Creating Value Through E-Commerce Business Models

Beenz.com believes it can mint money—or at least virtual money. The company, which is headquartered in New York City but has operations in Europe and Asia, last year introduced a web-based currency called "beenz" which works for online retailers much as frequent-flier miles do for airlines. Customers can earn beenz when they shop at stores such as Barnesandnoble.com or MP3.com, and they can spend beenz at some 300 websites around the world. Merchants, meanwhile, can redeem beenz for cash.

Launched in March 1999, beenz.com so far has performed more than 25 million beenz transactions. These numbers could grow higher in the future; beenz.com has just signed on BHO/FCB, a leading British ad agency, to help promote its brand worldwide. If these efforts succeed, who knows—perhaps it might spawn a new kind of job: the beenz-counter.

Frivolity apart, what's unusual about beenz.com? Certainly not the fact that it operates loyalty programs, which have been around much longer than the Internet. According to Raffi Amit, co-director of the Wharton e-Business Initiative (WeBI), and INSEAD's Christoph Zott, it is the fact that the value that beenz.com creates does not reside within the firm per se, but rather in the network of partners it brings together.

In other words, beenz.com coordinates the activities of several partners to create value for its customers. "Without its partner vendors, beenz.com would not create significant value," say Amit and Zott. "Its core product—the virtual currency beenz—does not have a high stand-alone value." If beenz.com can create value, it does so because of its business model.

Amit and Zott argue that beenz.com is not alone. In a paper titled "Value Drivers of E-Commerce Business Models," they point out that the way companies construct business models is crucial to their ability to create value. As businesses strive to implement innovative web-based initiatives, they increasingly will have to pay attention to e-commerce business models.

Amit and Zott would like to help. They have constructed a framework—called the eValue framework—which can help executives understand major value drivers of e-commerce. Amit and Zott note that "the value-creating potential of any business model is enhanced by the extent to which these factors are present."

Moreover, understanding the value-drivers of e-commerce business models could help companies stave off disaster. In the past year a number of Internet companies have gone bust. While various reasons account for these failures, Amit believes that flawed business models were at the core of these companies' weaknesses. Had these companies focused on their true value drivers, their chances of success would have been enhanced—in part because their business models would have been more robust.

First, though, what exactly is a business model? Amit and Zott point out that business models offer the "relevant perspective for understanding new business structures in the information age." Academic literature almost entirely ignores this approach. As a term, however, "business model" is often used ambiguously, with the result that contradictions and misconceptions abound about the concept. Amit and Zott attempt a precise definition. They describe a business model as "the architectural configuration of the components of transactions designed to exploit business opportunities." The revenue model, in contrast, refers to "the specific ways in which a business model enables revenue generation."

In other words a business model depicts the architectural configuration of economic exchanges. It describes the ways in which a company enables transactions that create value for all participants, including partners, suppliers and customers. So while a business model is about value creation, a revenue model centers on value appropriation. Revenues can be realized through a combination of subscription fees, advertising fees, transactional income (e.g., fixed transactional fees, referral fees, fixed/variable commissions, etc) and more.

Amit and Zott offer a simple example to show the difference between a business model and a revenue model. Consider beenz.com, the web-currency company. "Beenz.com generates revenues by charging a higher price for the beenz it sells to vendors than the price it pays for buying them back. Like a bank, it profits from a bid-ask spread on transactions," the researchers point out. The company's business model, however, is "that of a clearing house for a virtual currency with affiliated vendors." The company's revenue and business models thus are distinct, though they complement each another.

Having explained the architecture of business models, Amit and Zott go on to describe the main elements of their eValue framework, which they use to examine the value-creating potential of various business models.

The four key value drivers, in their view, are efficiency, complementarities, lock-in and novelty:

1. Efficiency

The Internet makes it possible to increase efficiency in several ways. One of the most significant is its ability to reduce so-called information asymmetries between buyers and sellers. Example: If a customer is looking for a new car, in the traditional world she would have had to suffer the tedium of going to dealership after dealership to get information about auto prices and availability.

A website such as Autobytel.com or Edmunds.com, however, dramatically transforms this situation. It not only provides the potential car buyer with detailed, comparative information about different models, but it also "facilitiates a reverse market, in which buyers put their desired purchase up for bid among vendors," say Amit and Zott. "The buying process is thereby substantially simplified and accelerated, and bargaining costs are reduced."

A business model can unlock hidden value by enhancing transactional efficiencies by enabling reduced search costs, transaction speed, reduced distribution costs, reduced inventory costs and more.

2. Complementarities

Companies have long known that they can leverage value creation for their own products when they bundle them with complementary products from other suppliers. On the Internet, bundling complementary products or services together is crucial because it can play a vital part in building online virtual communities. Example: E-bookers, a European online travel site, gives its customers access to weather information, currency exchange rate information, and appointments with immunization clinics.

"These services enhance the value of the core product and make it convenient for users to book travel and vacations with E-bookers," say Amit and Zott. In addition to exploiting complementarities among products and services, a business model enables value creation by capturing the benefits from combining online with offline businesses (e.g., office depot.com), complementarities among technologies, and complementarities among the activities of participants in the business model.

3. Lock-In

This refers to the ability of a business model to prompt users to engage in repeat transactions. Lock-in can be enabled, for example, by creating switching costs that customers would face if they were to switch to a different service provider. Switching costs are created through loyalty programs (beenz.com), by providing transaction safety and creating the perception of trust, through familiarity with the site, and also through customization and personalization. One simple example of a company that uses lock-in effectively is Amazon.com, which has developed an extremely simple "one-click ordering system" for customers who order books, videos, CDs or other products. This ease of use—as well as the fact that Amazon's database has credit card information on file for its customers that can be used for transaction after transaction—locks in buyers who return for more purchases.

Another instance of a company that developed an effective lock-in strategy is Hotmail, the e-mail service that now belongs to Microsoft. Hotmail grew rapidly by offering free e-mail services to clients. Once these customers had signed up to receive their e-mail through Hotmail, the inconvenience of having to change e-mail addresses represented the switching cost that kept them loyal even after other providers began offering free e-mail.

4. Novelty

Innovation has always involved the introduction of novel products or services or processes. The Internet, however, offers limitless possibilities to innovate the manner in which transactions are enabled—by introducing new business and revenue models. For instance, consider eBay, the first firm to introduce customer-to-customer auctions, which lets even low-value items be traded online. Or take Autobytel.com, which revolutionized the car-buying process in the U.S. by linking potential buyers, auto dealers, finance companies and insurance companies.

Amit and Zott believe that "by identifying and incorporating valuable new complementary products and services, combining activities, and integrating technologies into their business models in novel ways," these companies were able to tap new sources of value.

Among the companies that incorporate these value drivers in their business models, which ones are likely to be most long-lasting? According to Amit, that is hard to predict. The main reason is that companies are rapidly changing and evolving their business models in order to adapt to the rapidly changing market conditions. In general, says Amit, traditional or legacy firms, which combine their online operations with existing offline businesses, are well positioned to draw liquidity (i.e. transaction volume) and take advantage of complementarities and create lock-in.

Consequently, we see an e-business landscape in which a growing number of so-called old economy firms will develop powerful e-commerce business models and end up dominating their industries. In addition, say Amit and Zott, "we are likely to witness the integration of BtoC with BtoB business models which will once again transform the e-business landscape"

As the Internet continues to transform the business world, Amit and Zott point out that more research will be needed to analyze how business models contribute to wealth creation. The eValue framework, however, does offer executives tools to analyze how their own e-commerce efforts measure up against these criteria. It's a good place to start.