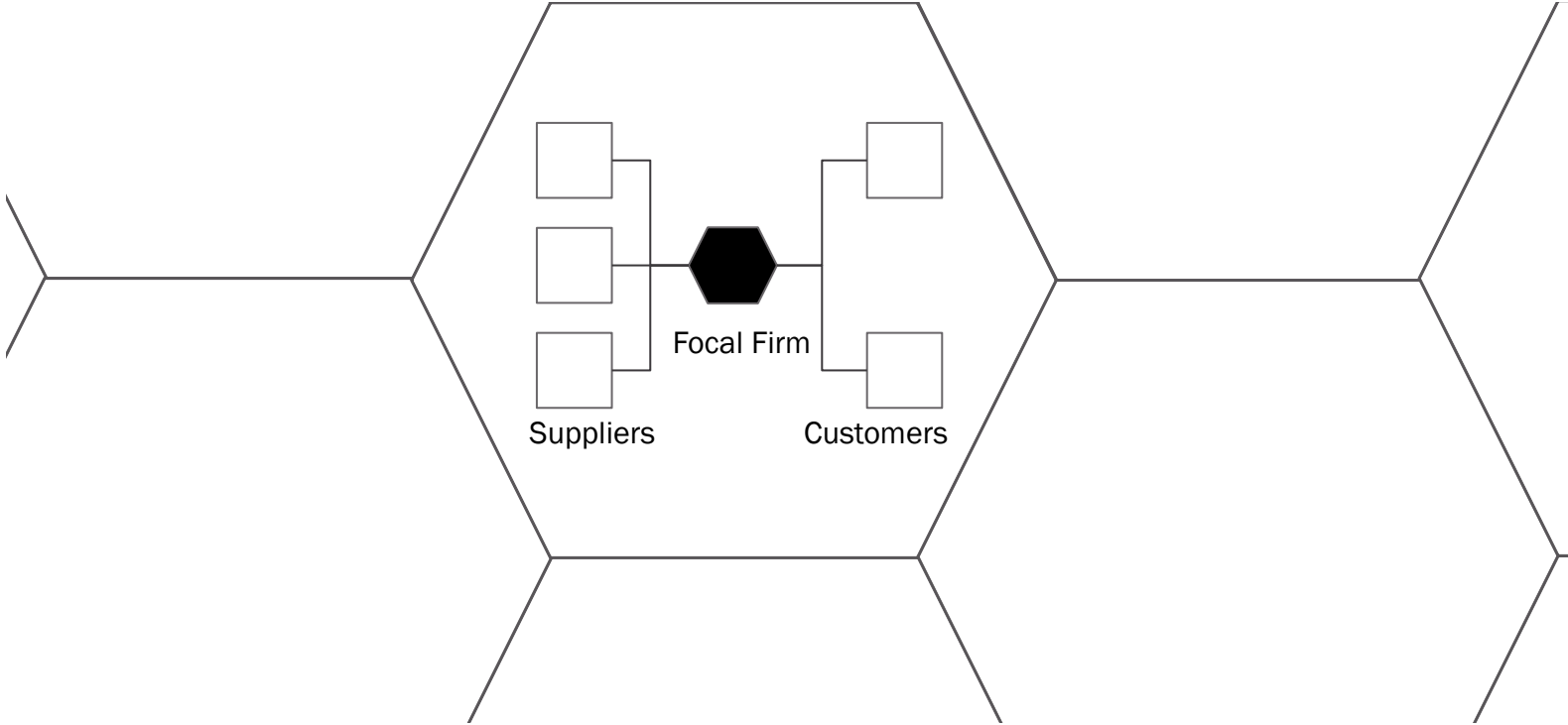
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- Clarifying the value proposition and re-designing the business model to support it.
- Assessing the viability of a new business idea by making all assumptions explicit and exploring potential risks and opportunities.
- Making the business model transparent to all stakeholders, in a qualitative and quantitative way.
- Verify existing policies, and finding new policies, that will improve value creation and thus the overall success of the business.
- Creating a learning environment for those in the firm that have to put new or changed business policies into effect.

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- 5 Example: Exploratory model of a professional service firm

# BUSINESS MODELS ARE CONCERNED WITH VALUE CREATION

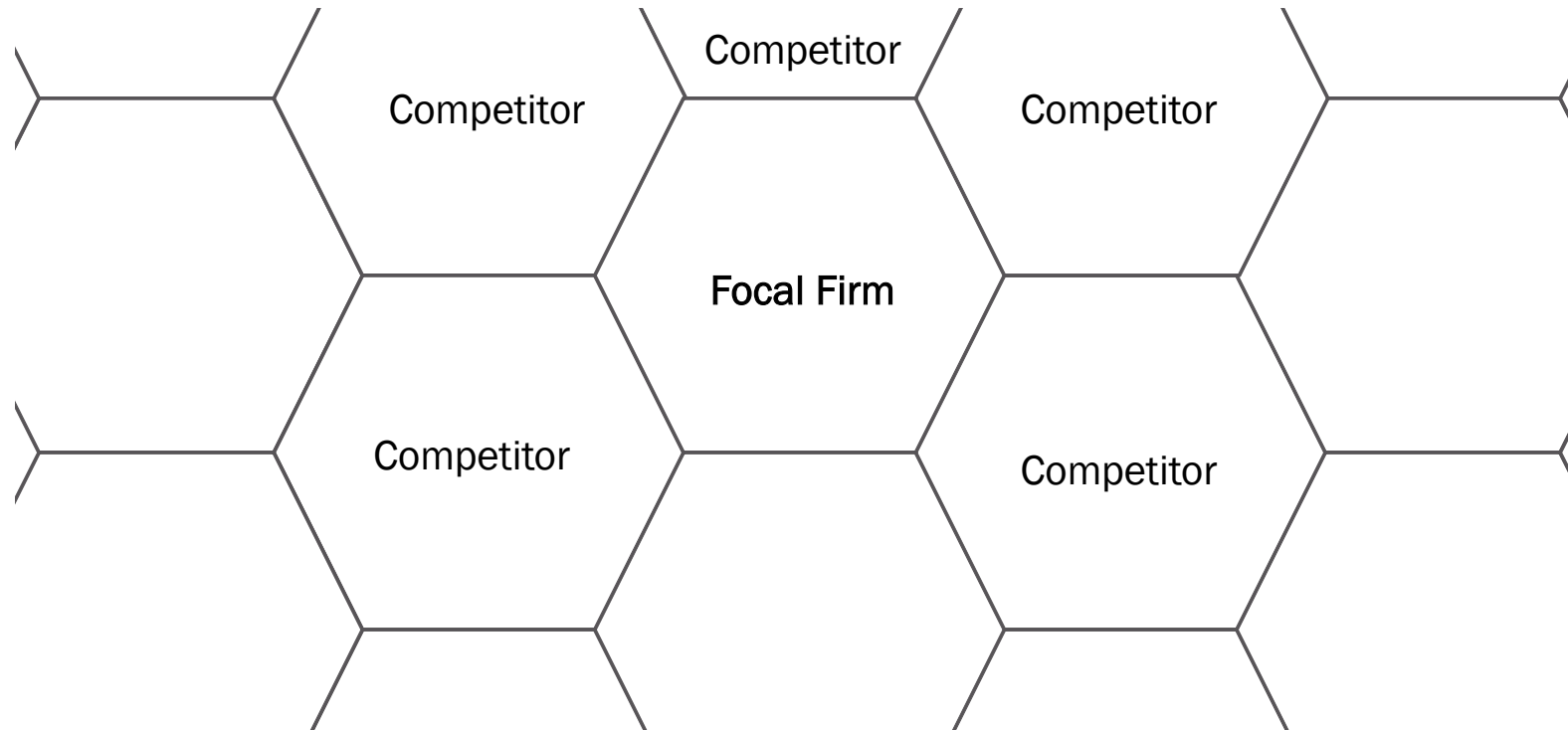
How do we create value for our stake holders?



Business models are concerned with creating value within a value network.

# BUSINESS MODELS ARE NOT CONCERNED WITH VALUE APPROPRIATION

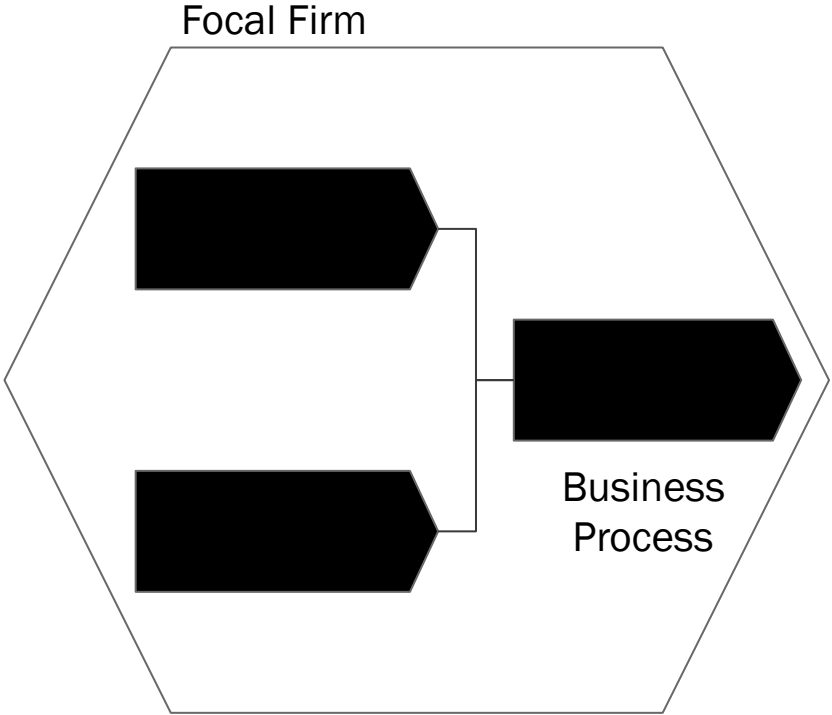
How do we position our firm towards our stake holders?



Value appropriation is the concern of a firm's positioning strategy.

# BUSINESS MODELS ARE NOT CONCERNED WITH VALUE DELIVERY

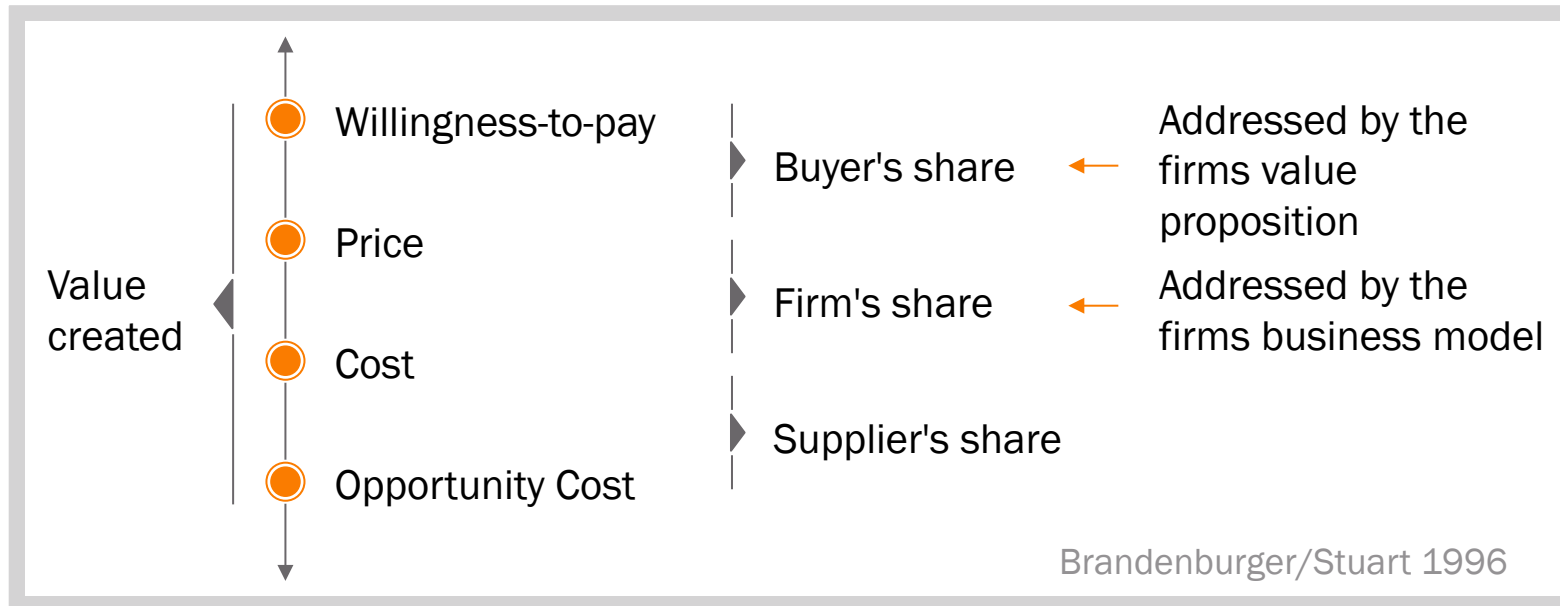
How do we deliver value efficiently?



Value delivery is the concern of a firm's operations.

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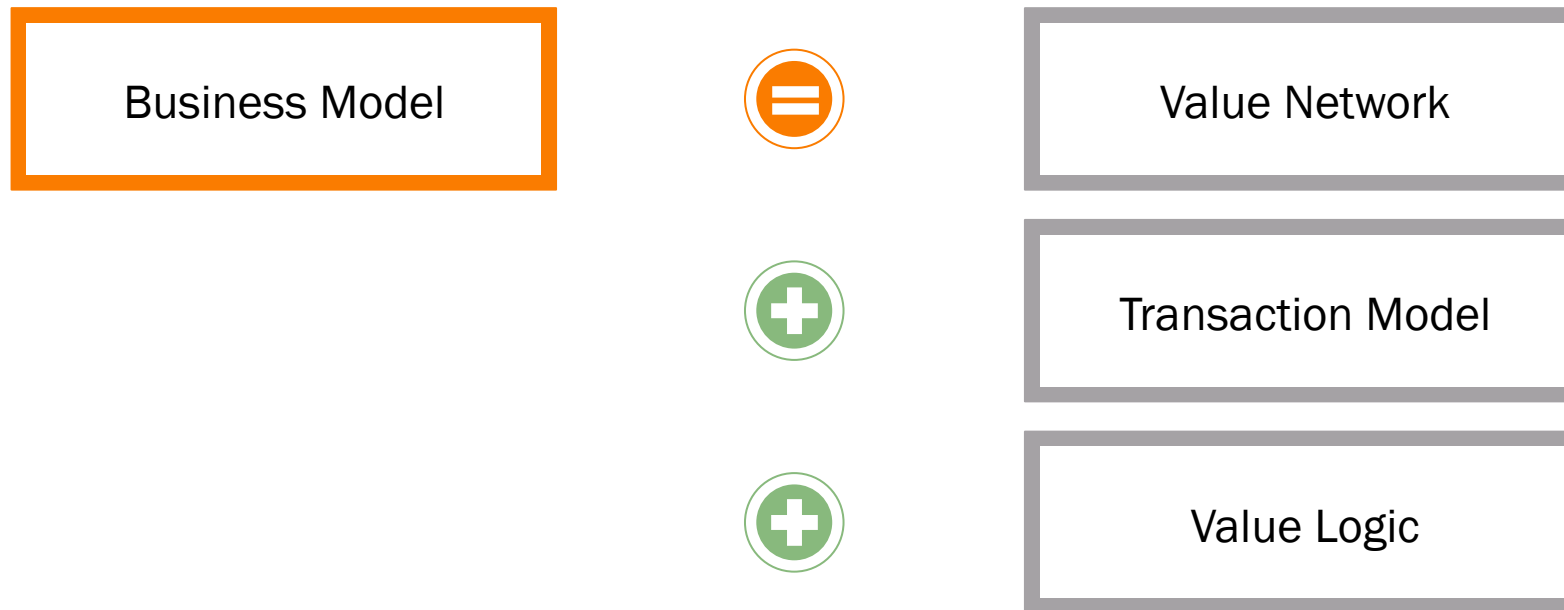
# THE VALUE CREATION CONCEPT



$$\text{Value} = \text{Benefits} - \text{Costs}$$

The concept of value creation is important because it distinguishes effectiveness ("Are we creating the right products?") from efficiency ("Are we creating the products in a cost effective way?").

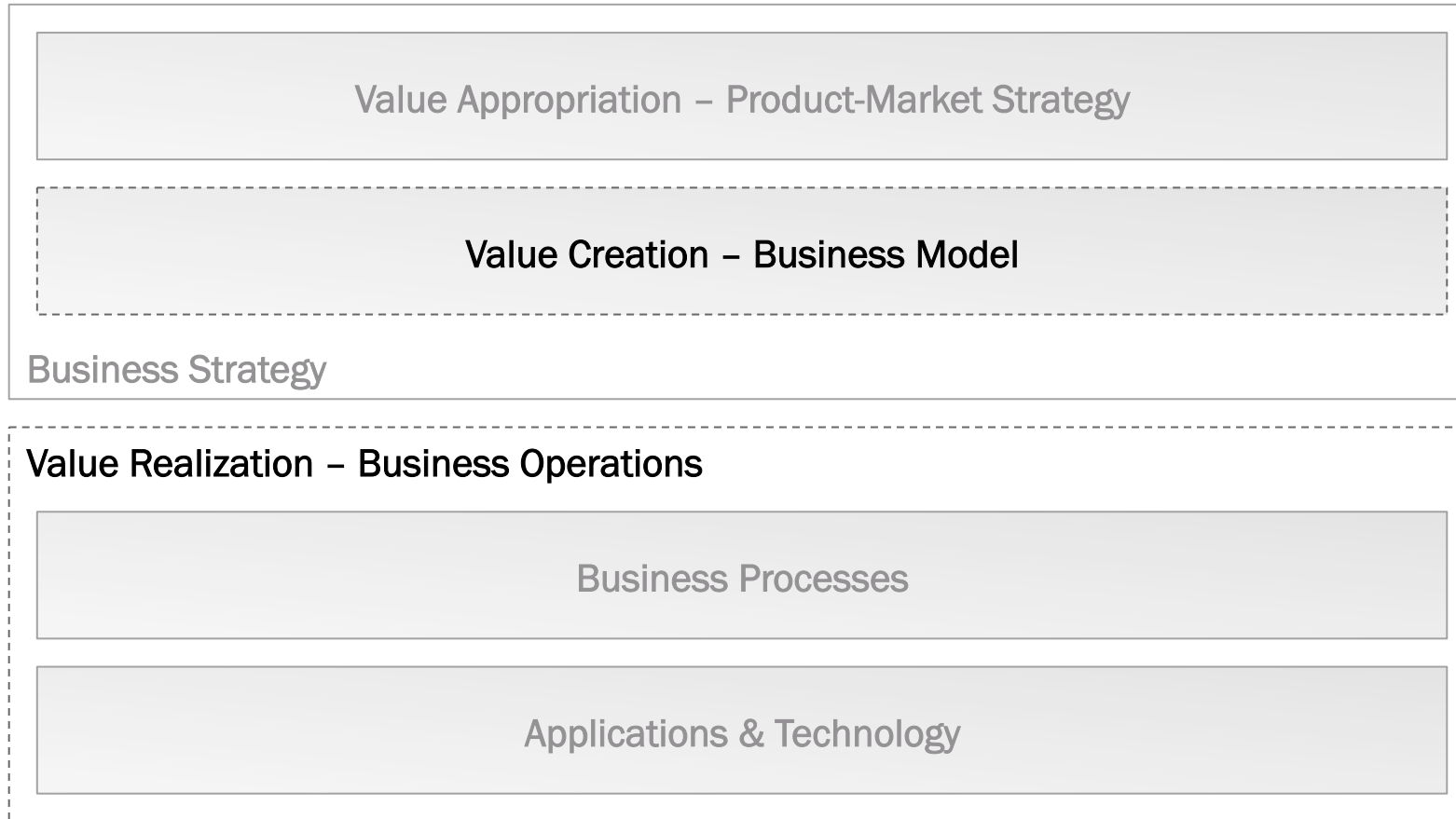
# DEFINITION OF BUSINESS MODEL



A firm's business model shows how it creates value for all the parties within its value network by defining its value logic and showing which products and services are exchanged via transactions between these parties.

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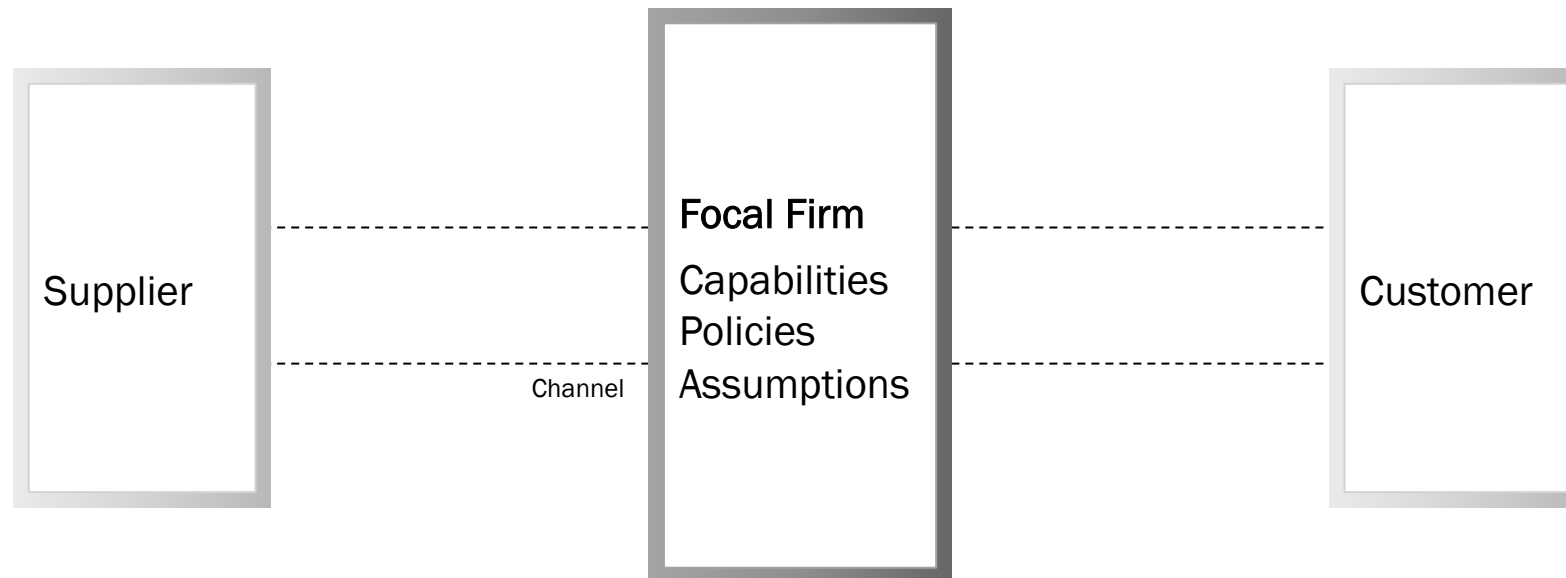
# BUSINESS MODELS AND ENTERPRISE ARCHITECTURE



Business models are situated within the strategy layer of an enterprise's architecture.

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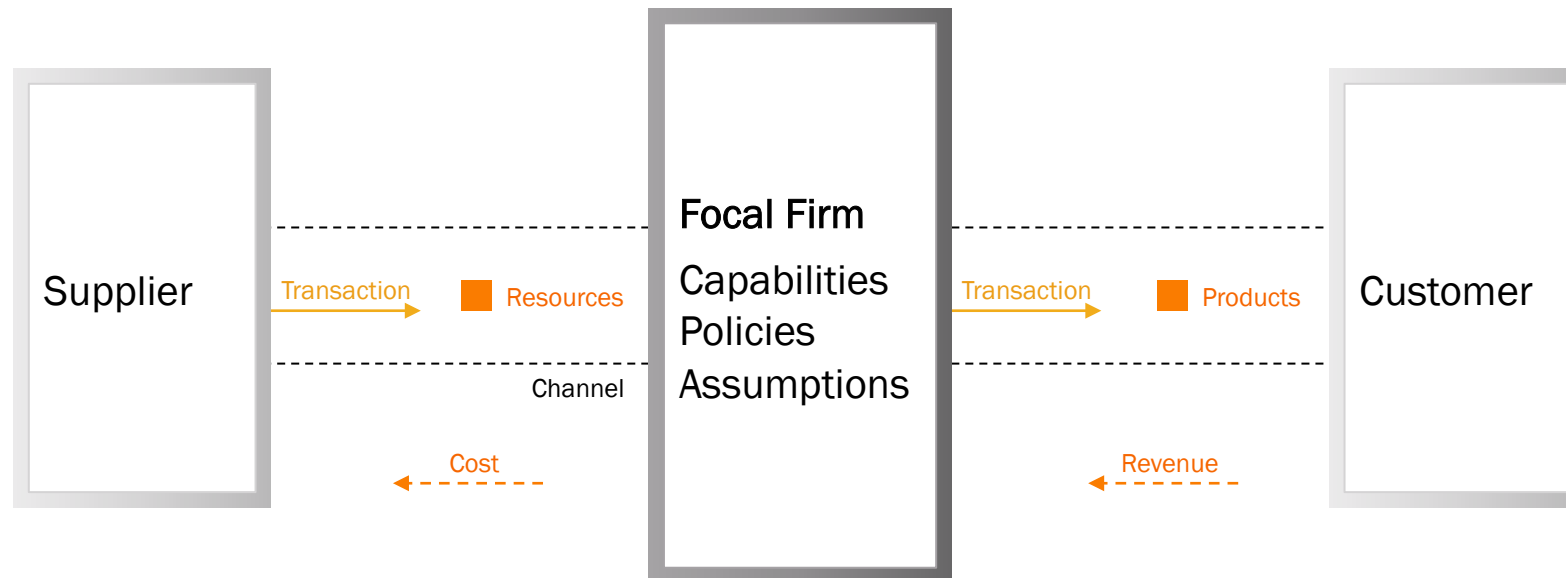
# BUSINESS MODEL: VALUE NETWORK



The value network shows which channels a firm provides to connect the parties in the product and factor markets.

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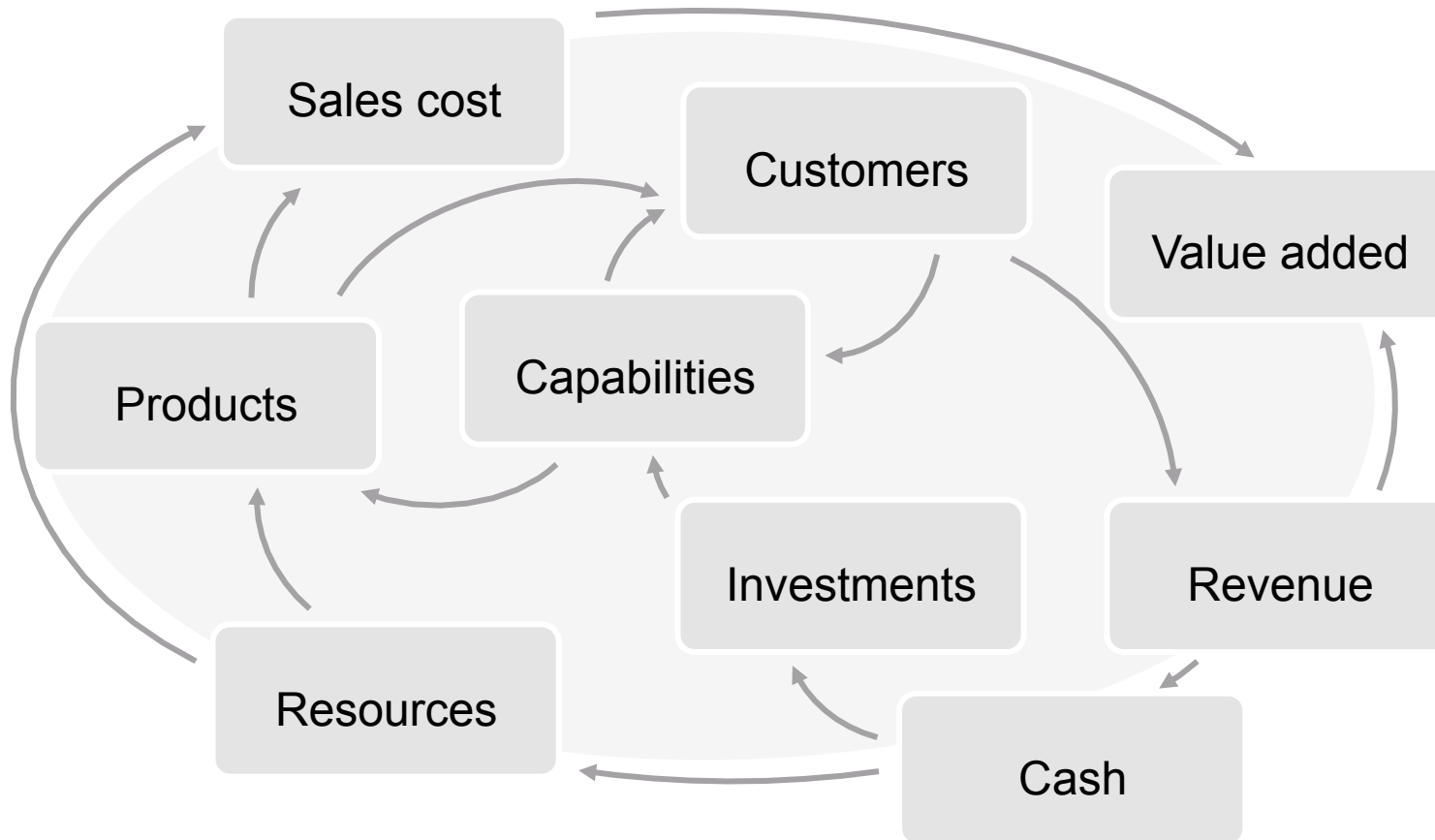
# BUSINESS MODEL: TRANSACTION MODEL



The transaction model shows which transactions are supported or enabled via the channels of the value network, and which products and artifacts are exchanged during these transactions.

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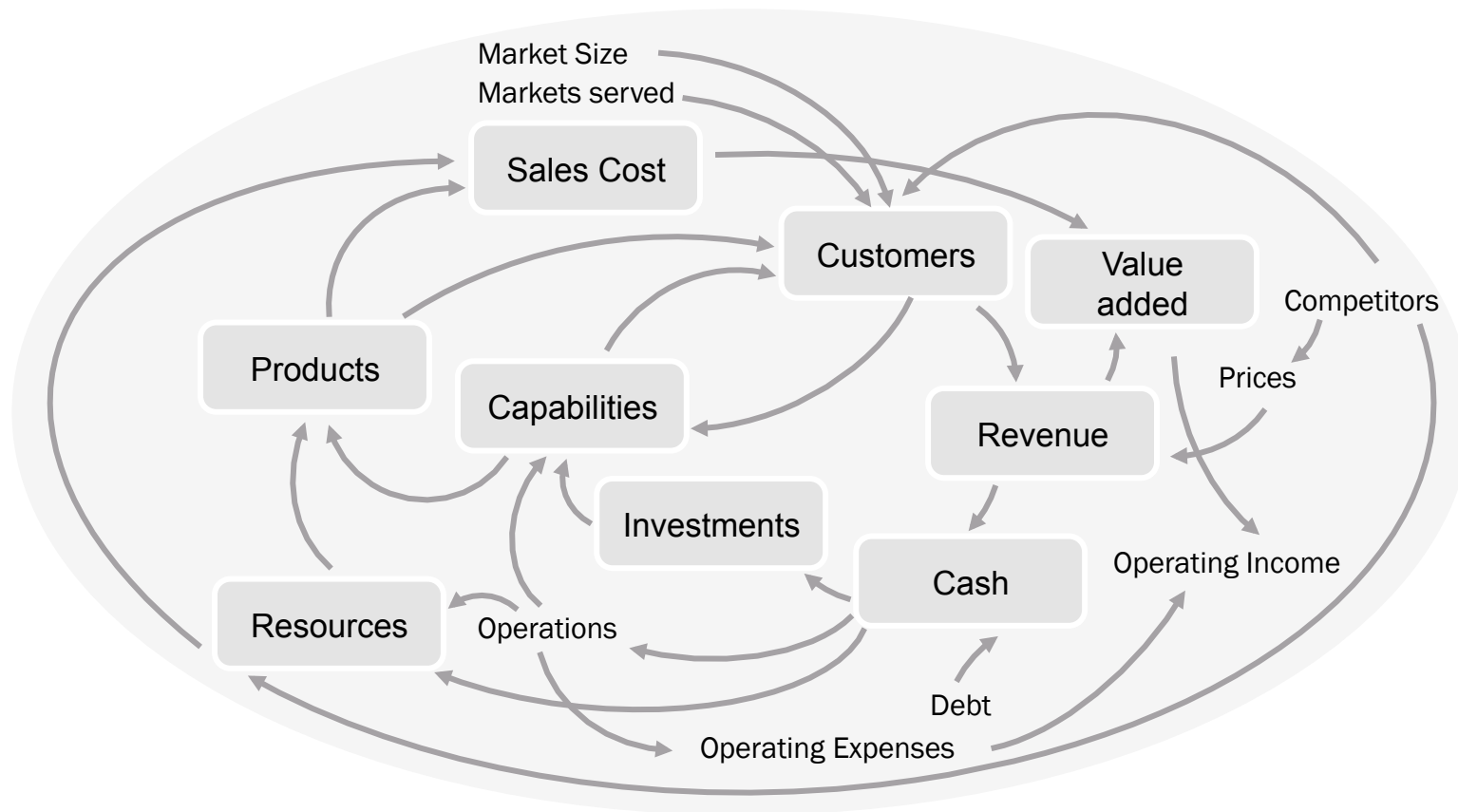
# BUSINESS MODEL: VALUE LOGIC



The value logic shows how resources and capabilities are used to support transactions, create products, attract customers and drive value creation in a self sustaining feedback loop.

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# FULL BUSINESS DYNAMICS



Business dynamics =  
value dynamics × market dynamics × operational dynamics

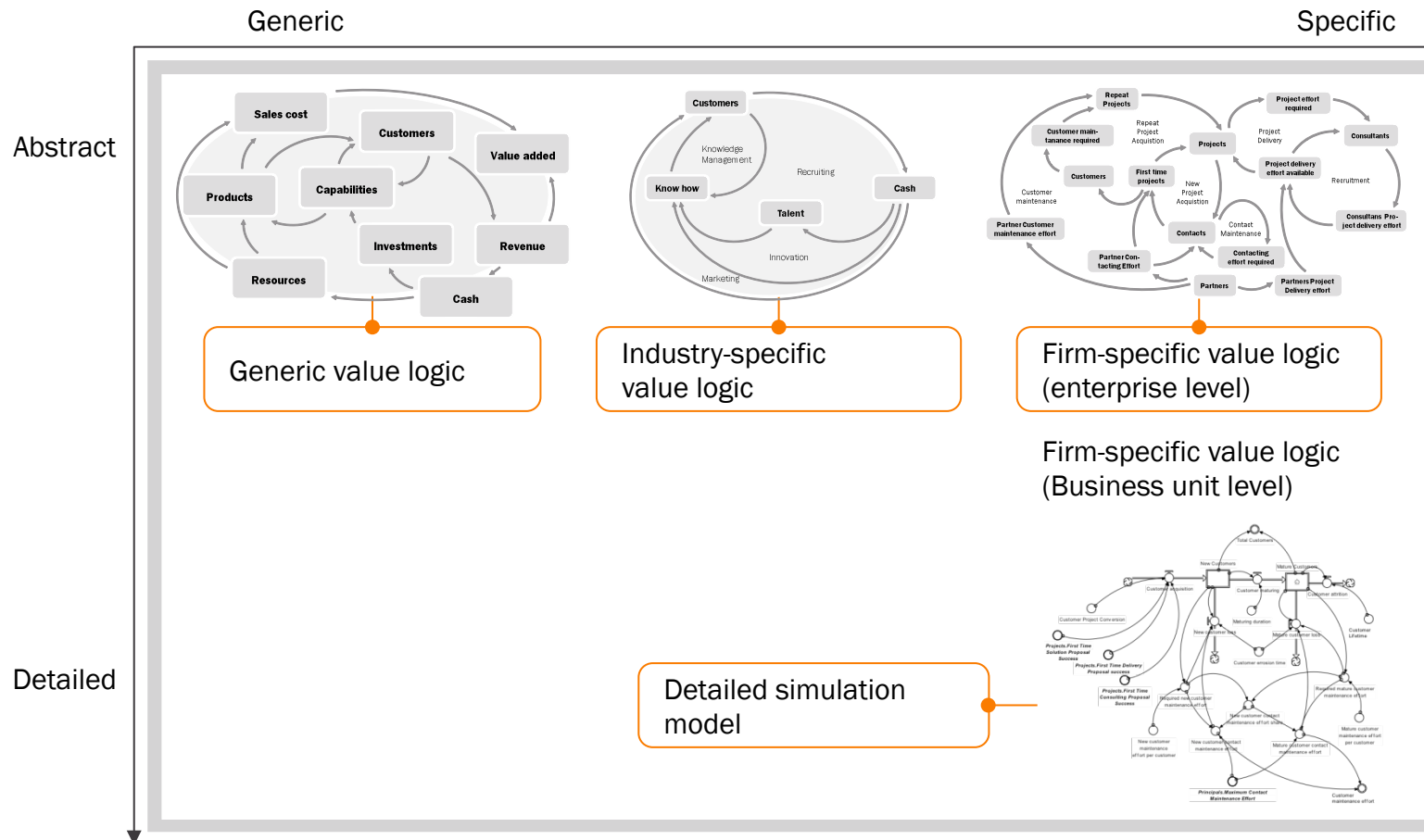


# BUILDING BLOCKS EXPLAINED

Artefact	Generally, an artifact is something created by a human for a practical purpose. Specifically in this context, an artefact is anything exchanged during a transaction besides the products themselves, examples being a proposal or a product description sheet.
Asset	The term "asset" is used as a generalization for resources and capabilities. An asset is a resource (e.g. physical property, intangible right) or capability that has economic value. Important examples are plant, equipment, land, patents, copyrights, and financial instruments such as money or bonds. A firm needs assets to enable its transactions, maintain channels and create its products.
Channel	A channel is a conduit by which a firm offers its products. These products are exchanged via a transaction.
Party	Any legal entity engaged within the business model. Examples for other parties besides firms are public authorities and public households.
Product	A product is any good or service produced by a business. Businesses are characterized by the fact that they produce goods or service beyond their own need and can therefore offer them to other parties via a market.
Transaction	Firms interact via boundary spanning transactions, which are supported or enabled by channels. A transactions takes place when a product is exchanged via a separable interface.
Value	The value created by the firm. A general definition is "Benefits-Cost". In practice this is frequently measured by the Free Cash Flow or Gross Margin

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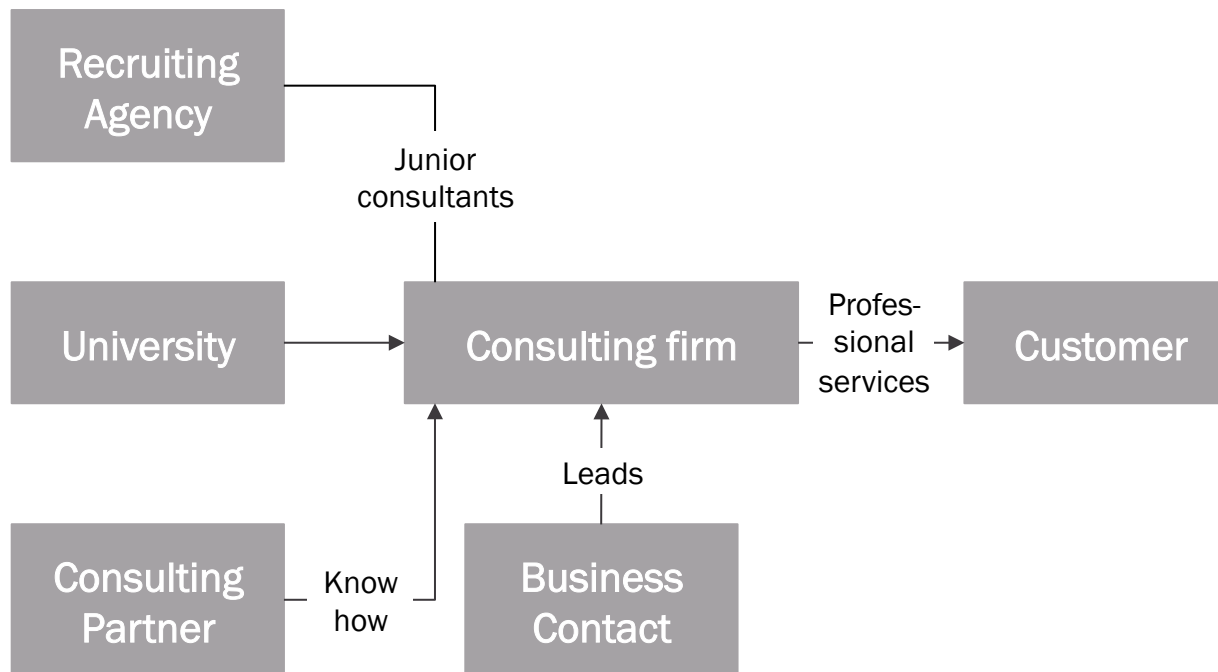
# LEVELS OF DETAIL AND COMPLEXITY



View business at different levels of abstraction.

Adapted from Winter 2003

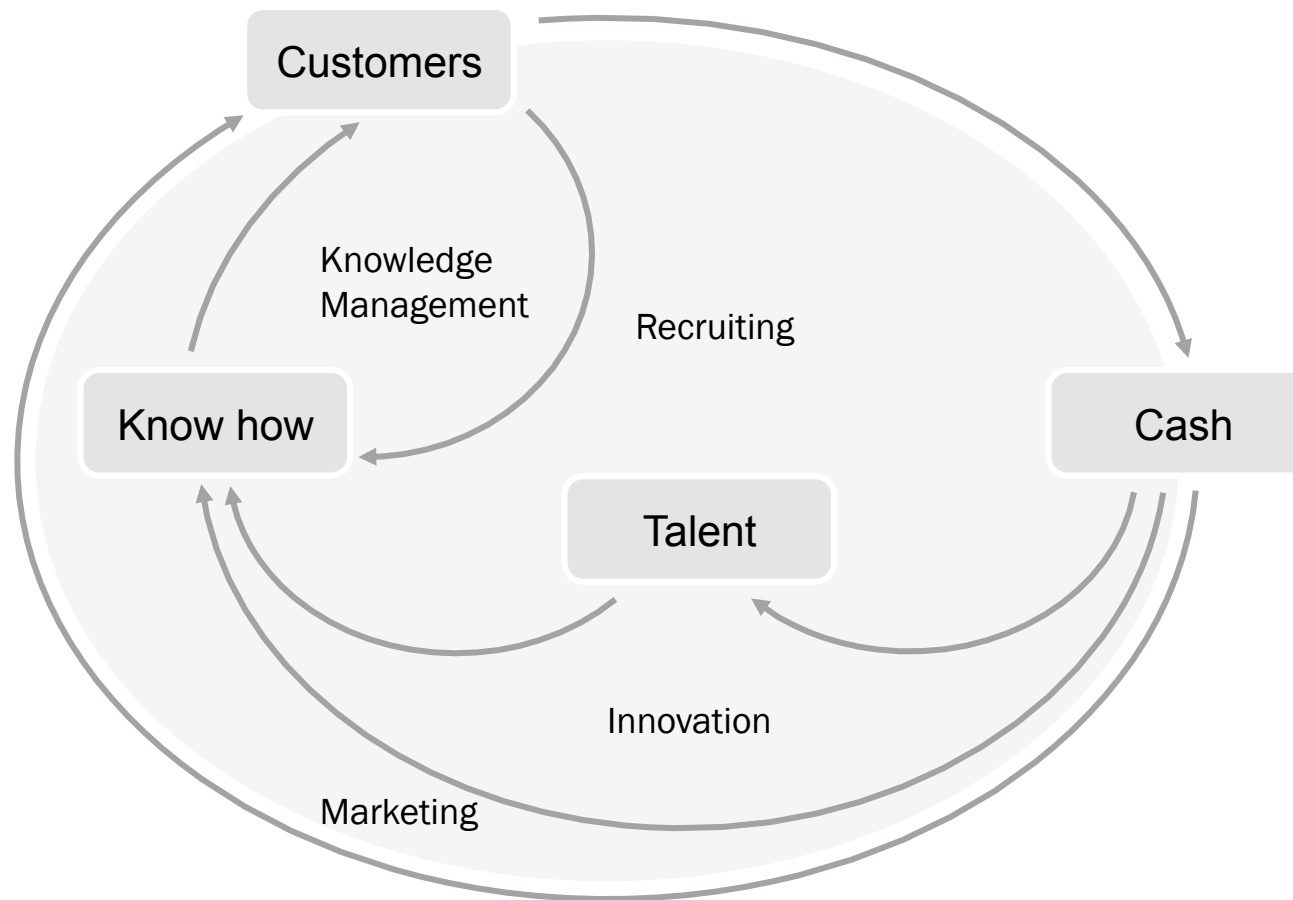
## Consulting firm value network



A consulting firm is a firm in which professional skills form the basis of its services to customers. The services are characterized by a high degree of customization and client contact.

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## Consulting firm value logic blueprint



Rode 2001

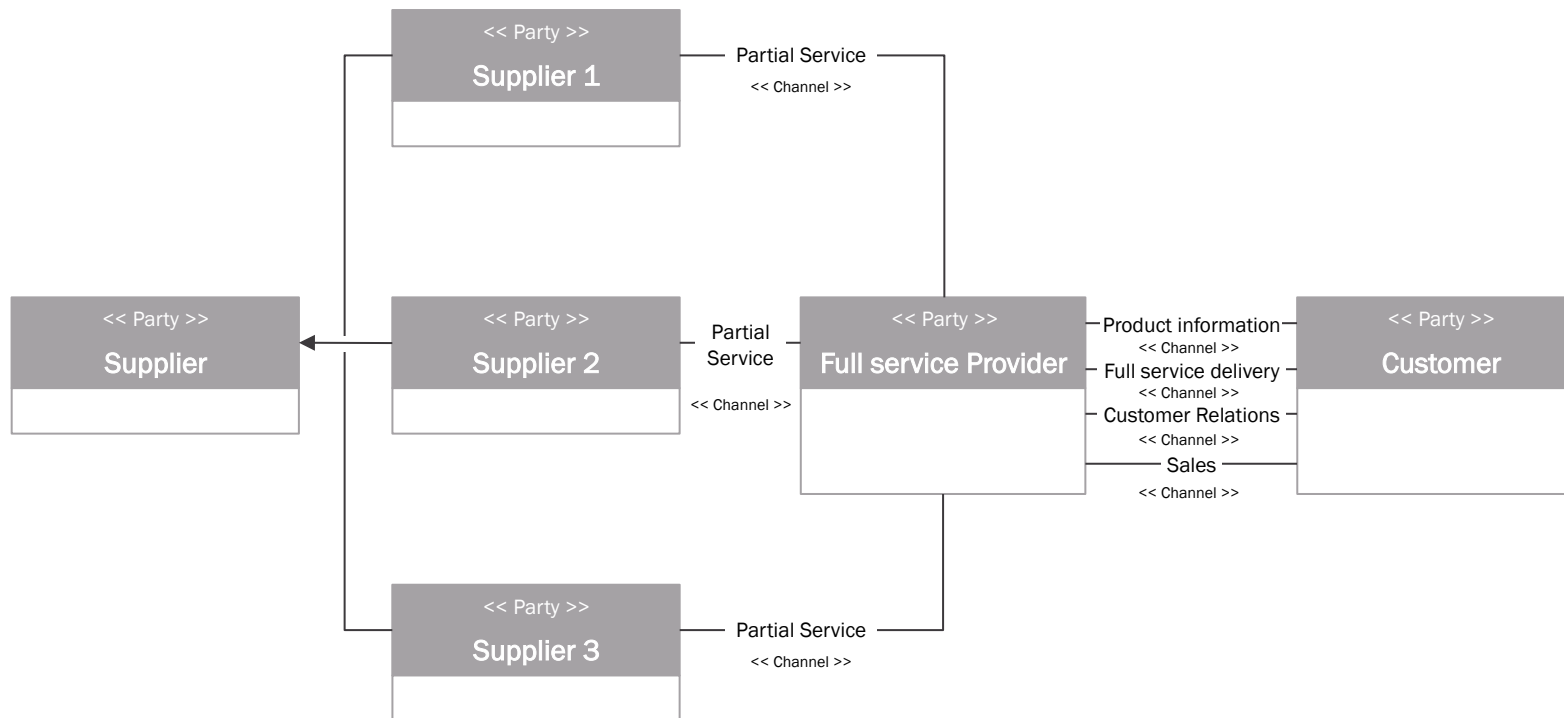
# BUSINESS MODEL BLUEPRINT: INDUSTRY SPECIFIC



## Further Consulting firm constructs

Artefact	Proposals White Papers and Case Studies Consulting Contracts	
Asset	Consultants Partners Freelance consultants	
Channel	Sales Channel Marketing Channel Recruitment Channel	
Product	Consulting Projects	
Transaction	Sell projects Deliver projects Hire and fire (freelance) consultants	Maintain business contacts Maintain customer
Value	Fee Cash Flow Gross Margin	

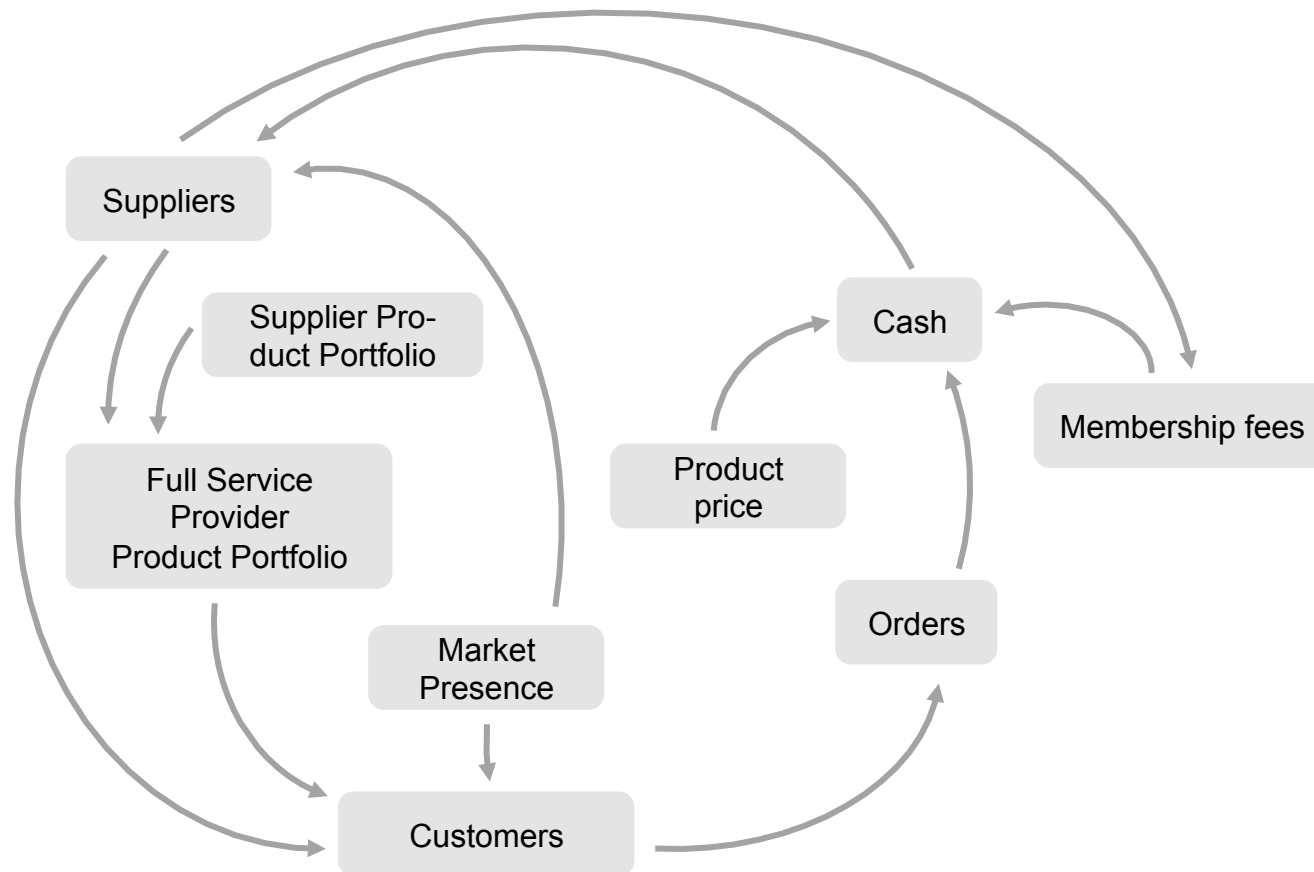
## eBusiness Full service provider value network



The full-service provider aims to meet the complete needs of a target customer segment in one domain by integrating the firm's own products and services with those of selected third party providers.

Weil/Vitale 2001

## eBusiness full service provider value logic



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# BUSINESS MODEL BLUEPRINT: INDUSTRY SPECIFIC

## Further eBusiness constructs

Artefact	Oder Summaries Invoices	
Asset	IT infrastructure Product management capability	Relationship management capability Brand management
Channel	Marketing Order Delivery	Customer Relations Supplier Management Bulling
Product	Books CDs Clothes	
Transaction	Search for products Order products	Fulfill order Send invoice
Value	Gross margin	

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- Case study based on work carried out for a professional service firm focusing on IT consulting.
  - ~1,100 employees worldwide
  - ~70 employees in Germany subsidiary
- Participants were the CEO, CFO and Head of Business Development.
- The company has a very stable history of financial success but is dissatisfied with growth rates.
  - Policy changes are hard to find and enforce in such conditions.

# KEY KPI'S FOR PROFESSIONAL SERVICE FIRMS ("MAISTER KPI'S")

$$\frac{\text{Profit}}{\text{Principal}} = \frac{\text{Profit}}{\text{Fees}} \times \frac{\text{Fees}}{\text{Hours}} \times \frac{\text{Hours}}{\text{Staff}} \times \frac{\text{Staff}}{\text{Principal}} =$$

$$= \text{Margin} \times \text{Value} \times \text{Utilization} \times \text{Leverage}$$

Hygiene factor  
Cost reduction

Hygiene factor  
Sales and delivery  
management

Health factor  
Innovation and  
Specialization

Health factor  
Standardization

Maister 1997

## WHAT THE PSF'S PARTNERS DO

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Partners are responsible for the following activities:

Generating repeat business through client maintenance

New customer acquisition

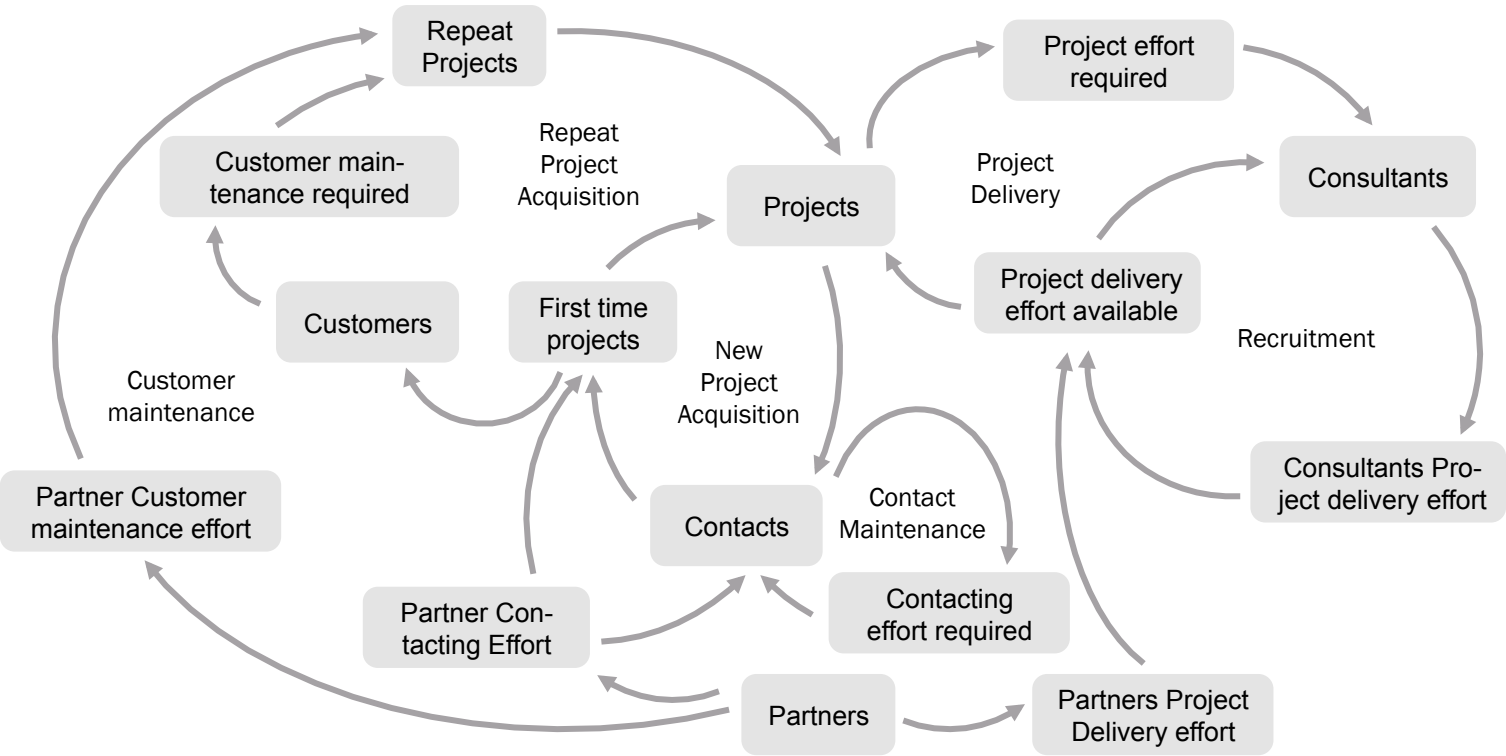
Project delivery

Recruitment and consultant development

Development of new consulting products

# VALUE LOGIC: FIRM SPECIFIC, CONCEPTUAL

## Conceptual value logic of this professional service firm



At this professional service firm, the partners have to share their time between customer acquisition, project delivery and customer maintenance.

## STRATEGIC QUESTION

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- How should partners spend their time?

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*Which organizational policies should be followed to ensure value and leverage are maximized?*

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## THREE SCENARIOS

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### Scenario 1 – Base Case

Partners spend up to 50% of their time in project delivery  
The other 50% go to customer development and innovation  
No time for standardization

### Scenario 2 – Concentrate on the customer

Project delivery is delegated to senior and junior consultants  
Partners focus on customer development and innovation

### Scenario 3 – Innovate and standardize

Partners focus more on standardization and less on innovation

# SCENARIO 1 BASE CASE

Principals.Maximum Project Time Share

0,00 ————— 1,00  
0,50

Principals.Maximum Contact Maintenance Time Share

0,00 ————— 1,00  
0,50

Products.Product Innovation Effort %

0 ————— 100%  
100

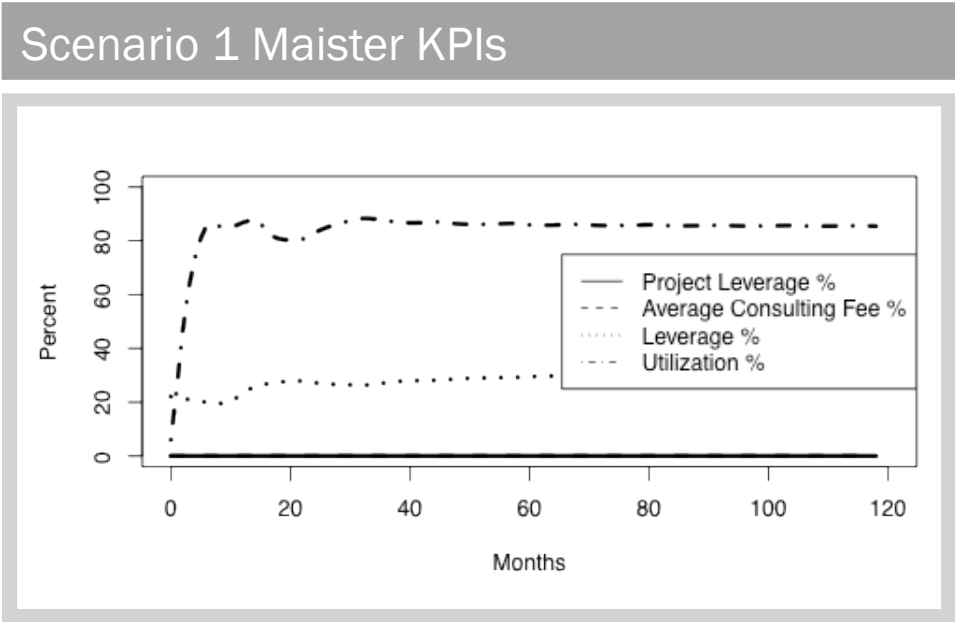
Products.Product Marketing Effort %

0 ————— 100%  
0

Products.Product Standardisation Effort %

0 ————— 100%  
0

Allocated: 100  
Unallocated: 0



# SCENARIO 2 CONCENTRATE ON THE CUSTOMER

Principals.Maximum Project Time Share

0.00  1.00

U

Principals.Maximum Contact Maintenance Time Share

0.00  1.00

U

0  100%

Products.Product Invoation Effort %

0  100%

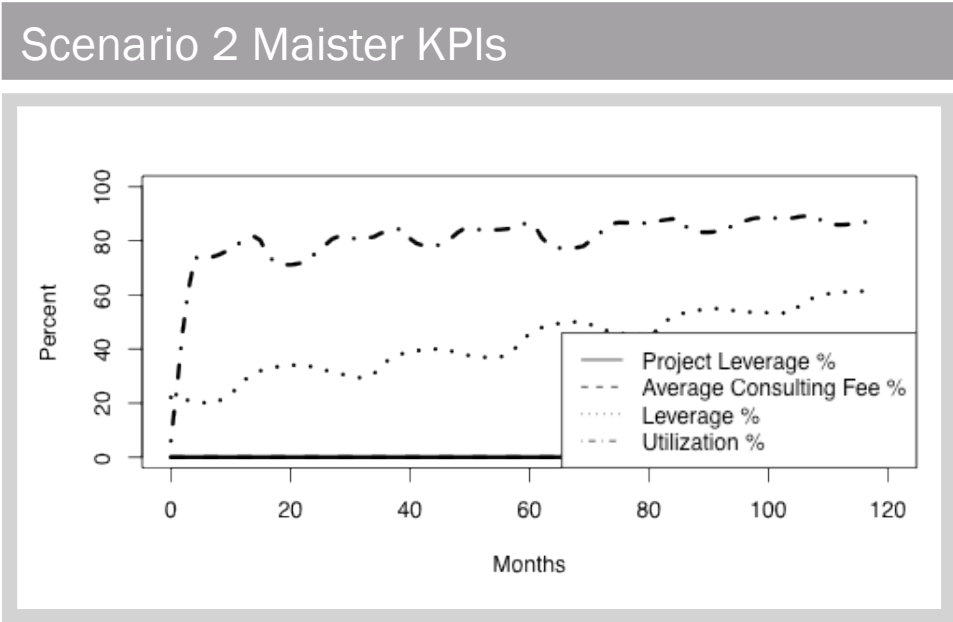
Products.Product Marketing Effort %

0  100%

Products.Product Standardisation Effort %

Allocated: 100

Unallocated: 0



# SCENARIO 3 INNOVATE AND STANDARDIZE

Principals.Maximum Project Time Share

0.00 1.00

U 0.00

Principals.Maximum Contact Maintenance Time Share

0.00 1.00

U 1.00

Products.Product Innovation Effort %

0 100%

9

Products.Product Marketing Effort %

0 100%

30

Products.Product Standardisation Effort %

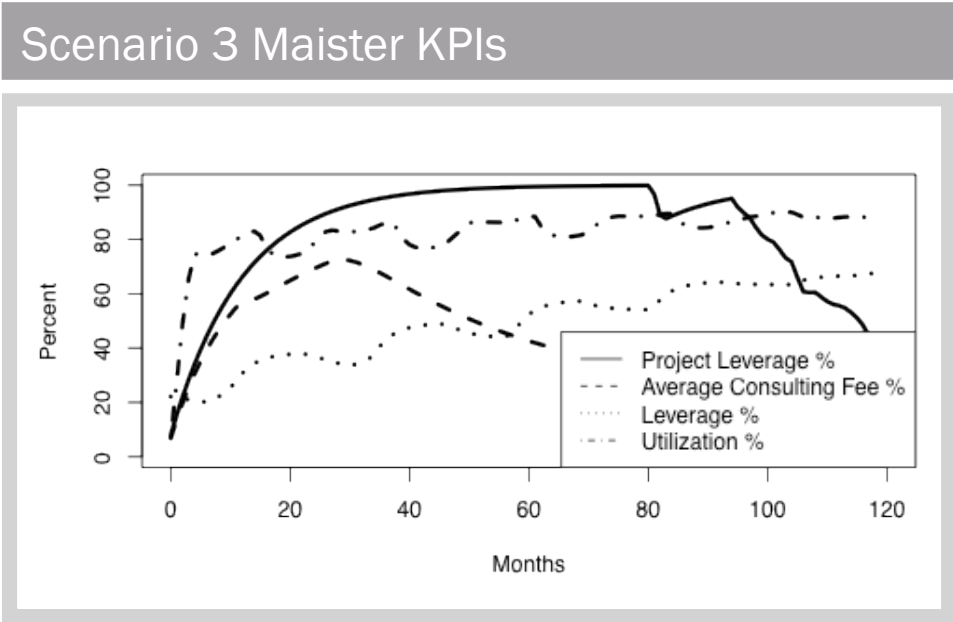
0 100%

61

Allocated: 100

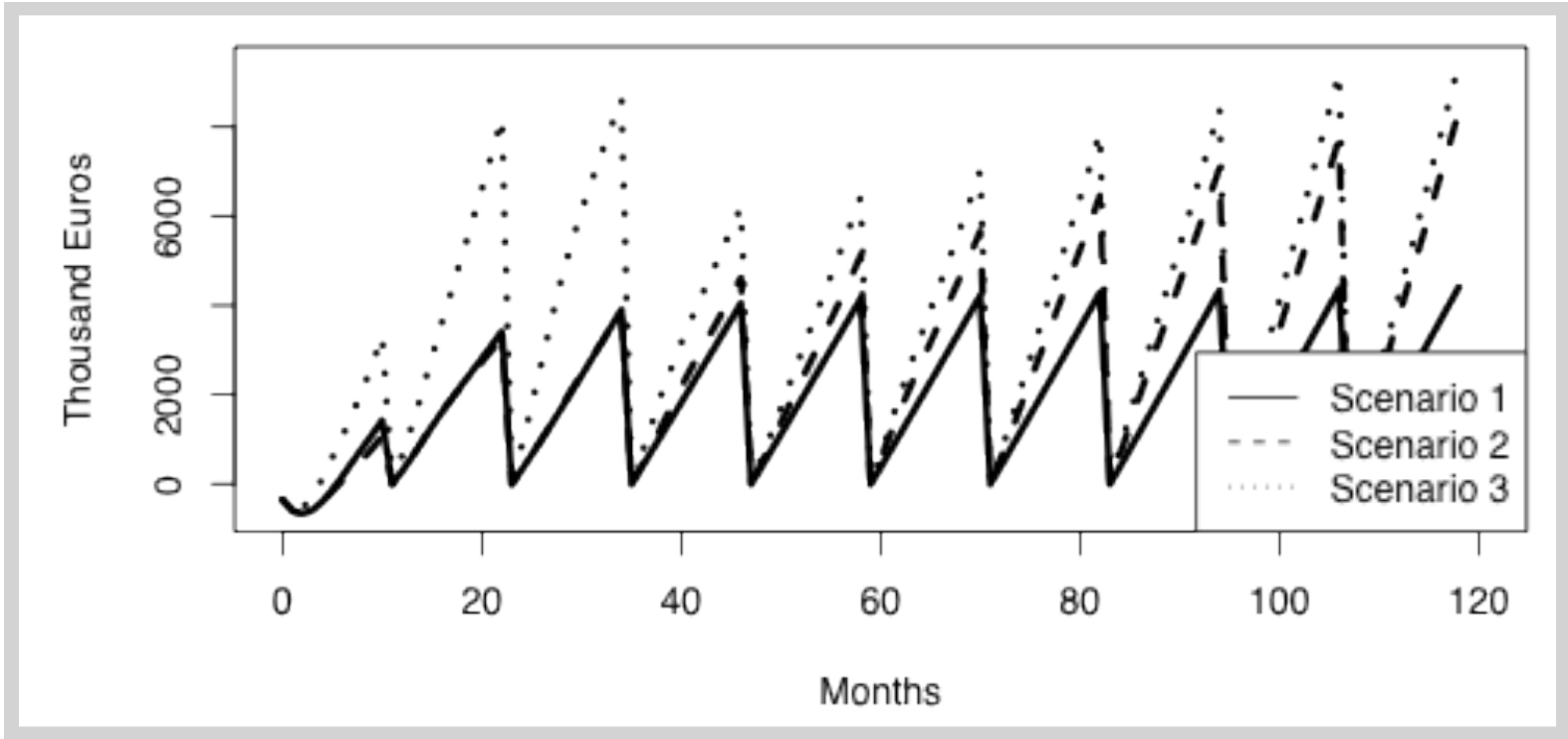
Unallocated: 0

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# GROSS MARGIN COMPARISON

## Gross Margin Comparison



# RECOMMENDATIONS FROM SIMULATION STUDY

- Shift partner effort stronger towards customer acquisition and maintenance and away from project responsibilities.
- Define concrete effort allocation policies and monitor effort allocation.
- Increase leverage by standardizing innovative consulting products.
- Reconsider “top-heavy” partner structure
- Monitor the effect of innovation on fee structure.

The real value of the model was in providing a testbed for policy experiments.

## SUMMARY

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- The question "How do we create value for all our stakeholders" is fundamental to any enterprise.
- An enterprise's value-creation logic is captured in its business model.
- It is important to understand the policies governing the value creation process and to manage them explicitly.
- Using a model-driven, visual approach to business model engineering is useful to create shared understanding of relevant policies across departments and hierarchies.

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## Value creation in complex systems

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