Management for Professionals

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Business Model Pioneers

How Innovators Successfully Implement New Business Models

Management for Professionals

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How Innovators Successfully Implement New Business Models

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Part I

Retail Business Model Pioneers

1 Introduction

The Oxford Learner's Dictionary refers to a pioneer as a person, who is among the first to pursue a new field of activities or undertakings. A pioneer is someone, who creates and develops new ideas, approaches and methods. The term "pioneer" has been used to describe fields of human interest and activity as diverse as scientific breakthroughs (innovator, trailblazer, developer), geographical discoveries (explorer, settler, colonist), alongside with cultural and philosophical advances (avant-garde artist, founding father of a school of thought). This is to give a very brief listing of the areas, in which the pioneering spirit comes forward. Without this particular condition of the human spirit, and without pioneers trying out new things, the world stands still—at least metaphorically speaking.

The present book takes a specific view on pioneers, by looking at a further field of activity in which pioneers shape the world, the business field. The aspiration of companies to act as pioneers, and more specifically, as business model pioneers, is accentuated by the extremely high frequency of change in today's economic environment. As competitive advantages rapidly lose their relevance, turbulent environments call for innovation and for rethinking tried-and-tested strategies. In times of growing competition, paired with constant changes in technological capabilities, firms have to continually develop new ideas and find creative solutions for their customers' problems.

The terms "innovator" and "pioneer" are, in a business context, to a certain extent synonyms. Both imply the pursuit of new strategies, managerial practices, and operating procedures. In business model terms, both imply new ways of creating and delivering value to customers. As well, both can indicate new ways, in which the organization gains a benefit or a return from customers. Yet having a closer look at the terms, one becomes aware of their differences: while the term "innovator" has a broader understanding, the term "pioneer" is more specific. Innovation can refer to an activity that is new to the world, or to an activity that is new to an industry or to a geographical region, as well as to an activity that is solely new to a company itself. All of these represent various degrees and forms of innovation. The term "pioneer" allows a clearer understanding by solely referring to

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activities that are new to the world. Business model pioneers surpass competitors in business model design, product innovation capabilities, as well as regarding their familiarity with technological trends and customer needs, as also noted by Teece (2010).

All business model pioneers portrayed in the course of this book show a form of inherent awareness of fundamental customer needs, which we found a compelling subject to study. The book consequently looks at business models that brought significant originality and individuality to the global business environment. Moreover, it analyzes company examples that had a long-lasting and significant impact on the marketplace—in the best sense, these are examples of successful business model pioneers. Nonetheless, the companies analyzed here still have their own battles to fight, and such challenges were not neglected within the pages of this book.

Some of the depicted examples (such as Amazon, Dell or Netflix) represent standalone business model pioneers, while others (for instance edX, Southwest or Spotify), are part of groups of companies, which pioneered a certain business model. Significant for the purpose of the book was to choose those companies, which were superior in their introduction of a new business model, rather than those, which merely experimented with various new approaches, without managing a consistent and sustainable competitive advantage out of these efforts. To give some examples, Walt Disney was not the first cartoon-maker. However, he succeeded in founding an entertainment empire based on cartoons and on their singular, outstanding characters, such as the Mickey Mouse. Werner von Siemens did not invent electrical telegraphy, but prevailed in establishing the first project business in this field. Anita Roddick was not the first entrepreneur to produce and sell natural beauty products—however, she was resolute about redesigning the business habits within the cosmetics industry, and became a prime example of social responsibility. Moreover, Arianna Huffington did not pioneer online news or political blogging, but she succeeded in challenging the classical "one-to-many-communication"-principle of news providers, opening new channels for readers to engage in the news-making process.

By first having a look at four industry branches in which innovation is recurrent—retail, media and entertainment, services and finally manufacturing—we employed an additional criterion, besides business model originality, for choosing the business model pioneers. Hereby, the main competitors and their course of action were key for selecting the pioneer examples. For a better understanding, the book provides an overview of the industry standards and competitive situation at the time when each pioneering business model was introduced. As regards for instance low-cost air travel, Southwest emerged as the ideal example to illustrate the shift in the value creation logic of airline companies, in spite of other airlines, which introduced low-cost initiatives at a time briefly preceding that of Southwest. Our approach did not inevitably lead to choosing the very first companies to try a pioneering business practice, but rather those with business models, which were meaningfully original, coherent and germane to their markets.

We found it useful to study business model pioneers that opened up completely new markets—Google, through its advertising business model, being one of the most prominent examples in this sense. We complemented this perspective by examining companies that exerted an unprecedented influence on established markets, such as Aldi in the food retail industry. The success of Aldi led to vast numbers of me-too business models. Imitation is one of the best indicators for the success of a new approach, and we used the number and relevance of imitators as a barometer for the market-relevance of a business model pioneer.

Other business initiatives, which have not risen to the prominence of Aldi or Google, are also helpful for understanding the concept of business model pioneers. We chose promising pioneers, the success of which is still to be determined by their upcoming market- and strategy-related developments. One of the best examples in this sense is edX, an educational online platform, which not only offers massive open online courses from world-leading universities, but contrary to its main competitors, acts as a non-profit organization. We found that young and vibrant companies help to better understand the significance and wide practical implications of the business model concept, and provide excellent cases of business model pioneers.

To give a preview of the next chapters, below are some of the most compelling questions, to which the business model pioneers discussed in this book can give an own answer:

- **Aldi**: How to simultaneously offer unparalleled low prices and create a trustworthy image in grocery and household article retail?
- **The Body Shop**: How to sustainably address a nonconforming customer group?
- **Starbucks**: How to attract devoted consumers of premium products in a non-premium industry?
- **Dell**: How to distinguish between relevant and irrelevant product features?
- **Amazon**: How to create a new market space and capitalize on it?
- **Google**: How to recognize who the core customers are, and build a business model starting from this customer group?
- **Huffington Post**: How to allow newsreaders to emerge from passive spectators to active partakers in the news-making process?
- **Disney**: How to generate synergies in your business model and profit from these?
- **Netflix**: How to create an innovative business model based on a new technology?
- **Spotify**: How to provide an ethical alternative to music piracy?
- **edX**: How to help democratize higher education?
- **Southwest**: How to win unlikely customers for your business?
- **Tesla**: How to create widespread awareness of a product that is still under development, and how to differentiate from Goliath-like competitors?
- **Siemens**: How to manage a complex business model in an international context?

Yet before moving on to discuss these questions and the answers provided by the business model pioneers, it is worth having a look at what the components of a business model are in the first place, and how this concept can be analyzed.

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The Business Model Concept

2

The success of the company examples provided in this book is not primarily based on a new product, service or technology, but on a pioneering business model. But what is in fact a business model? The idea behind this term was first expressed in the writings of Peter Drucker (1954). Drucker, one of the founders of modern management, defines a good business model as one that answers the following questions: "Who is the customer?", "What does the customer value?", "How do we make money?", and "What is the underlying economic logic that explains how we can deliver value to customers at an appropriate cost?".

Nowadays, to attempt a business model definition may initially seem challenging, as the research community somewhat disagrees regarding the elements entailed by business models. Numerous definitions exist, and some are the result of the particular field, in which the authors base their research. Nonetheless, most business model scholars refer to three main elements contained by each business model, as also noted upon by Peter Drucker: *value proposition*, *value creation* and *value capture*.

The *value proposition* refers to the products, services, or the mix of both, offered by a company to its customers. It illustrates the potential benefits a company creates for its customers. *Value creation* discusses the methods employed by companies for making and delivering the *value proposition* to customers. Value creation is generally accepted among researchers as the core of a business model, without which the other two main business model elements would not be possible. In turn, *value capture* defines the subsequent conversion of payments from customers into profits. Interestingly, payments do not always represent monetary transactions and may refer, for instance, simply to attention received from customers. This is the case of many online business models, which provide customers with a free service, basically in exchange of their time spent on the platform. Advertisers can make good use of this time by placing commercials on the platform. Hereby, the platform transforms non-monetary value from customers, who provide their time and information, into monetary value from advertisers. Google, a prime example of this value capture logic, will be discussed further in this book.

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Research attention towards the business model concept significantly grew in the mid-1990s with the boom in information technology, related emergence of web-based companies, and rapid advancements in e-business—the time of the New Economy. Business models came into the focus of companies and investors, gaining both business and media interest. At that time, researchers and practitioners were primarily interested in discovering and analyzing *value creation* mechanisms. However, a large number of the new e-business ventures failed, due to a lack of proper understanding of the *value capture* mechanisms in e-commerce initiatives. Only after the turn of the millennium and the burst of the dot.com bubble, business model scholars began to understand the significance of *value capture* mechanisms in defining a business model, and to refine the concept. As well, companies from the Old Economy started to rethink their business models, by adding web-based components to their businesses. This led to a revival of the business model concept and to it being understood as a stepping stone for innovation.

According to Magretta (2002), the term "business model" is frequently equated with the term "strategy". However, the two do not have the same meaning. A business model describes "the logic of the firm, the way it operates and how it creates value for its stakeholders" (Casadesus-Masanell and Ricart 2010). It presents the system of how single elements of a business fit together. A business model does not describe the way a company deals for instance with competition. Rather, this is the task of strategy. It is also a strategic task to select the right business model for competing on the marketplace. While business models and strategy differ in their functions and scope, they are inherently related. Let's consider a company looking for an adequate strategy to match its leading technology. Besides analyzing the market situation in terms of competitors and of customer demands, the company has to design a business model, which best exploits the technology. According to Chesbrough (2010), a technology will not be of great value, unless the company manages to develop a business model that captures value from it. This insight is confirmed by the technology-driven companies analyzed in this book, with examples ranging from Google to Siemens.

To illustrate the business models of the pioneering companies discussed next, the book follows the conceptualization of Osterwalder and Pigneur (2010). The researchers interpret business models as the way in which companies create and capture value, that is, the way in which the value proposition takes shape and is subsequently monetized. To better define value creation and value capture, Osterwalder and Pigneur (2010) introduced nine elements (Fig. 2.1), which in sum define the business model: the *value proposition* lies at the center of the model. It not only fulfills the customer demand, but represents the reason why a customer prefers one firm over another. The value proposition is surrounded by eight further elements. Whereas the ones on the left refer to the company side, the elements on the right describe customer-related aspects, as illustrated in Fig. 2.1.

As highlighted by Osterwalder and Pigneur (2010), the *key activities* ensure a functioning business model. These represent the fundamental tasks a company completes in order to create the value proposition, reach customers and generate

Key Partners
Key Activities
Key Resources
Value Proposition
Customer Relationships
Channels
Customer Segments
Cost Structure
Revenue Streams

Fig. 2.1 The business model canvas, as illustrated by Osterwalder and Pigneur (2010). Source: Osterwalder and Pigneur (2010)

revenues. Hereby, a firm makes use of a network of *key partners* (such as suppliers, joint ventures or R&D networks) and *key resources* (human, technological, informational, infrastructural, financial), which make the key activities possible. Since value creation generates expenses, the *cost structure* includes all costs incurred by operating a business model, as illustrated in the the last block on the left side of the graph. On the right side, the *customer segments* and *customer relationships* describe the groups of people a company wants to reach, and the involvement on behalf of the company and its customers respectively. Here, central questions regard whether a company has one main customer segment or whether it chooses to address different types of customers through different types of products and services. As regards the customer relationships, a firm can ask itself whether it sees any role for its customers in the creation of its offers (as is the case of co-development) and what degree of service it should provide to its customers (for instance, tailor-made experiences vs. simplistic self-service). The *channels* make it possible for a company to communicate with customers and to deliver its goods and services. Finally, the *revenue streams* represent the turnover a firm generates—which, depending on the particular business model of the firm, can take the form of usage, subscription or licensing fees. As noted above, some companies may even choose to offer a service or product for free (or subsidize it) to one customer segment, while gaining revenues from a different customer segment, for instance from advertisers. In this case, advertisers can be viewed as both key partners and customers.

Certainly, a company's design of its business model elements depends on its distinct strategy and market positioning. Each company has a specific business model, whether it is consciously aware of it or not, and each company shapes its very own, individual version of a generic business model. However, what all companies have in common is that each business model functions due to the interdependencies among its elements. A brilliant value proposition would not

make its way to fulfill a stringent customer demand without channels in place. A company with a well-established and loyal customer base would not be able to thrive without a proper revenue logic. Many times, an alteration (or innovation, for that matter) in one business model element brings along changes in further elements. This will also become evident in the following chapters, as the business model of each company is illustrated twice, first at the time of the company's launch, and subsequently at the moment when this book was written (2015).

The next chapters are built following a uniform logic, each chapter introducing the competitive landscape at the time when the portrayed company entered the market. This is complemented by highlighting unmet customer demands of the time—the demands, which the pioneer managed to address in an unmatched manner. As well, a look is given at the founder (or founders) of each company, in order to counterpart the market perspective by a view on the leading figures behind the pioneering companies. Next, each business model is analyzed following the approach provided by Osterwalder and Pigneur (2010), and the most meaningful developments of the business models are individually illustrated on a time-line. Finally, the current market outlook is sketched, considering its positive and negative implications. Naturally, the business models of the depicted companies include aspects, which find themselves in range and depth beyond the scope of this book. Yet we hope to provide an interesting and enjoyable reading, and to help unveil the essential business models elements of some of the world's most ingenious companies.

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3 Striving for Customer Benefit: The Case of Aldi

Aldi opened one of its first hard discount grocery stores in Germany in 1962. During the same year, Sam Walton inaugurated his first Wal-Mart in the United States. In spite of similarities such as the attention towards low prices, the two companies were about to follow quite different strategies: while Wal-Mart focused on opening stores in rural communities and small towns, tapping into new markets as a sensible geographic expansion, Aldi much more thoroughly competed on price. The genuine discount business model did not start with Wal-Mart, but with Aldi—the latter being, beyond doubt, the pioneer among hard discounters in the retail industry. Hard discounters, also called limited-line stores, focus on selling a high volume of a limited and flat product range, concentrating on essentials and simplification, as well as on cost and price leadership.

At the time of Aldi's launch, retail cooperatives chains were dominating the German grocery retail. One prominent example was Edeka, already at that time one of the largest grocery retailers. Besides, Rewe was another well-known association of independent retailers. These supermarket chains did not evaluate the emergent Aldi as a serious competitor, but saw mainly large, green-field stores as threatening. Built in vast remote areas, green-field shopping centers could now easily be reached by customers due to increased motorization. In neighboring France, Carrefour opened its first hypermarket in 1963, and managed to create international attention towards its store format. Hypermarchés, the French name for supermarkets or hypermarkets, were located outside the city center, providing a broad range of products and groceries in bulk packs at lower prices than in small corner shops. Interestingly, through Aldi's emergence, later on followed by the emergence of imitators such as Lidl, neighborhood shopping succeeded in remaining competitive in the face of the new green-field hypermarkets. Discounters and established grocery retailers complemented each other's assortment, in order to provide an attractive shopping infrastructure close to customers, and to successfully keep pace with green-field competitors.

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The launch of Aldi's discount business model gave a new impulse to the German retail industry: in spite of a visible trend towards larger stores, the company deliberately inaugurated discount stores with a limited sales area and a limited assortment. Moreover, while large department stores with lavish decoration and display windows were perceived as the future of retail, Aldi introduced a strongly contrasting and utterly simple shopping format.

3.1 Founders

Aldi's success story starts in 1946, when Karl and Theodor Albrecht became owners of their mother's small grocery store. Born in a merchant's family, the two brothers had close contact to the retail business from early on, and were able to observe, since childhood, their parents' customer-oriented business strategy. The idea of offering a specific assortment of quality products at low prices shaped the Aldi philosophy, following the company's motto of "Top quality at incredibly low prices—guaranteed".

Several personality traits serve to illustrate why the Albrecht brothers were so focused on setting up a pioneering hard discount business model with a stringent focus on low costs. Before inheriting the family business, Karl and Theodor Albrecht were prisoners of war. This experience of witnessing constant misery during the war might explain why the brothers acted particularly cautious in their subsequent business endeavors. Keen on preventing unnecessary expenses, the Albrechts thoroughly avoided costly investments. Their skepticism regarding new technologies often resulted in keeping the technological solutions implemented by their organization to a minimum. To them, a smart, well-functioning organization was at any time more important than investments in state-of-the-art solutions and technologies. Theo and Karl Albrecht permanently aimed at avoiding both extravagance and waste, setting role models for their employees. For instance, it became a common company practice to make sure to switch off the light whenever possible, and to write on both sides of a paper—Theodor Albrecht exemplified actions such as these daily to his employees (Brandes 2013). An aspect, which substantially contributed to Aldi's success, was that the company's corporate culture was lived and set as an example by the two founders. Due to its far-reaching implications, it was also particularly hard to copy by competitors.

To the Albrechts, speed was another essential attribute: after taking charge of the family business, the brothers swiftly started to increase the number of shops. To better manage a fast-growing business owned by two brothers with rather different personalities, the company was split up into two regional companies in 1961: Aldi Süd, owned by Karl Albrecht, and Aldi Nord, owned by Theo Albrecht. One year later, in 1962, Theo then opened the first Aldi hard discount store in Dortmund, Germany. The discount stores were now known under the name "Aldi", which originated from a combination of Albrecht and Discount. Since the split, the companies independently organize operations and financing, yet cooperate on major decisions, such as pricing policies and the choice of suppliers. Due to their

prevailing similarities, the following subchapter will view the Aldi business model as one entity.

3.2 Market Demand

The business model of the hard discounter was not only made possible by the founders' past experience, but was equally a response to the unmet customer needs of the 1960s. The company's logic was straightforward: to offer affordable, qualitative nutrition where it was needed most: to low- and middle-income consumers. The idea of the Albrecht brothers was to resolutely employ the no-frills principles of mid-1940s post-war times during the booming economy of the following decades. Previously, immediately after World War II, customers were confronted with the omnipresent need for saving, while shopkeepers were only able to offer a limited assortment of products. The Albrecht brothers learned the lessons of those times and applied their knowledge in form of low-price and store minimalism in the early 1960s.

3.3 Pioneer Business Model

Aldi's rigorous no-frills business model was an outstanding, original move during the booming economy of the 1960s, as will be discussed below. Figure 3.1 provides a summary of Aldi's business model elements at the time of the company's launch.

Value Proposition Aldi's purpose and value proposition was to provide good quality at the lowest price possible. All further elements of the value proposition were derived from this remarkable focus on price. For instance, the company offered a narrow product range of staples and non-perishable articles with high demand. In order to obtain the best prices possible, Aldi purchased from suppliers large amounts of a narrow assortment, which had the additional positive effect of allowing fast shopping. This limited product portfolio, containing only items with high demand, also helped the company to differentiate itself from other food retailers in the years of the German economic miracle.

Key Activities The company's early-day efficient and often innovative operations allowed it to pass on its cost savings to customers. First, in order to create some independence from the retail prices of brand articles, Aldi negotiated with well-known manufacturers the production of groceries as Aldi private label products. Second, the company restricted itself to stores with a particularly simple and coherent design, where products were sold directly from cartons. The Albrechts also increased efficiency by introducing the innovative concept of self-service from the very beginning, replacing the typical store layout, in which products were sold over the counter. Self-service enabled an extremely fast handling of the sale process, compared to the other retail businesses of the time.

Key Partners	Key Activities	Value Proposition	Customer Relationships	Customer Segments
Private label manufacturers Long-term suppliers	Simplification Coherent store design Negotiation regarding private label products	High quality groceries at low prices Staples and non-perishable articles Fast and simple shopping experience	Self-service Limited personal interaction Long-term relationships based on trust and credibility	Price-sensitive customers Customers looking for efficient shopping
	Key Resources		**Channels**	
	Corporate culture Warehouses and stores Fast clerks		Aldi stores "Aldi informs" brochure	

Cost Structure	Revenue Streams
Highly cost-driven cost structure Low total costs of sales and personnel costs Reduced publicity No services	High volume sales of a narrow product range

Fig. 3.1 Overview of Aldi's business model at the time of the company's launch. Source: own illustration, based on Osterwalder and Pigneur (2010)

Key Resources Aldi's most significant resource was its culture. Its values of responsibility, simplicity and consistency helped the company to create a clear profile—authentic, likeable and compatible with its customers. Derived from the company culture, its daily operations laid the foundation for success. For instance, the company relied on two central warehouses in Nordrhein-Westfalen, which were located in close vicinity to its first stores. This physical vicinity supported Aldi's efficient supply chain activities. Moreover, the stores were situated close to customers, allowing short shopping distances and hereby encouraging consumption.

Key Partners Manufacturers of Aldi private label foodstuffs represented the main partners, alongside general foodstuffs suppliers. Aldi's buying behavior and relationship to its suppliers resulted in a substantial buying power. The company dedicated much effort in developing fair, long-term trade relationships—expecting, in return, uncompromised quality from suppliers.

Customer Segments By introducing the hard discount concept, Aldi aimed at offering its products to price-sensitive customers, with low-and middle-incomes. Many among them were Italian and Turkish immigrants, who were participating in

making Germany's economic miracle possible. The plain store layout also additionally attracted customers simply interested in basic and fast shopping.

Customer Relationships Despite the fact that self-service minimized interaction with customers, Aldi managed to build substantial trust in further ways: first, by offering consistently good quality, and second, by thoroughly informing customers on prices rather than merely showing advertisements on TV and radio. The company focused on developing long-term customer relationships based on credibility and reliable information.

Channels As regards the sales channels, Aldi only sold products in its own-operated stores. Additionally, channels for customer communication were kept to a minimum. Aldi avoided promotion activities and advertisements, perfectly in line with Karl Albrecht's statement, "our advertisement is the cheap price". The company did not advertise, but advised. From the very beginning, Aldi promoted a selected range of products each week, publishing a brochure entitled "Aldi informs", which became its main communication channel with customers.

Revenue Streams Repeated purchases by long-term customers built the core element of Aldi's revenue generation. Instead of offering thousands of different articles, the company generated revenues through high volume sales of a narrow product range. In comparison, Edeka operated a wider product portfolio, offering fresh meat, pastries and frozen food already in the 1960s.

Cost Structure Known from early years as the undisputed cost leader in its industry, Aldi's cost structure is one of the most significant building blocks in its business model. As well, the cost structure is an expression of the company's efforts to reduce costs in all elements of the business model, particularly in the value proposition, key activities (repetitive, high volume buying activities paired with austere shops), and relationship to partners and customers (complete absence of publicity efforts). All of these created a cost-driven logic, which gave Aldi the head start in the hard discount retail.

3.4 Current Business Model

Figure 3.2 depicts the main changes of Aldi's discount business model across time, which will be discussed in the following. It is noteworthy that Aldi has not changed its no-frills principle, but rather enlarged its product portfolio.

In the following, Aldi's current business model as well as the depicted main changes in Fig. 3.2 will be discussed in more detail. Figure 3.3 provides an overview of Aldi's current business model, with the aspects marked in grey having remained constant over time.

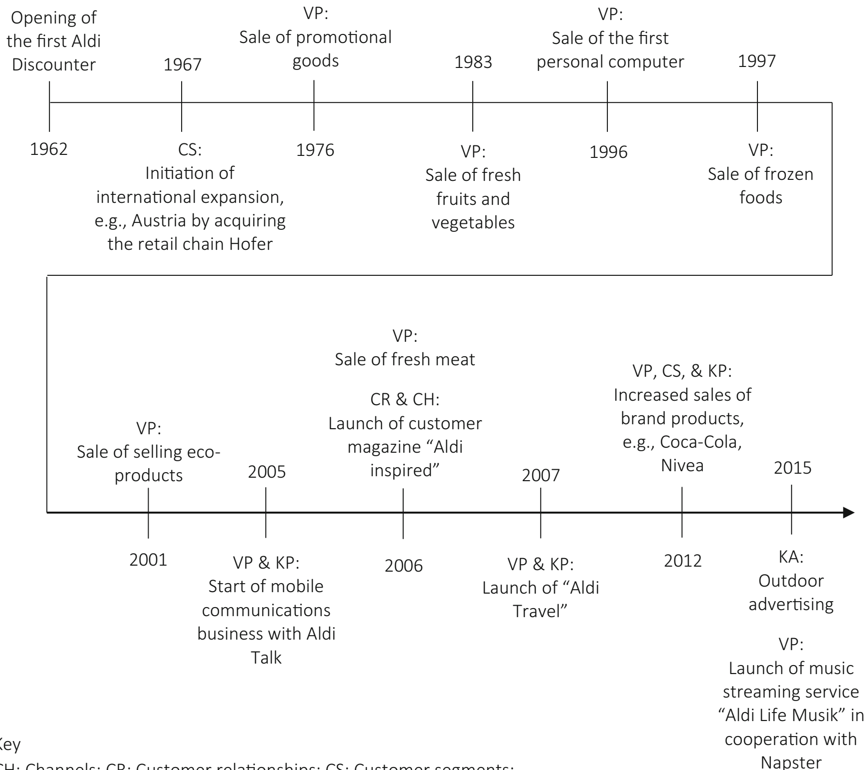

Fig. 3.2 Main changes in Aldi's business model across time. Source: own illustration

Value Proposition Aldi's value proposition continues to be, at core, the extraordinary price-quality ratio of a limited range of quality private labels sold at the lowest possible price. However, several customer-triggered business model changes and extensions occurred over the years: the product portfolio extended for instance with fresh vegetables and fruits since 1983, frozen foods since 1997, eco-products since 2001 and fresh meat since 2006 (Schmitt 2014). While the company initially left out brand-name products to avoid price fixing, it reconsidered this strategy in 2012. Since then, Aldi enlarges its assortment with brand-name products from Coca-Cola or Nivea. In order to provide a more attractive shopping experience, the regular assortment is expanded with weekly varying promotions, as well as with travel journeys, mobile communication, electronics and even a music streaming service. The stores nonetheless keep a limited assortment of around 1,000 basic articles, adding about 80 weekly promotional ones. A fast and simple shopping experience is hereby guaranteed. Despite its portfolio enlargement, Aldi's core competence and value proposition still consists of the "simplicity principle". For Aldi, shopping should simplify the daily routine.

<table>
<tr>
<td rowspan="2">Key Partners

Private label manufacturers

Long-term suppliers

Suppliers of brand-name products

Aldi Talk: Medion AG and E-Plus

Aldi Travel: Berge & Meer, Eurotours, Select Holidays</td>
<td>Key Activities

Simplification

Coherent store design

Negotiation regarding private label products and brand-name products

Lean thinking

Branding</td>
<td rowspan="2">Value Proposition

High quality groceries at low prices

Staples and non-perishable articles

Fast and simple shopping experience

Enlarged portfolio of non-food articles

Weekly changing promotional products</td>
<td>Customer Relationships

Self-service

Limited personal interaction

Long-term relationships based on trust and credibility

Customer retention: e.g., customer magazine “Aldi inspired”</td>
<td rowspan="2">Customer Segments

Price-sensitive customers

Customers looking for efficient shopping

Affluent customers

Customers searching for premium brands</td>
</tr>
<tr>
<td>Key Resources

Corporate culture/ Brand

Warehouses and stores

Fast clerks</td>
<td>Channels

Aldi stores

“Aldi informs” brochure

Internet especially for booking journeys</td>
</tr>
<tr>
<td colspan="2">Cost Structure

Highly cost-driven cost structure

Low total costs of sales and personnel costs

Strict cost control and lean thinking</td>
<td colspan="3">Revenue Streams

High volume sales of a narrow product range

Sales of brand-name products

Sales of non-food and promotional goods

Service sales, such as Aldi Talk, Aldi Travel or “Aldi Life Musik”</td>
</tr>
</table>

Fig. 3.3 Overview of Aldi’s current business model (the aspects highlighted in *grey* did not undergo major changes across time). Source: own illustration, based on Osterwalder and Pigneur (2010)

Key Activities Negotiation with well-known manufacturers for producing private labels is still a crucial activity, as the amount of private labels accounts for more than 90 % of the total product offer (Kumar and Steenkamp 2009). For instance, the rice pudding of Aldi’s private label brand Desira is produced by the dairy brand Müller, Aldi’s private label Belmont Cappuccino is equal to Nescafé Cappuccino or Aldi’s chocolate biscuits Choco Bistro are produced at DeBeukelaer (Schiesswohl 2015). In order to provide high quality at the lowest possible price, Aldi strongly focuses on efficient operations. In this regard, strict cost control and continuous processes improvement are crucial. The principles of lean thinking are part of the daily business routine. A lean supply chain is enabled by sourcing up to 60 % of fruits and vegetables locally. Aldi still buys high quantitates of a single product, maintaining its economies of scale. By sourcing products primarily just-in-time, Aldi is able to hold stock low and reduce capital lockup. Loyal to its initial business model, Aldi still sells its goods directly out of boxes and from pallets, which in turn saves costs for furnishing the stores. In comparison to competitive food retailers

focusing on marketing and customer relationship management, Aldi follows a different approach. The pioneer discounter relies on a well-defined appearance, disciplined leadership and consistent implementation (Brandes 2013). However, due to the massive advertising campaigns of core competitors such as Lidl, Aldi entered outdoor advertising with its image campaign "the simple principle" in 2015.

Key Resources To implement consistent and efficient operations, Aldi requires capable, multi-skilled staff and correspondingly dedicates efforts to train employees, a staff of more than 64,000 people in Germany by 2015. On a global scale, Aldi is employing an estimated number of 300,000 staff (Statista 2015k). As Aldi still operates solely on a brick-and-mortar business model, its consistently designed stores are still a key resource. High shop density creates customer proximity and increases the speed of shopping. In 2015, Aldi operated a network of more than 4,000 stores in Germany, and more than 9,900 globally. Aldi's brand name is another important resource, as 99 % of all Germans know the company (Brück 2008). In 2006, Aldi got recognition as Germany's third most-respected brand, following Siemens and BMW.

Key Partners Aldi's key partners can be divided in suppliers of private label products and suppliers of brand articles. Despite of its size and negotiating power, Aldi is regularly viewed as a fair partner (Gerhard and Hahn 2005), many of its suppliers being part of its network since decades. Nevertheless, the company has strict procedures and sets high quality standards for suppliers. In selecting these, two criteria are paramount: consistent high quality and competitive prices. In Germany, the independent rating agency Stiftung Warentest regularly tests the quality of various products and subsequently publishes the results. In cases in which Aldi's products do not receive the highest (very good) or second highest mark (good), these are subsequently removed from the assortment. The partner network has lately massively been expanded: for instance, to enter the telecommunications business with Aldi Talk in 2005, Aldi started a partnership with Medion AG by operating on the mobile phone network of E-Plus. By offering Aldi Travel, the discounter went into partnerships with tour operators such as Berge & Meer, Eurotours, and Select Holidays.

Customer Segments Aldi managed, over time, to shift from its image as a store for low-income people to a store for hybrid consumers and for those, who are not willing to spend high amounts of money for necessities (Gerhard and Hahn 2005). The term "hybrid consumer" describes consumers who trade down when it comes to staples, but trade up to premium brands for products, which matter from an emotional perspective. In 2014, about 9 % of Aldi's customers had a net monthly income of over 2,500 €. Initially only selling to consumers in Germany, Aldi started to expand internationally from early on, first to Austria in 1967. Today, the company is serving customers on three continents and in 16 countries, such as the U.S., UK, Australia, France, Spain or Belgium. To better meet country-specific

customer expectations, Aldi operates with different strategies in different markets. For instance, Aldi does not promote its products on TV in Germany. However, as UK customers expect discounters to do so, Aldi complied and advertises its products in the mass media (Lunn 2012).

Customer Relationships By providing good quality goods over decades, the company managed to win and maintain the trust of its consumers, being the most beloved discounter in Germany (Statista 2015a). However, the company never really received quite the same appreciation from its international markets as enjoyed in the home market. Germans are proud of Aldi, whereas in the international markets the company is viewed as just another cheap store. The company's efforts to maintain its image of trustworthiness at home and to improve its image abroad become evident in info brochures such as the long lasting "Aldi informs", the customer magazine "Aldi inspired" or an official U.S. "Aldi blog" for recipes and cooking ideas.

Channels Aldi's main channel for customer contact remain its stores, most of which are located in towns or downtown areas. Even for a company as down-to-earth and traditional as Aldi, the internet has gained significance: Aldi Travel mainly sells journeys over the internet, while the "Aldi informs" brochure can also be accessed online. The internet has allowed the company to provide much more information to its customers than via a printed brochure alone: for instance, its website and blogs offer abundant tips for seasonal holidays and home decoration.

Revenue Streams Aldi's revenue streams remain primarily based on high-volume sales of flat product ranges. Private label products make up for about 90 % of the revenues from the sale of goods, while brand products are often included in the assortment for marketing purposes. In 2014, the company generated estimated corporate sales of 65.1 billion € (Statista 2015a–k). In Germany in 2015, Aldi reported sales of 27.9 billion € and ranked number four among the leading food retailers after Edeka-Group, Rewe-Group and Schwarz-Group (Statista 2015d). Interestingly, Aldi's yearly 3,000 non-food promotional articles generate about 20 % of sales—and the numbers are steadily advancing.

Cost Structure Aldi's cost structure is highly cost-driven and illustrated in a philosophy of simplicity and minimal service. Low procurement costs, rooted in long-term relationships with suppliers, limited assortment, the purchase of excess capacity from suppliers and a focus on basic mass articles complement just-in-time delivery, which minimizes storage costs. This lean organization and favourable cost structure made Aldi's enormous success possible.

3.5 Industry Outline and Future Perspectives

Within the German food retail business, discounters accounted for about 42 % of total sales in 2015 (Statista 2015f). Motivated by Aldi's success, many competitive discounters emerged over the years, trying to imitate the concept. Aldi currently competes with Lidl, Netto-Marken-Discount, Penny and Norma, Lidl representing the main competitor. Both Aldi and Lidl represent hard discounters and offer a limited assortment of less than 1,500 articles, source globally and operate internationally. Lidl generally attracts younger people and students, offering a larger proportion of brand articles. Compared to Aldi, which practices decentralized leadership, Lidl operates according to the principle of centralized decision-making. Netto-Marken-Discount offers the broadest assortment in the German discount market, with around 3,500 articles. However, the company still has much less market power than Aldi and Lidl. Penny as a further discounter ranks fourth in Germany (Statista 2015g). Penny and Netto, together with their parent enterprises Rewe and Edeka respectively, aim to achieve high synergies in their supply chain activities. Both Penny and Netto are so-called soft discounters. In comparison to soft discount stores, hard discounters employ a more aggressive pricing strategy, use private labels and minimize customer service.

Quality supermarkets such as Edeka, Rewe or Kaufland are indirect competitors for Aldi. The stores offer a broader assortment, sell a much higher proportion of brand articles and promote quality rather than prices. Thus, although supermarkets and premium retailers provide staple food, it is often more expensive than at Aldi stores, which relativizes their real threat for Aldi. According to the German Bundeskartellamt, big players such as Aldi, Rewe, Edeka or Lidl have been driving smaller competitors out of the market, as the large players dominate 85 % of the German market. However, some industry analysts estimate a rising importance for traditional corner shops in city centres due to changing consumers' attitude. Shopping preferences change from buying groceries once a week outside the city centre to frequent, smaller shopping trips in the neighbourhood. Customers also appreciate that smaller, independent food sellers are more flexible and responsive to trends and customer demands, an area in which Aldi would face, in comparison, a much higher coordination effort.

According to a study by Ernst & Young (2014), 175 billion € were spent for groceries in Germany in 2014, of which only 0.5 billion € were spent for grocery shopping on the internet. However, an increase of 20 billion € in online sales is predicted by 2020, representing a market share of 10 %. Thus, one major trend in the grocery retail business is the surge in online shopping. As convenience and time saving become more and more important for German consumers, many supermarkets already started to offer products not only in their stores, but also online. One leading company in this business is Rewe. In the online shop, customers can select products and have these home-delivered. Further competitors with a similar business concept are Edeka24, All you need, myTime or Amazon. However, despite its convenience, ordering food online is more expensive, often limited to big cities and often restricted to a limited product range as demonstrated

by two recent studies of Spiegel Online and Focus Online in 2014 and 2015. For instance, for a selected underlying basket of thirteen products, consumers paid 33.09 € at Rewe Online, 42.07 € at Edeka 24, and 38.44 € at allyouneed.com. The same basket however, only cost 28.57 € at Aldi. Furthermore, in the case of Rewe online, there is a minimum order value of 40 € as well as service fee of about 2.90–4.90 € per supply. Thus, online supermarkets are not yet a threat for hard discounts such as Aldi.

A further new business model are food box delivery services such as the concept behind HelloFresh. Customers can select, depending on their preferences, between different sorts of boxes, for example the classic or the veggie boxes. In a weekly delivery, customers receive a package including recipes and fresh ingredients. However, the content of these boxes is limited only to food. Other staple foods or household articles are not delivered, thus this business model does not yet endanger the business model of discounters. However, it is not unlikely that at least for the elderly or for people searching for another fast shopping experience, such innovative business models might gain momentum, leading to a threat for incumbents such as the pioneer Aldi.

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4 Pure Beauty: The Case of The Body Shop

"In the factory we make cosmetics, in the store we sell hope". This famous quote of Charles Revson, founder of the U.S. cosmetics giant Revlon, best describes the value proposition of incumbent cosmetics companies during the 1970s, when The Body Shop emerged. The business model of Revlon and of other beauty brands back then was based on the so-called "hope-in-a-bottle" formula (van Someren 2005), having strong emotional and aspirational features. According to Cant et al. (2006), the incumbent cosmetics industry was already seeking to sell more than tangible cosmetic products, namely lifestyle, self-expression, exclusivity, status and femininity. Besides glamour cosmetics companies such as Revlon, a market niche for firms offering natural products was progressively emerging. The Body Shop was part of this latter movement and, beyond its cosmetics value proposition, made a long-lasting social impact.

Interestingly, when Anita Roddick entered the cosmetics market in Britain in 1976, a company named The Body Shop already existed in the U.S. The initial Body Shop, founded by Jane Saunders and Peggy Short in Berkley in 1970, was selling hand-labelled natural beauty products in refillable plastic containers. On a visit to California, Anita Roddick became fascinated of the original Body Shop's business model, deciding to set up her own version home in Britain. Similar to Anita Roddick's Body Shop, Saunders' and Short's company emphasized natural ingredients and offered for instance avocado and cocoa butter lotions and camomile shampoo. When Anita Roddick wanted to expand into the U.S. in 1987, she bought the rights to the name from Saunders and Short. The initial Body Shop was subsequently renamed "Body Time". In comparison to Roddick's Body Shop, Body Time rejected offers to franchise its business and is still a traditional, family-run skin care company. The main difference, however, is that Body Time never assumed an active campaigning role regarding environmental and human rights issues, in comparison to Anita Roddick's Body Shop.

Neither the original Body Shop (later Body Time), nor Roddick's Body Shop were the first companies to emphasize their focus on natural products, as Table 4.1 visualizes. Already in 1921, the Swiss company Weleda started producing

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Table 4.1 Overview of the main competitors at the time of the launch of The Body Shop

Company/brand	Year of foundation/ product launch	Value proposition
Weleda	1921	Anthroposophy, natural and organic beauty products
Revlon	1932	Cosmetics following the "hope-in-a-bottle" principle
Clarins	1954	Beauty treatments, plant-based cosmetics
Yves Rocher	1959	Mail order service for plant-based beauty products
Oriflame	1967	Plant-based beauty products
WALA/Dr. Hauschka	1967	Natural cosmetics
The "original" Body Shop (later: Body Time)	1970	Hand-labelled, natural beauty products in refillable containers
Clairol/Herbal Essences	1931/1972	Products with essences of herbs and flowers

Source: own illustration

cosmetics based on natural or organic ingredients, by applying the principles of anthroposophy. In the 1950s, Jacques Courtin-Clarins and Yves Rocher also experimented with plant-based cosmetics. Yves Rocher's business model relied on plants as core ingredients for cosmetics, which he then sold via mail order. Founded by the medical student Jacques Courtin-Clarins in 1954, Clarins first offered botanical body oil, before opening the beauty salon Clarins Institute de Beauté in Paris, focusing on treatments with plant-based products. In Sweden, a further natural cosmetics company, Oriflame, entered the market in 1967. During the same year, the pharmaceutical company WALA Heilmittel GmbH launched its first natural cosmetics under the brand of Dr. Hauschka. Moreover, other companies selling luxury cosmetics and mass-market products were also looking to introduce natural beauty products, such as the Herbal Essences shampoo by Clairol.

In comparison to the above-mentioned companies, Roddick's business idea went past offering natural products, and intended to change established business habits and to set an example of social responsibility. The main competitors at the time of The Body Shop's market introduction were companies with somewhat similar products, but not a somewhat similar mission. In turn, The Body Shop became the pioneer of socially aware beauty companies. Some authors argue that Roddick used trade in a revolutionary way, as an instrument for improving not only business practices, but also the world around (Bartlett et al. 1995). Her change drive was triggered by what she saw in the cosmetics industry: unrealistic product claims, idealized pictures for promotion and sophisticated packaging. In the words of Anita Roddick herself: "*I watch where the cosmetics industry is going and then walk in the opposite direction*".

4.1 Founder

Born in 1942 as the daughter of the only Italian immigrant family in Brighton, Anita Roddick had, from early on, a strong sense of being different, which might have been part of her motivation to swim against the tide with her cosmetics business. As a globetrotter, Roddick was fascinated by the different female beauty practices she saw around the world. The social movements of the 1960s, such as the hippie culture or the antiwar movement were also of interest to her. Furthermore, she was profoundly impressed by the implications of the Second World War and the Holocaust, and began advocating human and social issues. These convictions and values all became part of The Body Shop's subsequent business model. Anita Roddick was viewed as highly dedicated in her entrepreneurial endeavors and determined to achieve her goals. According to Bartlett et al. (1995), she was persuasive, had great marketing abilities and was enthusiastic in convincing others of her values. These traits are likely to have been supportive in starting an authentically responsible business model. Before opening her own Body Shop, Roddick and her husband ran a hotel, which they sold as he set off for an extensive hiking expedition. In charge of earning a living for herself and her two children, Roddick came up with the idea of opening her own shop, and selling body lotions made of natural ingredients.

The Body Shop's value proposition of functional cosmetic products was the natural result of Roddick's values. Products based on fair trade ingredients, which were not tested on animals, simply fit Roddick's inner set of beliefs and principles. By herself being different, she set her company apart from the other cosmetics retailers.

4.2 Market Demand

Since large incumbent companies essentially focused on attractively packaged, high-margin products, customers sensed that the prices were not necessarily justified. An unmet market demand for high quality natural beauty products at reasonable prices was emerging. Moreover, the incumbent cosmetics industry assumed that women rather lacked self-confidence and would pay inflated prices for simple products, if they believed that these would make them more attractive. Roddick contrastingly believed that women do not lack self-esteem and would prefer basic, functional and environmentally responsible products.

In the 1970s, the feminist movement against objectification challenged the fashion and cosmetics industry, and led to flat or declining cosmetics sales. However, not all women wanted to give up make-up altogether, and many faced a genuine "beauty dilemma". In order to ensure continuous sales, the beauty industry began to market cosmetics as natural, neutral, or invisible. Since "natural" had become a recognized psychographic segment in both the luxury and mass cosmetics markets, several incumbents added plant extracts to the old chemical formulas of their existing products. For instance, Clairol launched its shampoo Herbal Essences

in 1972, based on the essences of sixteen herbs and wildflowers. Yet "natural" in the 1970s did not mean that all ingredients were actually natural, or that cosmetics were not tested on animals. As incumbents only used plant-based additives, instead of reinventing product formulas, customers realized that this was just a naive marketing trend.

Animal testing of cosmetics represented an industry standard during the time. Yet increasingly prosperous customers became concerned about such practices, and about cosmetic products based on chemicals. Hereby, products based only on natural ingredients, which were environmentally friendly and animal cruelty-free, represented the unmet market demand during the late 1970s. Instead of first analyzing such consumer trends and then developing appropriate products and business strategies, Roddick based her products on her values and had an impeccable timing. Or, as Palmer (2012) rather heretically stated, she was lucky with the timing of her company's launch. As The Body Shop from beginning on stressed that its products were not tested on animals, it was able to establish a new market space and to create a new industry trend of animal cruelty-free, fair and functional cosmetics.

Interest in environmental issues was gradually taking on a political character at a larger scale than consumption alone, leading to the emergence of the first Green Parties around the globe. The values of counterculture and new social movements such as ecology, feminism, anti-war movements or gay liberation challenged established thinking patterns and conservative social behavior. Particularly the hippie culture transcended national boundaries sparking a new, alternative global awareness for pacifism and eco-friendliness. Environmentalists emphasized problems such as local pollution and perceived businesses as its main cause, viewing these as adversaries. Such new social, environmental and political trends and attitudes helped to shape the emerging business model of The Body Shop.

As regards the company's geographical setting, London was the worldwide center of youth culture, giving birth to new cultural trends and a generation searching for "the next big thing" (Gaillard 2010). Brighton, only an hour away from London, was the leading center of the alternative movement in 1970s Britain: scandalous, indulgent and racy. Hence, it seemed to be the perfect place to start a rather different cosmetics store. The changes in peoples' inner belief system, paired with meaningless product claims of some of the cosmetics incumbents, brought about a market demand for natural, functional products with an aura of rebellion. This made the success of The Body Shop's business model possible.

4.3 Pioneer Business Model

The following paragraph describes the business model at the time of the market launch in 1976, an overview of which is provided in Fig. 4.1.

Key Partners	Key Activities	Value Proposition	Customer Relationships	Customer Segments
Local partners (e.g., herbalist, chemist) for raw material sourcing and product creation Design student employed with the logo design	Sourcing of plant-based ingredients Preparing, packaging, refilling Point-of-sale activities, accompanied by storytelling and window displays	Environmentally responsible, functional products Renouncing glamour and expensive packaging in order to offer fair prices Unique shop atmosphere of honesty, excitement, and fun	Direct customer contact with personal assistance	Environmentally conscious women in the Brighton area
	Key Resources		**Channels**	
	Product know-how and creativity Exotic, valuable ingredients Company philosophy Minimal start-up-capital Initial store		Direct sales: initial brick-and-mortar store	

Cost Structure	Revenue Streams
Cost-driven Mainly variable costs of sourcing raw materials Eschewal of advertising and exclusive packaging	Products sales and refill service at mid-range price points

Fig. 4.1 Overview of The Body Shop business model at the time of the company's launch. Source: own illustration, based on Osterwalder and Pigneur (2010)

Value Proposition The Body Shop created a new value proposition within the established beauty and cosmetics industry, by using natural ingredients and not simply adding natural essences, as incumbent beauty companies did. Yet this was not all. In comparison to incumbents, The Body Shop willingly gave up the glamour appeal and elaborate packaging, hereby reducing prices and focusing on functional products. The company introduced the concept of "caring cosmetics"—body care with social responsibility—and additionally differentiated itself from competitors through its distinct social commitment. Beside its product value proposition, the company aimed to inform and educate customers on how to conserve the environment. A unique atmosphere of honesty, excitement and fun accompanied all of this in the initial Brighton store.

Key Activities To make the product value proposition possible, the start-up's main activity was sourcing and mixing raw materials and plant-based substances. Research was an ongoing process and related to finding herbs, flowers, fruits,

nuts and seeds for new product creations. For this purpose, Roddick traveled around the globe to learn about skin and hair care practices from men and women of various nations. Back home in Brighton, she dedicated time to understand personal care practices of locals and to gather their suggestions. Through this, she increased the likelihood that non-customers would buy her products, as they were in fact involved in creating these. Closely connected with the company's limited initial capital, the further configuration of key activities arose mainly from economic necessity, rather than from strategic considerations. The initial product batches were prepared in Roddick's home kitchen and packed into cheap reusable sample bottles, which she got for free from a local hospital. All products were hand-made and hand-mixed. In order to generate a greater choice for customers, Roddick offered each product in five sizes. Aligned with The Body Shop's philosophy, a refill service, offering 15 % lower prices, was introduced. The service provides further evidence of the company's focus on its core activity, namely on creating value through the products themselves, whereas product quality also acted as a powerful marketing tool. In comparison to incumbent cosmetics companies, The Body Shop made neither ingenious promotions, nor miraculous promises. As regards marketing activities, Anita Roddick was quite innovative in drawing attention to her Brighton store. According to an anecdote, she dispensed strawberry essence along the road leading to the newly opened shop, to encourage customers to pay a visit. Later on, in spite of avoiding conventional advertising, The Body Shop received a lot of publicity due to Roddick's enthusiasm, beliefs and art of storytelling.

Key Resources In order to set up her first shop and produce the initial 25 skin and hair care product batches, Roddick took a loan of £ 4,000, representing the start-up capital. This had to be split between sourcing exotic ingredients such as jojoba oil or rhassoul mud, alongside with setting up the company's first store. Having limited financial resources, paired with expensive raw materials, Roddick took calculated choices in what regards all other aspects of her business. For instance, she chose to paint the shop's walls green in order to hide water damage patches, rather than in anticipation of the green movement (Drexler 2007). Nonetheless the store, run by Roddick alone, represented an essential resource for the company.

Key Partners Facing capital limitations, Roddick asked for help from a local art student to design The Body Shop's logo, instead of employing a marketing agency for the job. She also relied on the expertise of a chemist, who helped her create lotions from different plant-based ingredients. As well, Roddick collaborated with a local herbalist, Mark Constantine, for sourcing ingredients. Constantine became a major supplier of The Body Shop and later on, in 1994, founded the competitive company Lush.

Customer Segments With an offer of natural beauty products, and a refill service designed to decrease costs and reduce waste, The Body Shop was primarily

addressing environmentally conscious young women, who wanted to avoid patronizing conventional stores. Thus, the company started by serving a niche market.

Customer Relationships In the atmosphere of her shop, Roddick was able to establish direct personal assistance to her customers, by giving individual advice on the products, and explaining the ingredients alongside with their effects, which brought her a loyal and enthusiastic customer base.

Channels The initial store represented the heart of the young company, and embodied the single direct channel for reaching and communicating with potential customers and for delivering the merchandise.

Revenue Streams The company relied on product sales as the single mechanism for generating revenues, with prices set on an intermediate level, higher than those of mass merchandised cosmetics, yet lower than in exclusive cosmetic stores. Products were deliberately not offered at cut-rate prices.

Cost Structure Initially, Roddick organized all store operations on her own and had no employees. In a sense, she was a one-man show. She prepared the first product batches in her own kitchen and operated the single rented store, which kept fixed costs low. The main cost block were the variable costs for sourcing raw materials, which grew proportionally with the production volume. By leaving out advertisements and emotional product appeal, and by solely focusing on product functionality, Roddick was able to save further costs. The Body Shop's initial cost structure can be described as highly cost-driven. In comparison, advertising and packaging created about 85 % of the total costs of incumbent cosmetics companies, with about 30 cents of each dollar being spent on advertising.

4.4 Current Business Model

While the value proposition of the company did not significantly change over time, other building blocks of its business model did. Figure 4.2 provides an overview of these changes up to 2006, when The Body Shop became a brand of the L'Oréal Group. In the following, the most relevant changes are discussed along the current business model, which is visulized in Fig. 4.3.

Value Proposition While the company solely offered 25 skin and hair care products for women in 1976, its portfolio grew over time, to include make-up and fragrances, as well as product ranges for men. In accordance with Roddick's vision, The Body Shop serves customers with ethical, high-quality products, relying on five core values: increasing the self-esteem of customers, defending human rights, protecting the environment, renouncing animal testing, and supporting the

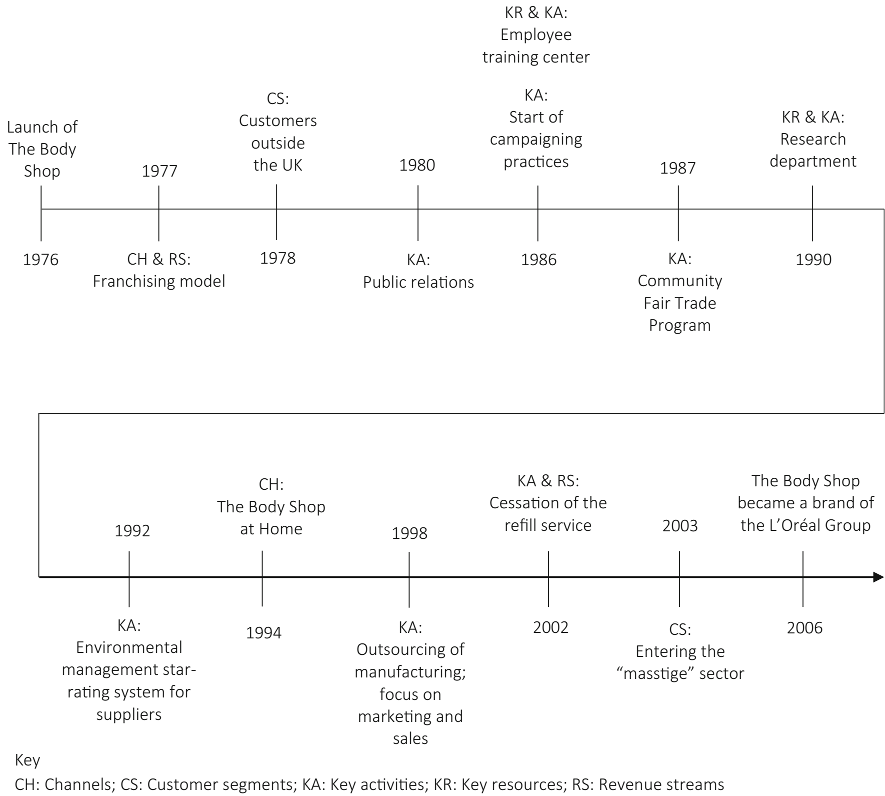

Fig. 4.2 Main changes in The Body Shop business model across time. Source: own illustration

Community Fair Trade (CFT[1]). The Body Shop still campaigns on issues regarding these core values, as one of the forerunners of the movement against animal testing. The EU adopted a corresponding legislation only after several decades, in 2013. Hereby, one aspect of The Body Shop's initial value proposition led to the establishment of a new industry standard on the European market.

Key Activities While manufacturing was a key activity during The Body Shop's initial days, supply chain management takes its place at present. Facing high manufacturing competition from low-cost countries in the 1990s, the company started to outsource manufacturing completely, and currently focuses on managing the contract supply chain, alongside with retailing. As manufacturing and parts of the sourcing processes are outsourced to third parties, The Body Shop has to safeguard quality and adherence to its core values along its value chain. For instance, to ensure that contract manufacturers maintain the set ethical standards,

[1]The CFT is The Body Shop's own, independently verified fair trade program, launched in 1987.

Key Partners	Key Activities	Value Proposition	Customer Relationships	Customer Segments
Community Fair Trade suppliers Product manufacturers	Creative research and development Supply chain management Quality management Marketing and customer retention Campaigning on issues regarding its five core values	Environmentally responsible, functional products Unique atmosphere of honesty, excitement, and fun Functional cosmetics Extensive enlargement of the product portfolio	Direct customer contact in own and franchise shops with personal assistance Internet-based customer service Customer hotline	Worldwide mass-market consumers
	Key Resources		**Channels**	
	Product know-how and creativity Exotic ingredients Five core values Shop assistant expertise and professionalism		Brick-and-mortar stores Direct sales force: Body Shop At Home™ Online, e.g., on retail platforms such as Amazon	

Cost Structure	Revenue Streams
Cost-driven Main cost drivers: store operating expenses, product development, marketing and sales	Products sales at mid-range price points Franchise fees

Fig. 4.3 Overview of the current business model of The Body Shop (the aspects highlighted in *grey* did not undergo major changes across time). Source: own illustration, based on Osterwalder and Pigneur (2010)

these are required to singularly source from Community Fair Trade suppliers. Since 1992, The Body Shop has an environmental star-rating system for suppliers, and uses audits to evaluate the upstream supply chain concerning quality, sustainability and competitiveness.

Key Resources The importance of creativity, ideas and product expertise increased with time. Kumar et al. (2006) labeled the cosmetics industry as one, in which product innovation is vital to success, as product life cycles are particularly short. In order to differentiate itself further from competitors, The Body Shop emphasizes its products based on mixtures of exotic plants, oils and fruits from around the globe. As the company grew, employees and franchisees became a further key resource: currently, around 8,000 employees work for The Body Shop around the world.

Key Partners Over time, independent manufacturers became key partners, as The Body Shop's offers are produced through supply contracts. Regarding the sourcing activities, already as early as 1987 the company established its fair trade program under the name Community Fair Trade, aiming to ensure fair market practices and pricing conditions with suppliers.

Customer Segments Focusing on a customer group of environmentally conscious, politicized, and "alternative" young women in 1976, The Body Shop's initial values somewhat lost their significance for younger consumers over time. Due to restructuring, in 2002 the company mainly entered the "masstige" consumer market (the word is a combination of mass-market and prestige), offering high quality products to mass-market customers (Kent and Stone 2007). The Body Shop lost its touch of radical campaigning and became appealing to a broader public. Since opening the first international franchise store in Brussels in 1978, The Body Shop now serves customers around the world. To address more demanding customer needs, it launched a new store format in 2014, Pulse 3.0, emphasizing its skincare expertise and further personalizing customer experience.

Customer Relationships Despite the heterogeneity of its customer base, the company stands for personalized in-store experience and individual assistance. As Roddick championed various social issues through her campaigns for human rights and against animal testing, the company cultivated a dedicated base of core customers, who share its values. The question however remains, whether the current marketing efforts and the personal in-store assistance can ever be as remarkable for customer binding as the strong, well-communicated vision of the company during in its initial years.

Channels In line with its expansion strategy, The Body Shop experimented with other tools for reaching customers, beyond classical in-store sales, for instance through a home party experience called The Body Shop at Home, which is similar to Tupperware parties.

Revenue Streams Since 1977, shortly after foundation, the business began to expand through franchising, hereby generating continuous revenue streams through license fees. During the restructuring of 2002, the product refill service was abandoned, as only 1% of customers regularly used it. Despite intense competition, the mid-range price points did not change, reinforcing the quality standards for which the company is known. In 2014, The Body Shop reported consolidated revenues of 873.8 million €, representing about 4 % of the consolidated sales of the L'Oréal Group.

Cost Structure First, as the company still primarily offers its products in its 3,200 own and franchised stores, shop-related costs, such as rents and labor costs, are essential cost drivers. Second, since products are not manufactured in-house, costs for sourcing the semi-final and final products are another significant cost block.

Finally, as marketing has become a core activity, it represents the third major cost block.

4.5 Industry Outline and Future Perspectives

According to the market research firm Grand View Research (2014), the global revenue for organic personal care is about to grow by almost six times over a six-year period, from 2.73 billion US $ in 2014 to 15.98 billion US $ in 2020. The natural and organic cosmetics market is a particularly lucrative one, attracting growing numbers of competitors. According to a study by Kline and Company (2013), the major global players besides The Body Shop are L'Occitane, Weleda, Yves Rocher, Aveda by Estée Lauder, Dr. Hauschka, Jurlique, and Oriflame. The Body Shop's business model has also seen many imitators, for instance Bath & Body Works since 1990, and Lush since 1994. Based on the strategic positioning and market presence, The Body Shop's main competitors are L'Occitane, Yves Rocher, Lush, and Weleda. These also focus on natural ingredients and environmental protection. Bath and Body Works is a particularly aggressive competitor, with three times the revenue of The Body Shop in 2014, and three times as higher operating profit margins—yet without a comparable social commitment.

Moreover, as pharmaceutical companies like WALA Heilmittel GmbH with its Dr. Hauschka brand are already competing on natural beauty products, other pharmaceutical companies are likely to also increase competitor numbers. For instance, the phytoneering pharmaceutical company Bionorica solely produces herbal medicine. As Bionorica already has know-how in herbal active agents, the next logical step might be to produce plant-based personal care products. The company is also already committed in ecological and social issues.

Additionally, The Body Shop will likely face direct competition from natural cosmetics companies on the emerging markets, such as the Asian one, which is also increasingly becoming its main sales market. Likely competitors might be the Korean beauty shops The Face Shop or SkinFood. Both sell personal care and cosmetic products and use natural food ingredients in their products. Although the two companies are currently primarily active in Asia, enlarging the global stores network is high up on their lists. In order to compete with The Body Shop's business model, natural beauty companies from emerging markets might have to reinforce their attitude towards environmental, social, and human rights issues to meet Western standards. A third group of competitors arises from established cosmetics companies, through their new natural cosmetic lines. For instance, Beiersdorf AG, worldwide known for its Nivea brand, launched a natural cosmetic series called Pure & Natural in 2011. With a particularly strong market position in Europe, Beiersdorf is present in drugstores and supermarkets, and reaches customers on their weekly shopping.

As The Body Shop becomes increasingly mainstream and as other market players cover all business model elements, which once made the company a true

pioneer, the question arises whether The Body Shop still walks in the opposite direction than the cosmetics industry, as once intended by Anita Roddick. Its convergence towards the mainstream represents a trade-off generated by growth and survival needs, in an increasingly competitive environment. There are countless companies offering “me-too-products” and eroding its market share, while just a few follow its emblematic initial ethical stance. The Body Shop has to reconsider whether good products alone can guarantee success, or whether holding on to its mission and values is the only chance of surviving in a crowded market. If the company looks back, it would probably find a great source of inspiration for future decisions. There is much to be learned from the past.

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5 Globalizing Coffee Culture: The Case of Starbucks

In the early 1970s, the U.S.A. was the largest coffee consuming country in the world, offering an enormous market potential for new entrants. However, a few large established players already dominated the market, for instance Procter & Gamble. During the 1960s, P&G took over its competitor, Folgers Coffee Company, and started to distribute coffee under this brand nationally. Soon after, Folgers became the top U.S. coffee brand. Yet the business models of P&G and Folgers were fully different from the one envisioned by Starbucks: the incumbents saw coffee as a beverage like any other. Their value proposition was instant and roasted coffee, sold in supermarkets, and intended for home brewing. No efforts were put into establishing a genuine coffee culture, for which Starbucks later became renowned.

A few other companies were operating in the U.S. coffee shop industry, and can be viewed as predecessors of Starbucks: one of these was Peet's. Founded in California in 1966, Peet's introduced custom coffee roasting to the U.S. While the company later became Starbucks' main competitor, its role in the history of Starbucks goes further than that. From the founder, Alfred Peet, the three Starbucks founders learned the art of coffee roasting, and how to effectively conduct a business in this industry. Similarly to Starbucks, Peet's focused on offering superior service quality and exclusive blends of coffee. Alfred Peet used to serve cups of coffee to customers who were waiting for their takeaway orders of coffee beans to be processed. In spite of the initial activities of Peet's, Starbucks created its very own approach with regard to coffee experience and coffee culture. More significantly, Starbucks managed to scale globally, as will be discussed in the following sections.

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5.1 Founders

The former teachers Jerry Baldwin, Zev Siegl, and the writer Gordon Bowker opened their first Starbucks coffeehouse in 1971. The young entrepreneurs started Starbucks as a small roaster and retailer of coffee beans, spices and tea, with one single store in Seattle. They named the newly founded coffee store after the helmsman Starbuck from the Moby Dick novel, a name evocative of the seagoing tradition of early coffee traders.

In 1982, Howard Schultz joined Starbucks as sales and marketing director, later on becoming the person with the most lasting influence on the company. Initially however, the three Starbucks founders were reluctant to hire Schultz, presuming that his "go-go style" might affect the emerging company culture (Romeo 2007). Yet Schultz was not only genuinely enthusiastic, but had a clear vision for Starbucks to become the nucleus of the coffee loving community. While visiting Milan for a conference in 1983, Schultz was fascinated by the city culture and urban traditions built around coffee. He saw espresso bars as spots for social interaction. Instead of having coffee in rush mode, the Milanese enjoyed meeting and spending time together in neighbourhood cafés. Schultz became aware that this coffee experience had great potential in the U.S.A. In result, Il Giornale opened two years later—it was the first espresso bar in Seattle to follow Schultz' concept, and it was a success. This motivated Schultz to convert all original Starbucks stores into coffee houses following the Italian fashion. In 1987, he bought the six original Starbucks stores from Baldwin, Siegl and Bowker. Later on, Schultz described the company as a "child of two parents", himself and the initial founders.

5.2 Market Demand

Interestingly, most U.S. coffee shops of the 1970s and 1980s focused on providing food rather than coffee, and can be compared to today's diners. Americans of that time did not view coffee shops in the sense of a community, or as a socializing possibility, and Italian-style coffee bars were barely known on the home market. Schultz sensed this as an opportunity to create a place for social interaction. The high customer numbers enjoyed by the Starbucks stores from beginning on confirmed his intuition.

As regards home coffee consumption, a further trend could be observed on the U.S. market of the end-1970s: after a flourishing time for companies providing coffee for home brewing, such as Folgers, the market started to shrink around 1978. This decline illustrated a demand for higher quality coffee. During the previous decades, the U.S. coffee market mostly offered instant and canned coffee from a mixture of Robusta and Arabica beans. Robusta is cheaper yet more bitter than the high quality Arabica. In order to save costs, many companies increased the percentage of Robusta in their coffee blends. Such instant coffee blends were available in most supermarkets and became particularly popular until the late 1970s, when

tastes began to change and consumers started to demand more than just instant coffee in supermarket quality.

5.3 Pioneer Business Model

In the following, the business model of Starbucks is illustrated in 1987, at the time when Howard Schultz gained ownership of the company. Figure 5.1 provides an overview of this initial business model.

Value Proposition In comparison to the incumbent diner-like coffee shops of the time, as well as to coffee brewers such as Peet's, Starbucks managed to transform coffee from a functional drink into an emotional experience. Schultz did not intend to sell coffee as a purely physical product, but rather to establish it as an inherent part of social coexistence (Hufenbecher 2000). Instead of only selling beverages, he created a unique coffeehouse atmosphere. Starbucks delivered the atmosphere and feeling of Italian coffee bars not only through coffee taste alone, but by appealing to all five senses: through flavor, product displays, the music playing in the background or the homely furnishing and decorations (Keller 2000). The coffeehouses were designed to remind of Italian coffee bars and make customers feel welcome to

Key Partners	Key Activities	Value Proposition	Customer Relationships	Customer Segments
Financiers Value chain partners (coffee suppliers) Real estate partners	Coffee sourcing, roasting and brewing Store design and location selection Quality control and operational efficiency	High-quality coffee Coffeehouse atmosphere and experience Excellent customer service	Personal assistance Long-term customer binding	Niche market of specialty coffee lovers
	Key Resources		**Channels**	
	High-quality Arabica coffee supplies Coffeehouses (stores) Employees, particularly baristas		Own brand coffeehouses	
Cost Structure		**Revenue Streams**		
Value-driven cost structure		Sales of coffee specialties and coffee beans Premium price strategy		

Fig. 5.1 Overview of the Starbucks business model at the time of the company's launch. Source: own illustration, based on Osterwalder and Pigneur (2010)

enjoy drinks and socialize. Additionally, customers could benefit from the information given by well-trained baristas regarding the varieties of coffee beans and drinks.

Key Activities The above shows the twofold nature of Starbucks' initial key activities: providing excellent coffee, paired with an excellent and customer-oriented service in a familiar, comfortable atmosphere. In order to illustrate how the company managed its key activities, these can be further broken down: by governing the entire supply chain through backward vertical integration, Starbucks could deliver its value proposition of high quality coffee. The company supervised the entire supply chain, from selection and sourcing of Arabica beans, across roasting and blending, to the final customer experience. In order to provide a consistent coffee experience throughout its stores, the company heavily relied on operational efficiencies and on thorough quality controls. For instance, milk had to be heated at exact temperatures and each espresso shot pulled within precisely 23 seconds, otherwise it had to be discarded. Its aim to create an uncompromised coffee experience truly helped the company build its brand in the following years. As regards its second key activity, that of establishing a unique coffee house culture, Starbucks focused on design and on finding top locations for its stores. Store location and design were crucial for getting customers to want to visit Starbucks in the first place. Through cozy furnishings, the stores completed the coffee experience by providing a comfortable and relaxed setting.

Key Resources A basic resource for high-quality coffee were the premium Arabica beans sourced by the company. Moreover, as the Starbucks experience did not only rely on good products alone, its employees' creativity and their way of interacting with customers massively drew attention towards its stores. The company's baristas played a key role in introducing customers to the company values, those of communication and social exchange, which accompanied a genuine appreciation for coffee. Baristas not only provided product information, but also ensured that customers feel welcome in the new coffeehouse world. The company relied on its baristas as a key resource, and besides investing in trainings, engaged more subtle ways of showing gratitude: Howard Schultz was for instance known to refer to all his employees as partners.

Key Partners In order to implement his vision, Schultz required three types of additional partners: financiers, value chain partners and real estate partners. For purchasing the company from the former owners, Bowker and Baldwin, Schultz relied on investors as key partners. Simultaneously, he established partnerships with premium coffee bean suppliers and with real estate partners for ensuring top store locations.

Customer Segments Starbucks began by targeting a niche market, as most consumers where not yet familiar with espresso drinks and gourmet coffee brews.

The business model was designed to attract specialty coffee lovers and provide them with a community feeling and a place to socialize.

Customer Relationships Gastronomy was at the time, as now, a business mainly reliant on long-term customer relationships. The Starbucks formula for ensuring customer loyalty was based on the familiar atmosphere of the coffeehouses, together with significant personal assistance from baristas.

Channels The company-owned coffee shops were the main channel for customer contact, especially as Schultz emphasized coffee as an experience, rather than a functional product. It would not have made sense for Starbucks to employ a secondary channel, supermarkets for instance, and sell coffee for home brewing. Such a strategy would only have contradicted the values, which the company was trying to embody and introduce to its market niche.

Revenue Streams In-store coffee sales were the primal source of revenues during the initial years. Since the company succeeded in showing its customers that it was not merely providing a product, but rather an experience, it was able to justify premium prices for its coffee.

Cost Structure For Starbucks, quality and service mattered more than the associated costs, making the cost structure value-driven. High quality coffee beans, store set-up and location as well as the well-trained staff caused the main cost blocks. Due to a strategy of increasing market presence by rapidly expanding the number of stores, the company accepted a loss of 330,000 US $ in 1987—profits emerged only after the following two years.

5.4 Current Business Model

As the business model of Starbucks remained essentially stable across time, the following discusses the main refinements and extensions within the building blocks, as also illustrated in Fig. 5.2. Figure 5.3 summarizes the company's current business model.

Value Proposition Over the years, the company further refined customer experience by extending its original value proposition with confectionery, snacks and tea-related products. Customers are given numerous possibilities for customizing beverages, for instance regarding the amount of espresso, the type of milk and the additional syrups. By introducing tea, soda, or alcoholic drinks to its product portfolio, Starbucks aims to become the "go-to spot for all things drinkable" (Taylor 2014), and thus continues to stand out from its sworn of imitators. In order to increase in-store sales, it also attempts to further extend its value proposition with breakfast, lunch and dinner offerings. During the course of time,

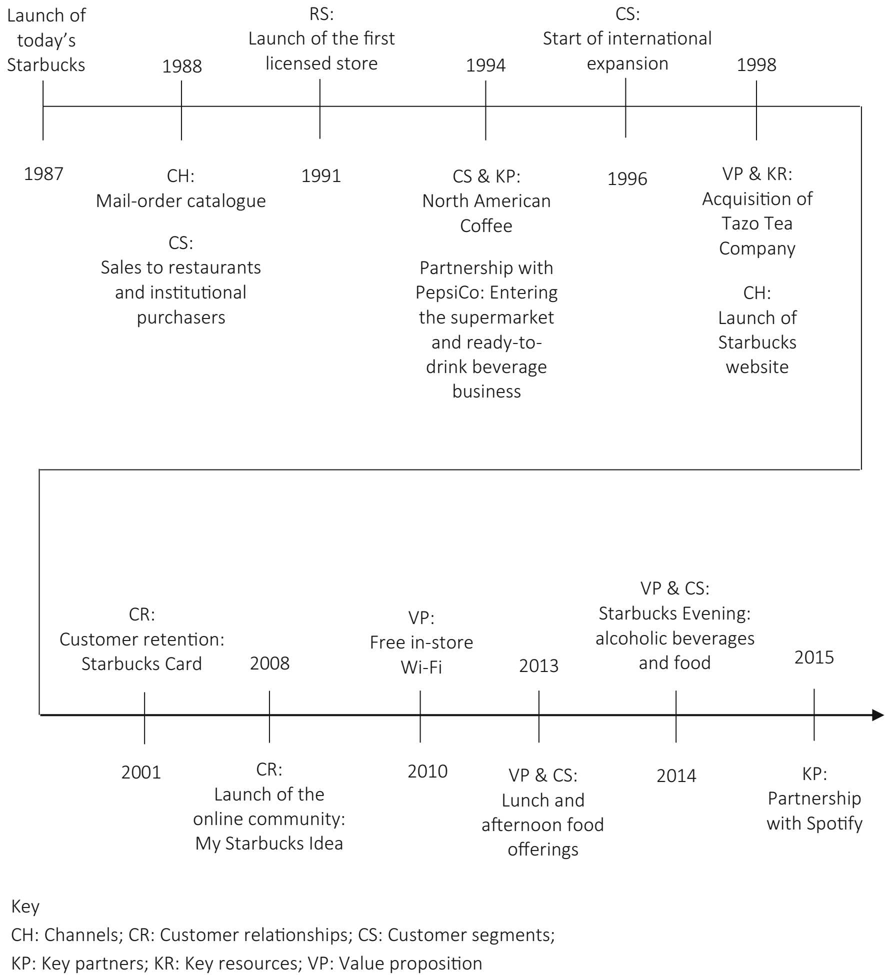

Fig. 5.2 Main changes in the Starbucks business model across time. Source: own illustration

Starbucks also reinvented itself as a place for mobile working. While initially charging for in-store Wi-Fi, it later changed this policy to accommodate larger numbers of people working on the go.

Key Activities The business model proved its feasibility in a number of various geographical locations across time. Therefore, the company is currently mainly concerned with sustaining its market position in mature markets, and expanding its market reach in new geographical areas, such as South Africa or Jamaica.

Key Resources Qualitative coffee supplies, excellent store locations and design, and the well-trained, customer-oriented baristas remain the company's key

<table>
<tr>
<td rowspan="2">Key Partners

Financiers

Value chain partners (coffee suppliers)

Real estate partners

Additional beverage and foodstuff suppliers (e.g., PepsiCo)

Media partners, particularly social media platforms</td>
<td>Key Activities

Coffee sourcing, roasting, brewing

Store design and location selection

Quality control and operational efficiency

Sustaining the market position

Expanding market reach</td>
<td rowspan="2">Value Proposition

High-quality coffee

Coffeehouse atmosphere and experience

Excellent customer service

Customer-tailored drinks

Supplemental food offerings

A spot for mobile working</td>
<td>Customer Relationships

Personal assistance

Long-term customer relationships

Customer retention: Starbucks member card

Co-creation: MyStarbucks Idea</td>
<td rowspan="2">Customer Segments

B2C: international mass market

B2B: food service companies</td>
</tr>
<tr>
<td>Key Resources

High-quality Arabica coffee supplies

Coffeehouses (stores)

Employees, particularly baristas</td>
<td>Channels

Numerous worldwide own and licensed coffeehouses

Own online shop

Retailers

Communication channels: largely social media</td>
</tr>
<tr>
<td colspan="2">Cost Structure

Value-driven cost structure

Variable costs: largely coffee sourcing

Fixed costs: store operating costs including labor costs</td>
<td colspan="3">Revenue Streams

Sales of coffee specialties and coffee beans, further customized beverages (tea), food, coffee machines, merchandise

Premium price strategy</td>
</tr>
</table>

Fig. 5.3 Overview of the current business model of Starbucks (the aspects highlighted in *grey* did not undergo major changes across time). Source: own illustration, based on Osterwalder and Pigneur (2010)

resources. In 2014, Starbucks relied on a workforce of over 191,000 employees worldwide. In Germany, during the same year, it received the 35th place in the ranking of the top 100 employers, showing its dedication to employees, as one of Schultz's personal commitments. The entrepreneur for instance provides health insurances not only to full-time employees, but also to part-time employees as well.

Key Partners Besides partnerships within its coffee supply chain, Starbucks established cooperations with well-known names from the food industry, such as PepsiCo or Kraft Foods. The cooperation with PepsiCo enabled it to diversify the product portfolio by offering iced coffee beverages as ready-to-drink alternatives in retail stores. As the company strives to increase the amount of food sales in its coffeehouses, further food suppliers became key partners, Danone being an

example for providing yoghurt specialties. In order to bring customer in-store experience to a new level, Starbucks partners with Spotify, enabling members of the Starbucks reward program to choose the songs played in the store via a mobile app. Additionally, an app in partnership with the New York Times allows reward program members to read free lifestyle and news articles.

Customer Segments During the course of time, the company managed to substantially extend its customer base from the initial market niche of coffee connoisseurs, and turned ordinary people into coffee enthusiasts, who are willing to pay above-average prices. While the current business model still highly focuses on quality, the dramatic company expansion is a shift towards serving the mass market. Since 1987, Schultz expanded throughout North America and Canada, and started international expansion by entering the markets in Japan and Singapore in 1996. Today, Starbucks serves customers from North America, Canada and Latin America, over Europe, Middle East and Africa, to Asia Pacific and East Asia. By solely operating under one brand, customer segmentation of the B2C customer group is not stringent. However, since 1988, Starbucks expanded into the B2B segment by providing coffee and tea-related products to institutional food service companies, which in turn serve hotels, restaurants, airlines or retailers.

Customer Relationships Schultz is famously quoted as saying "*We aren't in the coffee business, serving people. We are in the people business, serving coffee*". His extremely frequent visits to the Starbucks locations, as many as 25 per week, result from a personal conviction that the only way to truly learn about customer demands is to actually be present in stores and talk with the customers. In order to increase customer loyalty, the company introduced a member reward card in 2001, providing special offers, birthday discounts, a bonus program and supplemental in-store payment options. It also launched an online community in 2008, My Starbucks Idea, which functions as a co-creation platform. The platform enables customers to communicate impressions and suggestions, and to discuss these with employees. Starbucks thus aims to foster an atmosphere, which welcomes and appreciates the opinions and reviews from customers.

Channels Starbucks uses several distribution and communication channels nowadays. A year after its launch, in 1988, the company established a mail-order business, which helped to build brand awareness, grow sales, and find promising locations for new stores. A decade later, the internet became an additional channel, used for selling coffee for home brewing, mugs or brewing machines. The partnership with PepsiCo since 1994 opened up a new distribution channel for supermarket sales. Besides operating own stores, Starbucks began to license stores in 1991, in order to support its accelerated growth strategy. Nowadays, the stores are divided roughly fifty to fifty in own and licensed ones, their total number having massively increased from nine in 1987 to over 21,000 in 2014. As regards the communication channels, social media plays a major role for sustaining customer communication, as the company is on the spot on Facebook, Twitter, Youtube and further platforms.

Revenue Streams In the last three years, revenues grew from 13 billion US $ in 2012 to 16.5 billion US $ in 2014. The same year, Starbucks ranked number one among the leading coffeehouse chains regarding revenues: the competitor Tim Hortons reported around 3 billion US $ in sales, and Costa Coffee around $ 1 billion. Besides receiving royalty fees from store licensing, Starbucks generates sales from four product types: beverages, food, packaged and single-serve coffees and teas, and finally merchandise, such as coffee machines. In 2015, Starbucks ranked 52nd in the Forbes ranking of the most valuable brands worldwide. The company uses this high brand awareness to merchandise articles, such as mugs with specific city motives or sweatshirts with its own logo, which are becoming another noteworthy income source. However, despite the its efforts to boost food sales, the turnover share from food remained constant during the past years and represents an area for improvement.

Cost Structure Starbucks maintained its value-driven cost structure, yet managed to create a high amount of synergies regarding coffee sourcing and distribution across stores. To exemplify, the price composition of a Starbucks grande latte coffee in China as of September 2013 offers some insight in the company's cost structure. For instance, the largest share of 26 % is assigned to rent costs of the coffeehouse. Establishing a new store creates costs of at least 500,000 US $ (Wit and Meyer 2010). The second largest cost driver are expenses for operating the stores, which amount for 15 % of the price. Raw material expenses account for 13 % and labour costs for 9 % of the final price of a grande latte coffee.

Companies operating in the coffee industry have to take into account the highly volatile coffee bean prices, and require substantial and consistent risk management in order to keep costs down at all times. Starbucks' strategic buying practices in sourcing its coffee beans and dairy products are therefore based on forward hedging. For instance, the company already bought more than 40 % of its coffee supplies for 2015 in 2014 and was hereby able to bypass high coffee prices, due to harvest losses in Brazil, one of its main supplier countries.

5.5 Industry Outline and Future Perspectives

On the North American market, Starbucks' main competitor is Tim Hortons, a Canadian coffee house chain, founded in 1964 by a renowned Canadian hockey player. In Europe, competition arises particularly from the UK-based Costa Coffee, which operates stores across 29 countries. Founded in 1971 in London by two Italian brothers, Bruno and Sergio Costa, Costa Coffee follows a similarly energetic expansion strategy as Starbucks. In the UK for instance, while Starbucks has around 20 % market share, Costa Coffee has double as much. It also differentiates itself from Starbucks particularly through its supply chain—Costa Coffee sources solely from Rainforest Alliance certificated farms.

Dunkin' Donuts, although originating in the fast food industry, is also expanding into the coffee shop area, by supplementing food products with quality coffee. Due to the wide reach and well-known brand, it represents another serious competitor. In 2013, Dunkin' Donuts ranked second after Starbucks concerning the worldwide number of stores. With its slogan "America's all-day, everyday stop for coffee and baked goods", Dunkin' Donuts also shows its increasing focus on coffee consumers. Moreover, through free Wi-Fi and ecological awareness, the company is stepping in the footprints of Starbucks and Costa Coffee. However, its corporate store design, much a symbol of the American fast food industry, does not try to match the design and comfort expectations of Starbucks customers, for which reason Starbucks enjoys a certain degree of differentiation. McCafé by McDonalds is a further example of successfully combining coffee with fast food and pastry offers. For instance in 2014, for each Starbucks coffee shop in Germany, there were more than five times as many McCafé shops.

Beside large coffee shop chains, customers increasingly wish to support local businesses and prefer going to individual, local coffee shops. Competition however does not solely arise from local coffeehouses and large coffee chains alone. Considering coffee or caffeine consumption rather than café stores, Starbucks is facing an even more complex and aggressive business environment. Food companies offering caffeine-rich and invigorating products such as energy drinks, coffee brands for home brewing, as the particularly successful Nespresso concept, continue to seize market shares by offering simple and fast solutions. Teahouses and tea shops offer alternatives for caffeinated drinks. Finally, new business models such as the Legal Grind or Moonstruck Chocolatiers could endanger Starbucks' market position as well. Moonstruck Chocolatiers offer chocolate drink creations, coffee, tea and a variety of homemade pralines. The Legal Grind is a Californian coffee shop, where attorneys can offer legal advice over a cup of coffee, helping new law firms gain clients.

Summing up, Starbucks is operating in a highly competitive and heterogenous environment. In order to still differentiate from current and emerging competitors, the company adopted a strategy of diversifying the product spectrum with customized beverages and food offerings. This raises the question, whether Starbucks is perhaps eroding its core value proposition of coffeehouse experience, by adding a multitude of drinks and food offers. It still remains to be seen, whether the goal to become the "go-to spot for all things drinkable" is consistent with Starbucks' original idea of providing a heartwarming coffeehouse experience.

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6 Customized and Built to Order: The Case of Dell

Since the 1970s, computers started to become both more compact and less expensive. This led to an increased appeal to the mass markets. A prime example of this development was the Apple II. Released in 1977, it was one of the first personal computers (PCs), and paved the way for home computing. A few years later, another development was underway in the computer industry. At the beginning of the 1980s, the International Business Machines Corporation (IBM) released its own PC based on the concept of open modular architecture, working closely together with its suppliers for sourcing components (Kumar 2005). This modular architecture made it easier for start-ups such as Dell to rebuild and design their own personal computer, leading to a rapid growth in the number of PC companies. However, both the computer industry in general, and the PC industry in particular became enormously competitive markets, dominated by a few major players: IBM, Apple, RadioShack Corporation (Tandy) and Commodore International, while other emergent companies struggled for minimal market shares.

Two key aspects characterized the U.S. computer industry of the mid-1980s: product standardization/modularization on the one hand, and indirect distribution channels on the other. Standardization implied the usage of common architectural interfaces and standard components, which allowed PC makers to outsource purchase and production steps. However, this led to very low potentials for differentiation. Similarly, the indirect distribution model, as illustrated in Fig. 6.1, was the dominating approach and permitted little differentiation among PC makers. Manufacturers such as IBM, Compaq and HP relied on standardized components from suppliers as key resources, while their key activities were related to the PC-manufacturing process. The final products then went to distributors, who in turn sold them to a variety of retailers, resellers and integrators, who finally reached the end-customers. Thereby, it was possible to distribute an extremely large number of PCs and secure a broad customer base. Yet, even with accurate forecasting, the indirect distribution model was plagued by the need to hold high inventories at each step within the distribution channel.

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Fig. 6.1 Indirect distribution channel. Source: Kraemer et al. (2000)

As time was not perceived as being a competitive advantage, companies using indirect distribution did not treat inventories as a significant problem. Inventories were an expression of "business as usual" and time lags represented the industry standard. Delays were acceptable, as long as the other vendors had similar cycles, but did constitute a tremendous cause for value reduction. The launch of Dell in 1984 and particularly Dell's subsequent pioneering of direct distribution challenged all of this.

Besides Dell, a few other PC manufacturers emerged in the early- and mid-1980s, and soon became its direct competitors, both in the national and in the global market: Compaq (an indirect PC vendor) was launched in 1982, while Gateway (a direct PC vendor) was founded in 1985, one year after Dell. Outside the U.S., Lenovo was established by a group of scientists from the Institute of Computer Technology of the Chinese Academy of Science (CAS) in 1984, distributing PCs made by foreign companies, such as IBM, to generate income for the governmentally underfinanced CAS. Whereas Dell's competitors either used the indirect distribution model, or merely acted as distributors, it was Michael Dell who managed to successfully pioneer the direct distribution channel in the PC industry, as will be discussed in the following.

6.1 Founder

Born in Houston, Texas, in 1965, Michael Dell is often described as a man with clear goals and strong self-confidence. One of his first interactions with the business world took place at the age of twelve: as it was popular among children at that time, Michael Dell used to collect stamps. Yet the later entrepreneur did not trade these with his school mates, but contacted auction houses and delivered stamps to the action houses' clients (Nanda 2006). At the early age of 15, Dell bought his first personal computer, an Apple II, and disassembled it in order to see how it worked. Around the age of 16, he rather accidentally realized the benefits of customer segmentation and successfully adopted this model in his summertime job. Working as a seller of newspaper subscriptions, Dell directly contacted target customers—particularly focusing on newlyweds and new homeowners. This technique of customer segmentation significantly raised his newspaper sales, and the same principle was integrated, later on, in the business model of his computer company. During university years, Dell was highly engaged in his computer hobby, and gained experience by rebuilding and selling IBM-compatible PCs from stock

components. In spite of the parental encouragement of pursuing a career in medicine, Dell quit his studies in order to follow his interest in computers. Consequently, he founded PC's Limited[1] in 1984 with a capital of about 1,000 US $.

6.2 Market Demand

Michael Dell noticed something that his competitors did not—in fact, what he noticed was quite significant and the reason why his company became a business model pioneer: customers did not necessarily want to physically see a PC before buying it. The market was in reality more interested in obtaining state-of-the-art technologies faster than the industry incumbents could provide them. This unfulfilled market demand created a new business opportunity for the strategically oriented entrepreneur. Another unfulfilled market demand, which resulted from the indirect PC distribution model, was customization. The PC manufacturers at that time offered little customization possibilities, as a large number of parties were involved in the distribution process. Each intermediary attempted to minimize the own operational risks, by only selling products with high demand. In turn, customers looking for tailored solutions had considerable difficulties to obtain them.

Overall, the emerging market trends were customer sophistication, implying demand for the latest technology and fast delivery, smaller components with better performance, and the rapid development of information technologies in general. Through Dell's build-to-order philosophy, the company managed to take advantage of these customer- and technology-driven trends, and to provide customized PCs built on the latest technologies.

6.3 Pioneer Business Model

The present paragraph analyzes Dell's business model at the time of the company's launch, which is summarized in Fig. 6.2.

Value Proposition Dell's value proposition consisted of three elements: (1) PCs with an excellent price-performance ratio, (2) that could be individually customized, and (3) were home-delivered. This strong disparity in all three elements of the value proposition to the traditional logic of PC manufacturers and retailers is what made Dell a true business model pioneer.

Key Activities In order to be able to fulfill its value proposition, Dell's business model relied on two key activities: build-to-order assembly and direct sales. As the company did not manufacture parts and components itself, but assembled what had

[1] PC's Limited was later on renamed as Dell Inc., and is subsequently referred to as "Dell".

been ordered from suppliers, effective supply chain management was crucial for ensuring a smooth value creation. Dell shared detailed information with its partners upstream the supply chain, sourced components just in time directly from manufacturers, assembled these to custom-built PCs, and consequently delivered the final products directly to customers. By renouncing resellers, the company was able to both reduce costs in the value chain, and to gain information directly from end-customers. This ensured a much more efficient inventory management than the industry average, bringing a sustainable competitive advantage.

Key Resources The excellent assembly and logistics capabilities of Dell were the key resources, which helped the company to rapidly respond to customer demands.

Key Partners One of the further success factors was its good relationship with suppliers, which enabled the direct delivery model. For instance, supplier-owned warehouses were located near Dell plants, and the company shared a wide range of information concerning customer demands. As well, third-party logistic providers were integrated into Dell's supply chain, allowing a fast delivery process of the final merchandize.

Customer Segments The early offers appealed primarily to technology-literate customers, searching for quality at affordable prices. At the time of launch in 1984, Dell's customers were almost entirely private individuals, while already in the following year the company extended its offers to better accommodate B2B customers. Initially however, Dell did not significantly differentiate between major B2B customers and secondary ones (Magretta 1998), and well-defined customer segments were not perceived as important.

Customer Relationships By selling directly to final customers, the company could effortlessly build stable, long-term relations with users. Dell also relied on a personal assistance model, including support services, such as a 24-h hotline, and guaranteed fast shipment of replacement parts, all of which helped to increase its market credibility.

Channels The company's distribution model is illustrated in Fig. 6.2. Customers ordered PCs via telephone, and received these via postal delivery. As highlighted in the key activities section, Dell's direct distribution logic simultaneously enabled cost reductions, customization, and up-to-date insights into customer habits and

Fig. 6.2 Dell's direct distribution channel. Source: own illustration, based on Kraemer et al. (2000)

preferences. As regards the communication and marketing channels, advertisements in trade magazines additionally helped the company to get a foothold in the PC industry.

Revenue Streams At the time of the company's launch, the main revenue stream was derived from PC sales. Through direct distribution, Dell managed to keep prices below those of competitors, with a 15 % discount (Mendelson 2000) compared to incumbent PC manufacturers.

Cost Structure Product discounts were enabled by a sleek cost structure with minimal inventories and no intermediaries. The direct distribution model also allowed the company to avoid the costs of obsolete products. While the assembly capabilities created the major cost block, supply chain management represented the secondary one (Fig. 6.3).

Key Partners	Key Activities	Value Proposition	Customer Relationships	Customer Segments
Manufacturers of parts and components Third-party logistic providers	Direct sales to final customer Build-to-order production Supply chain management Just in time and lean processes	Customized PCs with the latest technology at reasonable prices Direct delivery service	Direct and highly responsive customer relationships, made possible by personal assistance via telephone	Technology-literate B2C and B2B customers, searching for quality at affordable prices No differentiation between major and secondary B2B customers
	Key Resources		**Channels**	
	Supplier relationships Product assembly and logistic capabilities		Ordering channel: telephone Delivery channel: postal Marketing channel: company website and trade magazines	
Cost Structure			**Revenue Streams**	
Highly cost-driven, achieved through built-to-order and direct delivery with minimal inventory Assembly capabilities and supply chain management			Sales margins from PC sales	

Fig. 6.3 Overview of the Dell business model at the time of the company's launch. Source: own illustration, based on Osterwalder and Pigneur (2010)

6.4 Current Business Model

Figure 6.4 provides an overview of the main changes in Dell's business model across time, as discussed next. Figure 6.5 provides an illustration of Dell's current business model.

Value Proposition In order to maintain its competitive edge, Dell started a substantial value proposition diversification during the 1990s. The company began to offer peripherals, such as printers, keyboards, and displays, as well as laptops, server technology and network switches. For ensuring a better device management, it also began to offer software as a complementary product. The product-related business is now rounded off by services, such as security and storage, as well as business- and development-related services. By enlarging its

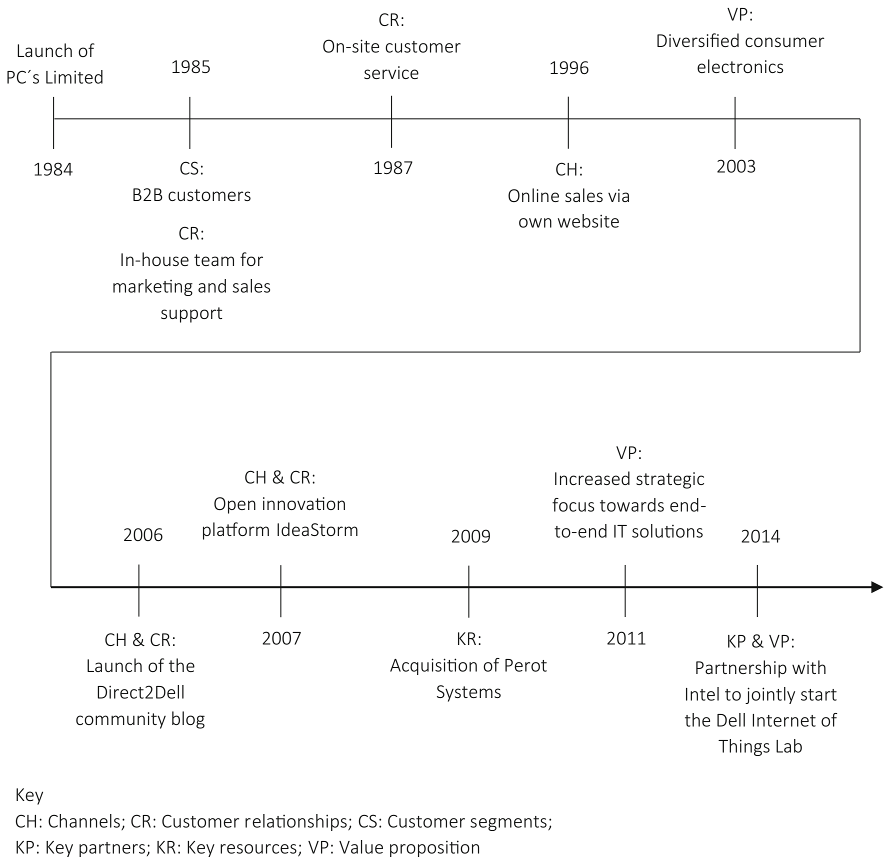

Fig. 6.4 Main changes in Dell's business model across time. Source: own illustration

Key Partners	Key Activities	Value Proposition	Customer Relationships	Customer Segments
Manufacturers of parts and components Third-party logistic providers Innovation partners	Direct sales to final customer Build-to-order production Supply chain management Just in time and lean processes Software development and R&D	Customized devices with the latest technology at reasonable prices Direct delivery service End-to-end solutions	Direct and highly responsive customer relationships, made possible by personal assistance via telephone On-site presence at the location of B2B customers Personal interaction via blog and open innovation platforms	Global B2B and B2C customers, divided in four main segments: - Large enterprises - Public institutions - Small and medium businesses - Consumers
	Key Resources Supplier relationships Manufacturing and logistic capabilities Software development know-how Brand value		**Channels** Ordering channel: mainly online and via third-party retailers and resellers Delivery channels: direct and via third-party retailers and resellers Marketing channels: multi-channel, including social media	

Cost Structure	Revenue Streams
Highly cost-driven, with an increasing share of R&D expenses	Sales margins from IT device sales and from product-service bundles IT service fees

Fig. 6.5 Overview of Dell's current business model (the aspects highlighted in *grey* did not undergo major changes across time). Source: own illustration, based on Osterwalder and Pigneur (2010)

value proposition, Dell is evolving to an end-to-end technology solution provider, and is tapping into promising business fields, such as the Internet of Things.

Key Activities As third parties still manufacture most of the products sold under the Dell brand, the company itself focuses on assembly, software installation, functional testing and quality control. As in 1984, a prime supply chain is essential. Additionally, software development and comprehensive services increasingly take the role of key activities.

Key Resources Dell relies on its broad portfolio of patents and licenses, which partially result from acquisitions. These range from IT infrastructure management, to security and data protection, up to virtualization and enterprise cloud software. The notable acquisition of Perot Systems in 2009 laid the foundation for Dell Services, by providing end-to-end IT services to customers.

Key Partners Operating a non-vertically integrated business model, Dell relies upon its suppliers and a global production network spanning from the Americas to Europe and Asia. Many of Dell's third-party vendors are located in developing countries, and contract manufacturers assemble a significant proportion of its products in Asia. In order to promote innovations and its strategy as an end-to-end solution provider, the company maintains partnerships with industry leaders such as Microsoft, Oracle, or SAP. Notable is also the cooperation with Intel since 2014, strategically designed to help the company tap into the Internet of Things.

Customer Segments Unlike other PC manufacturers in the B2C area, Dell began to focus on the more profitable corporate accounts from early on. Since 1985, local area businesses became its customers, and soon after, large corporations and government agencies followed. Over time, the customer segments also became more and more refined. Starting with only two customer segments (large and secondary), Dell divided its large customers into large companies, midsize companies, government agencies and education providers. Subsequently, the segment of large companies was further split up into local and global accounts. By doing so, Dell got a clear insight into specific customer needs, which made it easier to manage each account independently and to more accurately forecast demand.

Customer Relationships It has always been essential for Dell to retain its direct customer contact: as early as 1985, in-house teams for sales support were introduced. Since then, specialized account managers have provided personal assistance to customers. More significantly, in 1987, Dell was the very first PC company to offer on-site B2B customer service. During the past two decades, Dell has reached around 5.4 million daily customer interactions. In order to intensify its online interactions, the company launched several platforms, for instance the blog Direct2Dell, enabling fast two-way communication with customers. Moreover, by introducing the open innovation platform IdeaStorm.com, it encourages customers to share own ideas and improvement suggestions.

Channels In comparison to the single communication channel in 1984—the telephone—Dell currently uses multiple channels to reach customers. In 1996, it launched its first website, Dell.com, which enabled customers to order PCs online. Besides direct sales, the company established further distribution channels through retailers, third-party solution providers, system integrators and third-party resellers. This diversification among its sales channels does not contradict the mission of direct customer contact, but rather aids the company in maintaining its position as one of the three largest PC manufacturers worldwide.

Revenue Streams After a period of decline between 2006 and 2012, Dell's global market shares among PC vendors began to increase, reaching 13.6 % in 2015. This effect was largely attributed to the company's privatization, Michael Dell having regained the majority stake in 2013. At the time, Dell was the largest company in terms of revenue to be privatized. According to a 2014 Gartner research report, the company's flexibility increased in result, allowing improvements in its go-to-market strategies and value proposition. Beside asset sales, Dell increasingly generates revenues through IT and business services, such as support and deployment, security and warranty services. While in 2013 over 78 % of the total revenues were generated through product sales, the share of revenues from services is constantly increasing. A significant shift from products to product-service bundles can be observed, resulting from the company's goal of becoming an end-to-end-solutions provider.

Cost Structure Dell's cost structure can be described as cost driven, resulting from the company's mission statement of competitive pricing. Cost optimization is made possible through contract manufacturing and manufacturing outsourcing. More importantly, regaining the control of the majority stakes in his company allowed Michael Dell to increase investments in R&D and innovation, in order to support the diversification of the company's value proposition.

6.5 Industry Outline and Future Perspectives

Worldwide PC sales volumes exponentially grew from the mid-1990s onwards, and began to decline around 2001, particularly due to the burst of the dot-com bubble. Numbers recovered and substantially increased again until 2013, when global PC shipments suffered the worst decline in the history of the market. This was the result of an unprecedented demand for tablets and other mobile devices, which are replacing desktop PCs, especially in the emerging markets. According to a study by Gartner (2015), yearly sales volumes of desktop PCs will decrease from 157 to 109 million units by 2019. In return, tablet sales numbers are likely to increase from 19 to over 303 million units during the same time span. Currently, only five companies still play a major role on the declining PC market: Lenovo (20 %), HP (19 %), Dell (14 %), Apple (8 %), Asus (7 %), and Acer (7 %), the remaining 25 % of the market being divided among smaller players (Gartner 2015).

As Dell currently offers a wide range of products beyond PCs, including laptops, ultrabooks, tablets, peripherals and servers, as well as a broad variety of IT services, the company is in direct competition with numerous enterprises within the entire high-technology industry. Major players within the IT industry, which did not act as hardware manufacturers before, are following the boom of mobile devices: Google for instance launched own mobile devices, such as the Chromebook. This represents a hazard for Dell in two ways: on the one hand, Google becomes a direct competitor in the hardware business. On the other hand, the Chromebook is a

disruptive innovation, as it is designed to serve basic customer demands—online connectivity and access to information—at low price points. Yet Dell tries to moderate competition by partnering with Google in order to launch moderately-priced devices such as the Chromebook 13. Furthermore, Amazon made efforts to establish its own mobile devices on the market, by introducing the Kindle Fire tablet or the Fire Phone, which are, up to now, mainly competitive in the area of entertainment.

The examples of Google and Amazon are evidence for the increasingly intertwined business environment, and for the fact that companies are searching for new opportunities outside their core competencies. The same applies to Dell: especially in the field of IT services, the company became highly engaged in cloud computing, mainly through server and storage solutions. Here, it competes with established players such as IBM, Fujitsu, HP or Accenture. Dell's strategic shift from desktop PCs to portable devices alongside its evolution to an end-to-end solution provider brings up a mixture of heterogeneous competitors. Yet the company has shown that it is ready to take advantage of leading trends such as cloud computing, IT security, and big data, opening up new business opportunities and refining its business model.

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7 Creating the Global Shopping Mall: The Case of Amazon

While Amazon managed to bring the shopping mall at one's doorstep and currently seeks to bring the Internet of Things in one's home, the company began much more humbly in 1995, by selling books. However, it was the first company in its industry to truly harness the power of the internet. At that time, the landscape of book retail entailed two main types of competitors: on the one hand, small market players such as independent bookstores located in city centers, neighborhoods and at focal points of mass transportation. On the other hand, large corporate groups were the ones dominating the market: bookstore chains such as Barnes and Noble and Borders, each with about a quarter market share in the U.S. (Wasserman 2012), together with walk-in chain stores such as Walmart. The market found itself in a phase of predatory competition, in which corporate groups drove out small, owner-managed bookshops. However, this fragmented group of booksellers had one thing in common—the absence of online book sales. There were only some few exceptions: a small number of authors had own websites, where readers could order new publications. Amazon therefore faced no significant rivalry at the time of its launch—at least, not online. This fortunate outset helped the company to evolve from an online bookseller into an "everything store". Moreover, it led to Amazon becoming the pioneer of online mass retail.

The internet has a fourfold commercial effect, as an independent sales medium, a communication medium, an order and payment medium, as well as a medium for distribution (Walgenbach 2007). As far as transactions go, consumers began to find and buy whatever needed, without actually visiting classical brick-and-mortar stores. Before the internet hype, bookstores were highly traditional retailers. E-commerce transformed much of this, placing severe pressure on most brick-and-mortar stores. As a communication, sales and distribution medium, the internet simultaneously brought booksellers and publishing houses exciting opportunities and unprecedented challenges, depending on their individual positioning. In the mid-term, it offered start-ups a great potential for rapid growth, and for challenging traditional business processes. Jeffrey Bezos, the founder of Amazon, was one of

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the entrepreneurs, who immediately recognized the vast possibilities of selling online, and started exploring the prospects of developing an internet business.

7.1 Founders

Jeff Bezos was born in 1964 in Albuquerque, New Mexico. As a child, he showed a keen interest in learning how things work, particularly in the technological area. At school, he was much praised for his inventiveness, receptiveness and enthusiasm for studying. One of his teachers once noted that "[there] *are probably no limits what the boy can achieve, when he gets some instructions*" (Stones 2013). After graduating with honors in computer science and electrical engineering at Princeton in 1986, Bezos worked on Wall Street, being named the youngest vice president of the investment firm D.E. Shaw in 1990. Four years later, he quit his job in order to make a new start in the nascent world of e-commerce, by opening the online bookstore Amazon.com.

With a strong personality and determination, an eye for detail and striking innovativeness, Jeff Bezos stands for the typical technical entrepreneur (Carr 2015). He is described as a passionate problem solver, with an ability to focus on customer satisfaction, while simultaneously taking bold bets on new products. This naturally resulted from his vision for Amazon to become the most customer-centric company worldwide. Some of his staff may think of Bezos as a quite difficult character and manager. Despite his well-known hearty laugh and the public image of good-humor, he has also been described as having a tendency towards outbreaks of snappy derision (Kirby and Stewart 2007). As a detail-enthusiastic manager with an inexhaustible source of new ideas, Bezos can be uncompromising when the efforts of his team do not match his expectations. However, his personality remains much of a mystery to Seattle's business world, where Amazon is headquartered, Bezos being rather reserved in disclosing personal information, thoughts and strategic intentions.

7.2 Market Demand

In the early 1990s, Bezos' assumption was that online book shopping is only worthwhile, if the retailer provides a wide selection of book titles. With its large number of over 20,000 publishers and low concentration in online trade, the book industry appeared to be a suitable starting point for a new internet venture. As today, customers interested in buying books were primarily searching for three attributes: high selection, low prices, and a convenient and fast delivery. While the largest bookshops offered a maximum of 170,000 titles (Walgenbach 2007), online retailers could virtually offer an unlimited number of volumes at reasonable prices—this was the logic that drove Amazon's business model. Moreover, the timing was just right, as people were already getting used to searching for retail information via the internet.

The market demand for fast, affordable and convenient shopping regards books as much as any other retail products. So Amazon began by making a name for itself in an area with little (online) competition, and then used its brand name to diversify its product and service spectrum in areas with increased risks. But which elements did the company's early business model entail?

7.3 Pioneer Business Model

The following paragraph analyzes the business model in 1995, the year when the company's website was launched. An overview of the initial business model is given in Fig. 7.1.

Value Proposition The value proposition involved from the very beginning a 24-h online book ordering service, offering approximately one million titles at an average 2–3 day delivery time (Walgenbach 2007). By delivering books directly to the customer, Amazon provided an unprecedented level of convenience. Customers benefited from an array of titles too large for local booksellers to imitate, mainly due to inventory costs. In addition, the user-friendly design of Amazon's website and, for an online start-up, the particularly good customer service complemented the value proposition. By employing the business model configuration discussed below, Amazon was able to pass on its cost savings to customers, and wrap up its value proposition by low prices. Amazon acted from the very beginning

<table>
<tr>
<td rowspan="2">Key Partners

Wholesalers and distributors

Logistics partners</td>
<td>Key Activities

Fulfillment

IT infrastructure & software development</td>
<td rowspan="2">Value Proposition

Convenient online book shopping with attractive pricing

Unprecedented range of available titles</td>
<td>Customer Relationships

Self-service</td>
<td rowspan="2">Customer Segments

American consumers with internet access</td>
</tr>
<tr>
<td>Key Resources

IT & fulfillment infrastructure</td>
<td>Channels

Own website</td>
</tr>
<tr>
<td colspan="3">Cost Structure

Cost-driven

Cost of sales, fulfillment costs and costs for technology and content</td>
<td colspan="2">Revenue Streams

Sales margins from book retail</td>
</tr>
</table>

Fig. 7.1 Overview of Amazon's business model at the time of the company's launch. Source: own illustration, based on Osterwalder and Pigneur (2010)

as a market driving company (Schindehutte et al. 2007), and succeeded in introducing a new marketplace for traditional offers.

Key Activities The main difference to traditional booksellers was brought by the integration of the internet in Amazon's most relevant processes, which allowed a sleek cost structure. This regards in particular value creation and delivery activities. High dedication towards software development was essential in order to ensure a functioning platform, and recurring customer interactions. Besides the IT infrastructure for operating orders, further key activities were logistics and fulfillment management. Fulfillment regards activities such as stocking, packing, and the supporting cross-section processes and infrastructures.

Key Resources The Amazon platform and the related know-how became the company's vital capital. Correspondingly, key resources were the IT- and fulfillment infrastructure.

Key Partners As customers still preferred local bookstores for bestsellers, it was important for Amazon to signal that even an online bookseller can reliably and promptly deliver well-known titles, along many more. Hereby, its partners played a significant role. As the company did not have any internal logistics capacities, and therefore no own possibilities for product delivery, this step was outsourced to logistics providers. A second group of key partners was formed by wholesalers and distributors, Amazon relying heavily on product availability, in order to guarantee rapid and dependable fulfillment to its customers.

Customer Segments Americans looking for a convenient way of shopping, and for a large variety of book titles, formed the initially undifferentiated customer segment. Amazon did not target any particular market niche, although internet access and a general interest to experiment with online shopping were significant prerequisites.

Customers Relationships Beside salient changes in the key activities, resources and partners compared to traditional bookstores, more subtle changes in the process of customer interaction took place as well. Instead of personal interaction with booksellers, human-computer interaction handled the ordering process, via self-service. Hereby, customers got the task of getting familiar and comfortable with a new and somewhat demanding communication channel.

Channels Since the website acted as the sole communication and ordering channel, Amazon's operating costs were massively reduced, compared to brick-and-mortar bookstores. The physical store location became obsolete, and was entirely replaced by a virtual user interface. Amazon was hereby able to simultaneously offer low prices and gradually develop its online presence.

Revenue Streams Revenues were initially only generated by book sales, which shows that the company relied on a single revenue source. In spite of its risks, this strategy conveyed the benefit of focus, at a time when numerous new entrants with various business models were trying to gain a foothold in the e-commerce industry. Most internet start-ups at the turn of the century did not have such a simple and well-defined revenue logic as Amazon, a reason why many subsequently failed during the burst of the e-commerce bubble. The simplicity of the business model, and of the revenue stream in particular, made it possible for Amazon to pursue a philosophy of rapid and sustainable growth. While for instance eBay reached 0.4 billion US $ in revenues during its first five years, and Google 1.5 billion US $, Amazon reached as much 2.8 billion US $ (Statista 2015a).

Cost Structure Without an extremely sleek cost structure, Amazon could not have entitled itself "Earth's biggest bookstore" as soon as 1995, at its launch. The online business model and the cooperation with warehouses, distributors and logistics providers required no significant investments in land, buildings or salesforce, and the costs for operating an actual bookstore could be avoided. The cost structure can be summarized as highly cost-driven, largely derived from the cost of sales, fulfillment costs and costs for technology and content. The cost of sales refers to the inventory value of the products and additional direct labor costs, while fulfillment costs refer to the costs of receiving, packaging and delivering goods. The costs for technology are composed of platform maintenance and R&D costs for platform development. Finally, the costs for content consist of expenses for merchandise selection, editorial content and product range extension.

7.4 Current Business Model

Figure 7.2 provides an overview of the most significant changes and extensions within the retail business model of Amazon, which will be described in the following.

Nowadays the company operates an array of different business units, each with its own business model, making it nearly impossible to include all in one single illustration. In order to highlight Amazon's evolution, the present section considers the economic significance of its retail business, and focuses on the company's retail merchandizing activities. Figure 7.3 correspondingly provides an overview of the current retail business model of Amazon.

Value Proposition Throughout Amazon's development, it was particularly important for the company to maintain its low-price strategy, which ensured its success in the first place. Its retail value proposition has experienced an evolutionary transformation, with a current portfolio largely relying on electronic media devices, household goods, and apparel. The company tremendously extended its offer, doubling the product palette between 2013 and 2015. Simultaneously, it focused

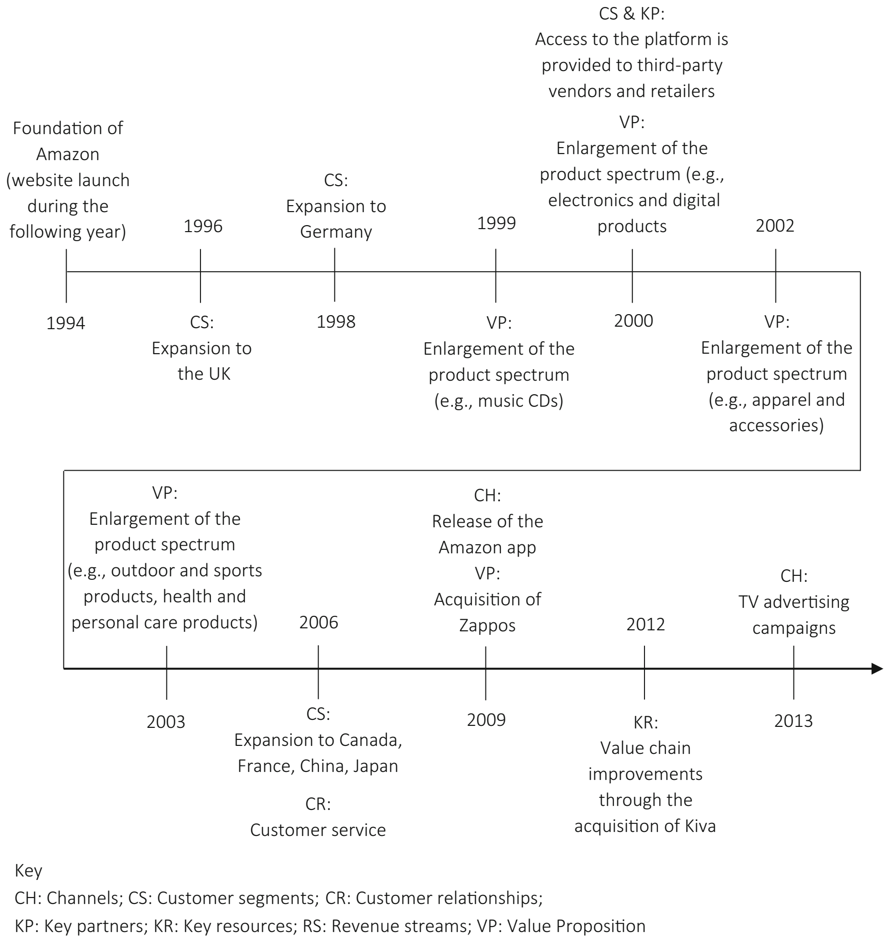

Fig. 7.2 Main changes of Amazon's business model in its e-commerce division across time. Source: own illustration

on increasing convenience through the Prime service, which allows 1–2-day delivery. Yet Prime is also an opportunity to test new business models in the entertainment area. The service offers its subscribers the possibility to view movies and TV shows from a catalogue comparable to that of Netflix, and to listen to music at no additional cost. Hereby, Amazon benefits from higher numbers of visits to its website.

Key Activities As regards product sales, Amazon's business logic relies on its long-tail business model, providing not only bestsellers, but also low-volume products. A derived key activity is that the company does not stock all the products it sells, but cooperates with independent vendors for retailing products with low

<table>
<tr>
<td rowspan="2">Key Partners

Wholesalers and distributors

Logistics partners

Third-party vendors and retailers</td>
<td>Key Activities

Fulfillment

IT infrastructure & software development

Merchandising own product portfolio

Developing and extending the reach of its international websites</td>
<td rowspan="2">Value Proposition

Global online retail (electronics, media, household goods, apparel)

Additional services (e.g., Amazon Prime)

Convenient shopping with attractive pricing</td>
<td>Customer Relationships

Self-service

Customized online profiles and recommendation system

Long-term customer binding through effortless shopping experience</td>
<td rowspan="2">Customer Segments

Global consumer market

Third-party vendors and retailers</td>
</tr>
<tr>
<td>Key Resources

IT infrastructure & software

Fulfillment infrastructure

Amazon brand affiliates</td>
<td>Channels

Language/-country-specific websites

Mobile app</td>
</tr>
<tr>
<td colspan="3">Cost Structure

Cost-driven

Cost of sales, fulfillment costs and costs for technology and content</td>
<td colspan="2">Revenue Streams

Long-tail revenue streams stemming from the immense product offer

Sales margins of product and service sales as well as monthly subscriptions (e.g., for the Prime service)

Service fees from third-party vendors</td>
</tr>
</table>

Fig. 7.3 Overview of Amazon's current retail business model (the aspects highlighted in *grey* did not undergo major changes across time). Source: own illustration, based on Osterwalder and Pigneur (2010)

sales volumes. This ensures the manageability of its long-tail business model. By relying on the experience of independent sellers and itself warehousing only the most successful items, Amazon is able to optimize inventory costs.

Key Resources A well-scaled IT infrastructure supports the operations of Amazon, allowing customers to efficiently search, evaluate and order a wide variety of items. Amazon's global fulfillment infrastructure with warehouses, logistics centers and related personnel allows worldwide product delivery. Further important resources are affiliates, such as the acquired company Kiva Systems (now Amazon Robotics), a storage robot manufacturer, which improves the efficiency of the fulfillment processes.

Key Partners Due to the minimal array of Amazon's own product portfolio, the company heavily relies on manufacturers, which form the most relevant partner group. Among these are independent vendors, a heterogeneous group of renowned brands and sellers of no-name products. Since 2000, these have the possibility to

use the Amazon platform as a channel for online retail and marketing. The second group of partners are logistics service suppliers, such as DHL, UPS or FedEx, for delivering ordered goods directly to customers. However, the company attempts to become more independent from parcel delivery services, and experiments with different delivery concepts, such as Prime Air, a delivery service using drones. A more traditional delivery model employed by Amazon are the delivery lockers, located for instance in non-stop supermarkets, allowing customers to collect parcels themselves.

Customer Segments Due to its sustained international expansion since 1996, a year after the platform's launch, Amazon now provides to the global consumer market. Noteworthy exceptions are countries such as Afghanistan, Cuba, Iran, Iraq, North Korea, Sudan and Syria. The company's main markets are the U.S., Germany, Japan, and the UK. The latter three account for more than 80 % international net sales, and Germany alone generates about 35 % of these. Interesting is also the fact that not all countries have access to the same or sometimes similar product spectrum, for instance German consumers can choose from a much broader range of products than customers in Eastern Europe.

Customer Relationships The long-term orientation towards customers translates in Amazon's goal to become the world's most consumer-centric company. To achieve this, constant effort is devoted to understanding online shopping experiences and behaviors. Amazon not only attempts to build trust and reliability through secure transactions, but also makes use of customized online profiles and recommendation systems. These are designed to provide guidance during the shopping process, and to increase price transparency.

Channels Amazon still is a pure e-retailer, reaching customers primarily via its own top-level domain amazon.com, alongside with websites for each country or language area. Thus, the company's main channel for doing business remains its own direct channel. With the increasing popularity of mobile devices, an own shopping app was released in 2009. Despite the fact that most customer contact is established via the company's website, Amazon provides additional assistance since 2006 via telephone, for instance regarding parcel tracking.

Revenue Streams During the past decade, Amazon's sales continuously increased, having reached around 89 US $ billion in 2014. During the same year, over 68 % of the net sales were generated by electronics and general merchandise. Amazon's retail business is highly affected by seasonality, with higher sales volumes generated in the fourth quarter, largely due to Christmas shopping. The company learned how to take advantage of this customer behavior and adapts its prices accordingly throughout the year.

Cost Structure The main cost drivers are cost of sales with around 70 % of the operating expenses, followed by fulfillment costs, amounting to about 12 %, and the costs for technology and content, with around 10 % of the operating expenses.

7.5 Industry Outline and Future Perspectives

Amazon was named after the world's largest river in terms of water volume carried, an allusion to its goal of large-volume product delivery. During the past decade, the company has managed to scale its business internationally and to accomplish the delicate balance between volume, range and price. The company's acquisitions also show that the retail business model remains an important pillar in its strategy. In 2009, Amazon made its most expensive acquisition up to present, purchasing Zappos for 1.2 billion US $. The purchase of the online shoe store was accompanied by acquisitions such as that of Quidsi in 2010 for 545 million US $, a company owning single-word retail domains such as casa.com, vinemarket.com, afterschool.com and look.com. In a further attempt to consolidate its traditional value proposition, Amazon bought Goodreads in 2013 for 150 million US $, an online community specialized in book recommendations and ratings. However, as newer company divisions receive increased strategic importance, out of which Amazon Web Services providing cloud computing solutions is best known, the retail division has to internally compete for top management attention.

Yet the retail business model of Amazon is still lucrative, as the company is the most popular retail website in the U.S. and Europe alike. In the U.S., it leaves its largest competitors eBay, Apple, Target and BestBuy far behind. In Europe, Amazon managed in 2013 to earn three times the net revenue of its largest competitor, the Otto Group. Alibaba is currently Amazon's main competitor in the Chinese market, as the retailer handles approximately 80 % of all private online shopping in its home market. In spite of the current downturn, the Chinese market remains relevant, while Alibaba manages considerably higher net profit margins than Amazon. Although Alibaba currently only dominates its home market, the company plans a massive international expansion, targeting in particular Amazon's market shares.

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Part II

Media and Entertainment Business Model Pioneers

8 Beyond the Search Engine: The Case of Google

Google has become the epitome of online search. The popularity and success of websites often depends on their page rank on Google, which shows the search giant's influence and market power. The search engine evolved into an innovative money-spinning machine, which consistently outperforms its peers. In time, it also extended its activities beyond pure web search, disrupting industries as diverse as advertising, broadcast and cable TV, or mobile telephony—and the list goes on. However, these additional business segments were made possible through the stunning success of its advertising business model. Google's online advertising business was initiated two years after the company's incorporation in 1998, representing the cornerstone of its market success. Although the company brought further business model innovations to the market, the present section solely discusses its advertising business, as advertisements have been, up to now, the source of over 90 % of its total yearly revenues.

At the time of Google's web domain launch, in 1997, one year before the official company founding, the search engine industry was split between a few early entrants: Infoseek, Yahoo, Lycos, Excite, AltaVista and GoTo.com. All these search platforms were launched between 1994 and 1995, already having several years of market experience before Google. Yahoo enjoyed a leadership position, offering a better-than-average service through its team of editors, who individually selected and indexed websites. GoTo.com was another noteworthy competitor, with a well-functioning revenue mechanism, yet unexceptional search results. In turn, Google took the search result quality to a new level, by making use of its own, patented PageRank algorithm.

By applying PageRank, Google succeeded in perfecting and later brilliantly monetizing its search capabilities, although it did not itself pioneer the concept of search engines. The PageRank algorithm allowed users to find the most relevant results for their searches, uncompromised by results that were heavily advertised and for that reason well-ranked, as in the case of its competitor GoTo.com. Unlike GoTo, which ranked search results based on the amount of money paid by advertisers, Google showed unbiased results based on PageRank. In comparison

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to GoTo, Google focused on first serving search customers themselves, and not the advertisers. This in turn led to the development of a pioneering business model among search engines, by reconsidering the value proposition and value capture logic. Moreover, the number of search customers grew, and so did the number of advertisers, which brought Google its remarkable market success.

8.1 Founders

Google was founded by Lawrence (Larry) Page and Sergey Brin in 1998, in Stanford, California. Page, the son of two computer science professors, enjoyed early access to technology in his family home, using his first computer at the age of six. Later on, he graduated in computer science at the Stanford University, where he first got in contact with Sergey Brin. Brin was born in Moscow, and moved with his family to the U.S. His father worked as a mathematics professor at the University of Maryland, where Brin studied mathematics and computer science. After completing his undergraduate degree, he went on to study on a Ph.D. level at Stanford, focusing on data patterns and methods for data analysis.

There are numerous examples of Stanford alumni, who founded hugely successful internet companies during their studies or after graduation. However, Larry Page was neither primarily interested in founding a company, nor in creating a search engine. He was essentially driven by the mathematical principles of the internet and by the task of structuring the information available on the internet. His Ph.D. research showed that it was much more challenging to perform a backward analysis of website links, than to simply follow links from one website to another. However, this backward analysis was a good reference point for assessing the importance of websites. For a better understanding, one can compare websites to academic papers—the quality of a paper can be partially deduced from the number and quality of the articles it cites. In the same manner, the quality of a website can be deduced from the number and quality of the websites to which it is linked. Due to the increasing complexity of the research, Page asked Brin to join the project and, as a result, the two not only began to work together, but subsequently abandoned their Ph.D. degrees altogether. They had the drive to complete the backward analysis method, despite its high risk of failure and its merely hypothetical practical applications. Finally deciding to launch an own internet venture, Brin and Page settled for the name Google. As the aim of the company was to structure the rapidly growing set of information on the internet, a modification of the mathematical term googol, which describes the number ten raised to the power of 100, seemed fit.

8.2 Market Demand

The major IT trend before the turn of the millennium was undoubtedly the swift internet expansion, characterized by both exponential domain growth and increased business and private internet access. One of the reasons for growing domain

numbers at the end of the 1990s was the trend of personalized websites. This was facilitated by companies such as Geocities, which were specialized in providing web space and web addresses for individual purposes. In 1999, Geocities was the third most visited website worldwide, leading to a snowball of personal and corporate blogs. Another trend could be noticed in the first attempts at e-commerce, with companies gradually using the internet as a marketing and communication channel.

Almost a decade earlier, during the early stage of commercial internet at the beginning of the 1990s, new websites became known through advertising and word of mouth. After the internet started to experience high growth rates, this became increasingly inefficient, leading to the introduction of server listing websites. The advent of search engines mid-1990s made it possible to search websites for distinctive keywords. The primary purpose of search engines was to check website content for specific information requested by the user.

To ensure appropriate results, search engines were supposed to cover a high amount of the available web content. However, at the time when Google was introduced, existing search engines largely had uneven coverage rates, which created a market demand for a more performant search mechanism. Another issue faced by the first search engines lied in the frequent updates of website content, requiring search engine databases to be accordingly refreshed. However, continuous refreshing was inefficient, costly and unsatisfactory. With both offer and demand for internet-based content soaring, search engines were struggling to keep pace. This created the need for an improved search engine logic—one, which was subsequently provided by Google. Then as now, the main market demand was not merely fast access to information, but rather fast access to *relevant* information.

8.3 Pioneer Business Model

The following section analyzes Google's business model in 2000, following the introduction of its advertising revenue stream, AdWords. Besides PageRank, AdWords represented another highly significant element for a functioning business model, allowing the company to monetize the value created for its search customers. Figure 8.1 gives an overview of this initial advertising-based business model.

Value Proposition In 2000, Google's value proposition for its search engine visitors was simple, namely a fast search process with comprehensive results and free of cost. Yet the company relied on an additional value proposition, without which the main one would not have been possible: the company offered advertisers marketing space for a targeted audience. The logic of many web-based portals offering free services lies in this additional value proposition for a second customer group, the advertisers. These could employ Google AdWords for placing own ads next to relevant search results. Yet to keep the search results *relevant*, Page and Brin strove to keep these free of commercial considerations. The entrepreneurs managed

<table>
<tr>
<td rowspan="2">Key Partners

Leading web portals such as Yahoo</td>
<td>Key Activities

Applying and optimizing the PageRank algorithm and the AdWords monetization model</td>
<td rowspan="2" colspan="2">Value Proposition

Relevant search results (for search customers)

Targeted online text advertising (for advertisers)</td>
<td>Customer Relationships

Self-service (for both search customers and advertisers)

Customer binding through undistorted search results</td>
<td rowspan="2">Customer Segments

Search customers

Advertisers</td>
</tr>
<tr>
<td>Key Resources

PageRank and additional algorithms

Platform and IT infrastructure</td>
<td>Channels

Search platform (for search customers)

AdWords platform (for advertisers)</td>
</tr>
<tr>
<td colspan="3">Cost Structure

Search-related research and development

Maintenance and improvement of IT infrastructure and platform</td>
<td colspan="3">Revenue Streams

AdWords: Advertising fee based on a cost-per-thousand impressions model</td>
</tr>
</table>

Fig. 8.1 Overview of Google's business model at the time of the company's launch. Source: own illustration, based on Osterwalder and Pigneur (2010)

this by combining the advertising business model with their relevance-based search mechanism PageRank. Although GoTo was the first search engine to attempt a pay-per-click model, Google had the clear goal to offer relevant and unbiased results for customers, leading to an outstanding market recognition. As Google was ranking search results based on relevance and not on the amount of money an advertiser had paid (as GoTo did), it became the first search engine to focus on its search customers.

Key Activities To become attractive to advertisers, Google had to ensure that its search engine was frequently used for a high amount of searches. The company accomplished this by continuously optimizing its PageRank algorithm, which effectively measured the human interest devoted to a certain website, and ranked search results accordingly and objectively. To the same extent, developing and optimizing the auction-based advertising service AdWords represented a key activity. In result, AdWords became the interface between search customers and advertisers.

Key Resources PageRank was Google's underlying key resource for its search engine and for its associated AdWords service. Not just search results, but also ads were ranked through PageRank. Users had the power to define the relevance of an ad, resulting from the number of clicks on it. This implied that in a list of

advertisements associated to a search result, popular ads would rise to the top of the page, while less popular ones would fall.

Key Partners Initially, Google partnered with web portals such as Yahoo or AOL and provided its search services to these websites. For instance, Google powered the search engine for Yahoo, at a time when Yahoo was the leading internet portal (Olsen 2002). More interestingly, Google chose not to partner with GoTo, although GoTo had a functioning revenue model at a time when Google was still unsure how to make money. Brin and Page decided that it made no sense for their start-up to share revenues with GoTo, which had a less performant search algorithm and a different approach in terms of who the most important customers are. GoTo believed it was the advertisers, whereas Google believed that a functioning business model in its field could only be successful when focusing on the search customers.

Customer Segments As noted above, Google's primary customer segment were information-seeking internet users. By the end of the year 2000, Google was already the largest search engine on the web (Hill and Jones 2010), tremendously surpassing its rival GoTo in outreach. By experimenting with text-based advertising and introducing AdWords, Google gained access to its second customer segment, the profit-yielding advertisers.

Customer Relationships From early on, Google understood that it has the potential to become and remain the search engine of choice for an unmatched number of customers. In an industry with a high frequency of innovation and low switching costs, gaining customer trust is essential. For this reason, behind one of Google's declared guiding principles, "*Don't be evil*", was the company's goal of providing uncompromised, fair search results to its customers.

Channels Google solely employed direct online channels to reach both its customer segments. While search customers used the company's main website, advertisers were approached via the AdWords platform. The latter was designed as a self-service advertising solution, following the same principles of simplicity as google.com.

Revenue Streams Until the burst of the dot.com bubble at the turn of the century, Google mainly relied on venture capital funding. The changes in the market environment put pressure on the company to act quickly towards creating a functioning revenue logic. This is how AdWods came about. Google began to experiment with ads as a source of revenue in 1999, selling text-based advertising space, and gaining revenue from advertisers on a cost-per-thousand views model. In 2000, when AdWords was launched, it was initially also relying on this cost-per-thousand impressions model. Revenue was generated resulting from the estimated number of people having viewed a particular ad. Yet this cost-per-thousand impressions model alone did not fully convince advertisers that their money was well spent, and required improvement. The answer came two years later, through

AdWords Select, which allowed a thoroughly enhanced pay-per-click revenue generation mechanism. AdWords Select is discussed in the following section, as one of the developments to the initial business model.

Cost Structure Resulting from Google's key resources and activities, the main costs in the year 2000 were mostly fixed costs, largely created by the IT infrastructure and its associated data center, alongside with the payroll for around 60 employees.

8.4 Current Business Model

Figure 8.2 depicts the main changes in Google's advertising business model since the launch of the company's domain in 1997, as discusses below. Figure 8.3 summarizes the present advertising business model of the company.

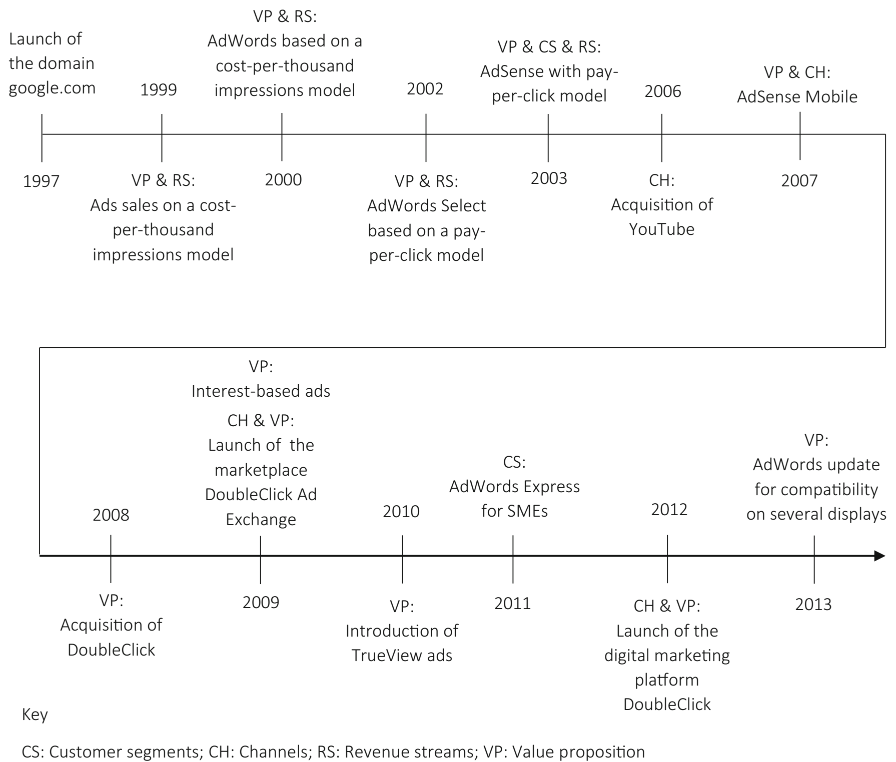

Fig. 8.2 Main changes in Google's advertising business model across time. Source: own illustration

<table>
<tr>
<td rowspan="2">Key Partners

Google Network Members:
- search partners
- publishers

Google Partners: online marketing firms</td>
<td>Key Activities

Management, maintenance, and improvement of platform and related know-how

Analyzing user-generated data

Extending the reach of its platforms</td>
<td rowspan="2">Value Proposition

Relevant search results and a multitude of additional services (e.g., Google Finance, Gmail and Youtube)

Targeted online advertising solutions (for both advertisers and publishers)
- content related
- interest related
- placement targeting

Advertising marketplaces (for both advertisers and publishers): DoubleClick Ad Exchange</td>
<td>Customer Relationships

Self-service

Customer binding through excellent search results

Personal assistance for corporate key accounts

Reliance on user feedback</td>
<td rowspan="2">Customer Segments

Search customers

Advertisers

Website publishers</td>
</tr>
<tr>
<td>Key Resources

PageRank and additional algorithms

IT infrastructure and multiple platforms

World-class employees

Brand value</td>
<td>Channels

Direct channel model: own websites/ platforms

Third-party websites

Mobile devices

Ad marketplaces: DoubleClick Ad Exchange</td>
</tr>
<tr>
<td colspan="2">Cost Structure

Traffic acquisition costs

Fixed costs: data center, platform, IT infrastructure, R&D, marketing and sales</td>
<td colspan="3">Revenue Streams

Advertising fees: cost-per-click model and cost-per-thousand impressions model, from own websites and partner websites (Google Network Members)</td>
</tr>
</table>

Fig. 8.3 Overview of Google's current advertising business model (the aspects highlighted in *grey* did not undergo major changes across time). Source: own illustration, based on Osterwalder and Pigneur (2010)

Value Proposition In 2002, Google launched AdWords Select, its pay-per-click version of AdWords, which consistently improved the value for advertisers and led to a substantial increase in their numbers. In 2003, AdSense was included in the portfolio, providing third-party publishers with access to Google's network of advertisers. Google began to act as a facilitator between website publishers and advertisers. Publisher websites are scanned by AdSense, which then places fitting advertisements. Since 2009, the company has been going one step further and began interest-based advertising on YouTube. This was enhanced through the service TrueView, which enables users to skip an irrelevant ad after five seconds, if it does not fit their interests. Further, Google employs target placement for providing ads. Here, ads are correlated with the demographic characteristics and geographic location of the search customers. With the acquisition of the digital marketing company DoubleClick in 2008, banners as advertising options are also part of Google's portfolio. Around the same time, publishers were provided access to the service Ad Manger, which enables them to define advertising spaces on their websites and to easily manage the ads. Since 2009, Google has been operating its

real-time marketplace DoubleClick Ad Exchange, which supports publishers and advertiser networks in buying and selling advertising space.

Key Activities To be able to match the most suitable ads with website content and visitor interests, Google's key activities are platform management and acquisition of extensive customer information. Maintaining and continuously improving its platforms' functionality and usability are derived activities. To further optimize its offer portfolio, Google constantly analyzes user data, gaining a clear profile of its users and an insight into competitive advertising networks. An associated activity is the expansion of its reach. For instance, by providing free access to Ad Manager, Google sustainably acquires new customers for its charged service AdSense.

Key Resources Google's services rely on several platforms, for instance the search platform itself, the company's platform for advertisers AdWords or the marketplace DoubleClick Ad Exchange. In this regard, globally located data centers are the underlying resource. Google's success relies on its immense know-how, diverse areas of competence and skill sets. As well, the company's success has been attributed to the bi-generational leadership of Eric Schmidt alongside with the founders Brin and Page. Schmidt, who joined the company in 2001, had decades more experience in U.S. tech industry than the young entrepreneurs did, bringing a rather more mature standpoint to the company, as some analysts suggest. Moreover, the company makes sure not only to hire people who are excellent in their particular field of expertise, but who also make an excellent fit to its culture. In 2014, 53,600 full-time employees worked for Google, about 21,000 of whom worked in the field of R&D and over 17,000 in the field of sales and marketing. Google is known for allowing employees to use 20 % of their working time for work-independent, innovative projects. In turn, the company gets the rights for all innovations and creative ideas, which result from this creative time-out. All of this contributed to creating a further key resource: brand value and company reputation. Proof of this is the fact that Google ranks second as the most valuable brand worldwide, after Apple (Interbrand 2014).

Key Partners The core business model of Google would not function without its advertising partners. The company has established strong partnerships in this area and, for better management, divided its network twofold: a search network, comprising partners such as AOL, and a display network, comprising two million publisher websites, such as nytimes.com or weather.com. Within the service Google Partners, the company is working with online marketing firms, which provide customized services and tools for online marketing.

Customer Segments To summarize the above, the company extended its initial two customer segments, search customers and advertisers, with a third segment, independent website publishers. The latter are approached through the service AdSense.

Channels While Google initially only sold advertising space on its own website, it now has a multitude of channels, both own ones and ones resulting from collaborations with third-party publishers via AdSense. Own channels are for instance the websites Google Finance, Gmail or Youtube, the latter being acquired in 2006. The launch of AdSense Mobile in 2007 additionally expanded Google's multi-channel reach.

Customer Relationships Regarding customer relationship management, Google's approach has not essentially changed over the years, neither for search customers, nor for advertisers or publishers. Customer relations remain mainly self-service. For instance, AdWords Select is designed as a self-service platform, and the company still provides automated web-based services, such as the AdWords Help Center. Over the years, phone support was reduced and shifted primarily to e-mail and help desks in text form. Nonetheless, sales teams provide personal support to key customers. As regards ad choice and placement, Google heavily relies on user feedback. For instance, the expected click-through rate is based on user voting and helps Google decide which ads best fit each search query.

Revenue Streams The company maintains both a cost-per-click and a cost-per-impression revenue model. Both generate fees, but on different bases: within the cost-per-click model, an advertiser only pays a fee when a user clicks on one of its ads. Within the cost-per-impression model however, the advertiser pays the fee depending on the number of times the ad is displayed on Google websites or on Google's partner network websites. The cost-per-impression model is more suitable for advertisers striving to increase general brand awareness. For advertisers trying to boost sales numbers and website hits, the cost-per-click-model is a better fit.

Google employs different keyword-based price levels for the displayed advertisements. For example, a 2011 survey reported the most expensive keywords in AdWords: advertisers paid 54.91 US $ pay-per-click fee for the keyword "insurance". The ad with the highest ranking receives the top placement on a website, and advertisers only have to pay the minimum amount to keep their ad placement and format. For instance, advertiser on position one only has to pay a fraction as much to beat the ad on position two and maintain its upper placement. In order to ensure the relevance of the ads, beside advertiser bids three quality factors are important: expected click-through rate, landing page experience, and ad relevance. The expected click-through rate shows to which ads users really respond, and is based on "votes" through clicks. Highly significant landing pages, namely those on which users find best fitting results to their search queries, also attain a higher score. The quality of a landing page depends on the relevance and originality of its content, ease of navigation and transparency. The third quality factor is ad relevance, which is determined by analyzing the language in the ad and how it relates to the search query. The more information about the business is provided on the website, such as telephone number or website domain, the more likely users will click on the ad, and thus the higher its impact. By combining the bidding system

with the three quality factors, Google was able to steeply increase advertising revenues. Within just a decade, the advertising revenue soared from 3 billion US $ in 2004 to 59 billion US $ in 2014. Google's current ad revenues are twice as much the amount of ad revenues of all U.S. newspapers combined. The amount of ad revenues generated on Google's own websites account for 68 % of the company's total revenues, while the partner websites in the Google Network bring in 21 % of total revenues. Google thus earns around 90 % of its total revenues though the advertising business model.

Cost Structure By operating a network of partner websites (Google Network Members) and co-working with partners, which direct search queries to Google, the company has so-called traffic acquisition costs. These accounted for about 23 % of advertising revenues in 2014, representing the business model's highest cost block. As the company strives to constantly improve its services and to offer innovative solutions, it heavily invests in R&D, as much as 13.3 % of revenues in 2014. In comparison, Microsoft invested 13.4 % of revenues into R&D the same year, Amazon 8.8 % and Facebook as much as 21.4 %. Sales and marketing expenses represent another pool of fixed costs, which accounted for 12.3 % of sales in 2014.

8.5 Industry Outline and Future Perspectives

In 2014, as much as 40 % of the global advertising expenditures were spent on TV as an advertising channel, 15 % on newspapers and 19 % on desktop internet devices. The market shares of these established advertising channels are, however, constantly dwindling, as the share of advertising expenditures on mobile internet is likely to increase globally from 5 % in 2014 to 13 % by 2017. Conversely, the share of TV ad expenditures will decrease to 37 %, whereas the share of expenditures for desktop internet ads will likely remain stable in the same period.

The total global online advertising revenue in 2014 amounted in 133 billion US $. Google alone reported revenues of 59 billion US $, making the company the current undisputed market leader within the industry. In the U.S., Google's digital ad market share amounted to 41.6 % in 2014, leaving Facebook (10.6 %), Microsoft (5.9 %), Yahoo! (5.1 %), or Amazon (1.5 %) far behind. However, it is predicted that Google's market share will lose about 5 % by 2017, whereas Facebook's market share is expected to increase to 16 % in the same time frame. Although currently Google still faces little serious competition in the internet advertising industry, the company should not underestimate the power of social media rivals such as Facebook. Amazon Products Ads also represents an attractive choice for e-commerce firms considering alternatives to Google's AdWords. Amazon displays search-related ads next to the query results, in a similar manner as Google does. However, Amazon provides a platform, on which customers are already involved in the buying process, which dramatically increases purchase likelihood.

Being the undisputed market leader among web browsers brings Google a virtuous cycle of increasing search user numbers, which lead to increasing advertiser numbers. The company managed to design an ecosystem, in which users and advertisers perfectly interact and complement each other. The success of this ecosystem allowed Google to massively expand its business divisions with programs as diverse as self-driving automobiles, internet provision to remote areas and high-tech medicine research. What fuels all these endeavors is the company's effort to remain significant in a business landscape in which, perhaps in ten years' time, the search engine itself will be an antiquated reminder of the dot-com boom, in the meantime already replaced by a more performant search mechanism.

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9 Journalism 2.0: The Case of the Huffington Post

The online news platform Huffington Post was launched by Arianna Huffington, Jonah Peretti, and Kenneth Lerer in May 2005. At that time, two trends dominated the newspaper industry: declining revenues from subscriptions and advertising, as well as a blurring distinction between the different media domains. For traditional newspapers, these changes implied a need to respond by migrating to the internet. Newspapers evidently competed for customers with other news sources in form of radio, television and magazines. Yet this was not a new and not a very threatening competition. The internet, however, strongly pointed towards the emergence of a new business model in the news and media industry, endangering traditional media providers.

The classical business model of print newspapers did not change much since the mid-nineteenth-century and was based on two pillars, journalistic content provision and advertisement commercialization. As Huffington Post's business model was also financed through advertising, it did not significantly vary from traditional newspapers on this point. However, compared to traditional newspapers such as the New York Times doing investigative journalism, the Huffington Post aggregated news from different sources, and provided a platform for unheard voices. All of this was done on the internet—and readers were granted content access for free.

Since the 1990s, leading newspapers also began their expansion on the internet. According to Riley et al. (1998), half a dozen major U.S. newspapers and about a dozen smaller ones offered internet content in the early 1990s. This number increased to 1,520 at the end of 2004 (Veglis 2007). For instance, in 1995, USA Today and in the following year the New York Times went online. However, incumbent newspapers did not effectively exploit the opportunity of interactivity offered by the internet, using their websites only to mirror and reproduce already printed content. This did not change much after the turn of the millennium, as shown in a study conducted by Rosenberry (2005). Journalists had little interest to interact with readers, and were rather stupefied about readers starting online

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discussions. And this attitude was diametrically opposed from the one of Huffington Post.

In its early days, Huffington Post was envisaged as a liberal alternative to the competitive republican Drudge Report. The Drudge Report, launched by Mart Druge in 1997, is a news and commentary aggregation website. Besides original reporting, the Drudge Report links news stories and columns from other online sources. In comparison to Huffington Post, the Drudge Report has lost much of its significance since 2009, as it emerged that some of its news-reports were misleading (Taylor 2015). Moreover, the Drudge Report's business model was much more traditional, as it did not employ interaction and a personal blogosphere, key elements of Huffington Post's later success.

Further online news aggregator platforms with human editors were American Online (AOL) or Yahoo News. AOL reconfigured the traditional value proposition of news providers, offering an online news channel, which enabled readers to customize the information they wanted. Computer algorithms also began to replace human editors, exemplary in this regard being Google News, launched in September 2002. Its algorithms enabled search users to look up any subject and to receive news results from more than 10,000 news sources. Due to the absence of human influencing factors, Google News offered unbiased information, operating as a fully automated news service.

In 2003, a few news providers such as the Washington Monthly or the Slate Magazine began to hire bloggers to write for their websites. Still, a year later, blogging was not very popular, as over 60 % of Americans with internet access did not know what a blog was (Rainie 2005). News providers also did not really believe that money was to be made through the content created by bloggers. Before the launch of the Huffington Post in 2005, bloggers were not taken seriously. However, the Huffington Post ventured to base its business model on the blogger community, disproving former industry assumptions.

The business model of the Huffington Post was fueled by the 2004 presidential election. Since the platform started as a political blog by aggregating news and providing a place for discussion, it built its business model by bringing together and bringing forward political blogs. Although there were other news aggregators on the market, such as the Drudge Report or Google News, the Huffington Post disrupted the online newspaper industry by exploiting the internet's interaction possibilities and offering a community-based news source. The Huffington Post contradicted the industry assumptions, as it became the most widely read independent news website during the following presidential election of 2008. As noted by Glaeser (2014), the platform tried and succeeded in disrupting the classical "one-to-many" communication principle. The Huffington Post understood the power of interactive internet and the importance of political blogging, and founded an original business model exploiting these trends.

9.1 Founders

According to the founding story, Arianna Huffington and her friend Kenneth Lerer came up with the idea while discussing the power of the internet during the presidential race of 2004. Arianna Huffington, the daughter of a Greek newspaperman, received her Master's degree in economics from Cambridge in 1972, after which she moved to the U.S. Huffington gained national prominence after campaigning for her husband during the U.S. Senate election of 1994. Afterwards, she worked as a political and social commentator. Her passion for debating and her interest in politics, coupled with a keen understanding of the internet's power, led her to start an own political blog. Before launching the Huffington Post, Arianna Huffington hosted two political websites, Resignation.com and Ariannaonline.com. She has a good sense for connecting with people and networking, a trait also reflected in Huffington Post's business model: to bring in new voices and to provide a platform for discussion. Huffington is also perceived as gregarious, effusive and innately social, with complementing personality traits as her co-founder Kenneth Lerer.

Kenneth Lerer is often described as reserved, private and cerebral. After dropping out of college in order to work as campaign manager in the Senate election of 1974, he started freelancing with an own PR firm in 1986. With expertise in creating and marketing brands, he also had a good sense of timing the launch of the Huffington Post. After having played a pivotal role in the development of the company, Lerer left in 2011, in result of Huffington Post's merger with AOL.

Jonah Peretti, the computer wizard from the three entrepreneurs, received a postgraduate degree of the MIT Media Lab and became well known for creating viral internet content—content, which is innately interesting or fun, hereby achieving a high number of viewers/readers in a short time-span. His initial success made him guest of several U.S. talk shows and finally led to his collaboration with Huffington and Lerer. He left the Huffington Post in 2011 to concentrate on his company BuzzFeed, an online platform for distributing and sharing entertainment content and journalism, which since has become one of Huffington Posts' main competitors.

9.2 Market Demand

Between 2001 and 2010, the Pew Research Center conducted a study on U.S. news consumption. The findings show that a surging number of citizens were using the internet as an information source, their proportion increasing by almost 80 % between 2002 and 2004, from 14 to 24 %. On the other hand, while half of the population read print newspapers in 2003, the numbers decreased to 36 % as soon as 2005. According to a further study, in 2004, almost half of all 18–34-year-olds used internet portals like yahoo.com or msn.com as daily news sources (Brown 2006). In comparison, only 19 % of the same age group relied on newspapers. In 2004, the

golden era of print newspapers ended, as these became the least preferred news source among younger U.S. citizens.

The decline of print equaled the rise of internet news. The market demand for the latter was facilitated by its increasing speed and reinforced by generational change and perceived time scarcity. Younger generations not only expected higher transparency on behalf of news providers, but also a chance to personally become engaged in the news making process. Although U.S. newspapers were beginning to understand this, online interaction with readers was not part of their agenda. Yet this was detrimental. Even the media mogul Rupert Murdoch emphasized in 2005 that consumers wanted larger online communities for talking, questioning and debating. This brings to light an unmet market demand for interactivity and media co-creation. By establishing a news platform based on blogging and news aggregation, the Huffington Post responded fast to this emerging demand, enabling consumers to become active partakers, rather than passive spectators.

9.3 Pioneer Business Model

The following describes the business model of the Huffington Post at the time of its launch in 2005, as also illustrated in Fig. 9.1.

<table>
<tr>
<td rowspan="2">Key Partners

Community and network of readers and bloggers

Arianna Huffington's network of well-renowned marketing partners</td>
<td>Key Activities

News aggregation and editing

Establishing a strong community of readers and contributors

Creation of original content

Marketing and building the brand</td>
<td rowspan="2">Value Proposition

Online news platform with high readership engagement: connecting news, reader opinions, and expert comments</td>
<td>Customer Relationships

Close customer relations through news co-creation</td>
<td rowspan="2">Customer Segments

Readers

Bloggers

Advertisers</td>
</tr>
<tr>
<td>Key Resources

Website as core of the business model</td>
<td>Channels

Direct, own channel via the Huffington Post website</td>
</tr>
<tr>
<td colspan="3">Cost Structure

Cost-driven cost structure

Cost savings by aggregating news from other websites and content creation by users and unpaid bloggers</td>
<td colspan="2">Revenue Streams

Advertising revenues</td>
</tr>
</table>

Fig. 9.1 Overview of the Huffington Post business model at the time of the company's launch. Source: own illustration, based on Osterwalder and Pigneur (2010)

Value Proposition The Huffington Post was designed as an engagement platform, closely connecting news, reader opinions and expert comments. In comparison to the traditional business model of newspapers, the Huffington Post imagined news as a shared undertaking between producers and consumers. Offering community-powered news stories and providing a platform for discussion, the Huffington Post changed the news production principle, redefining the relationship between readers and journalists. Readers became journalists.

Key Activities The platform's key activity was to aggregate and publish blog posts from unpaid contributors, and excerpts of stories published elsewhere. Building a community of content providers was pivotal, and so was editing community-based-content in real time. Besides news aggregation and hyperlinking to other websites, the Huffington Post editors also created original content. Platform optimization was a further key activity: in order to increase traffic, Peretti put significant effort into the technologies, and into finding out what viewers prefer to read and to share.

Key Resources A starting capital of about $ 1 million was needed for getting the business running, and was raised by Lerer and Huffington. The website undoubtedly acted as the key resource, as it concentrated the entire business model of the company. It provided a stage for the voices of bloggers and commentators, for content creation and content distribution. In order to make all of this possible, half a dozen site administrators and an editorial staff team were involved.

Key Partners The most important partner of the Huffington Post was the community itself, with readers and bloggers acting as both customers and suppliers of news stories. The young business relied on its community in two ways. On the one hand, the community created content and responded to content at no cost. On the other hand, each article had its own target readership, diversifying the audience and hereby increasing the survival chances of the platform. Another success factor lied in the positive media endorsement made possible by Arianna Huffington's personal network of celebrities, who actively promoted the start-up.

Customer Segments The platform brought together well-known bloggers with previously unpublished ones and with highly engaged readers and commentators. By starting a news business converging towards politics, the Huffington Post mainly attracted politically interested readers and bloggers. However, Arianna Huffington once mentioned that she wanted to reach as many people as possible, rather than to focus on any particular niche group, which explains the later content diversification. As neither readers were paying for the content provided, nor bloggers were paying for being featured on the website, advertisers formed the third customer segment—and the only one, which brought in revenues.

Customer Relationships The nature of the business model itself lead to a strong community feeling among readers and contributors, as these roles were constantly

shifting. A single person was able to act as reader, blogger, or post commentator, hereby becoming strongly engaged with the platform and its content.

Channels The company's value proposition made the internet not only a perfect channel, but in fact the only possible one. Without the internet, the options for interaction with readers would have remained antiquated. Additionally, the internet allowed content to be updated several times daily, ensuring instant access to the newest available content.

Revenue Streams The Huffington Post generated revenues through advertising. The company rejected the idea of subscriptions and content paid individually and hereby solely based its revenue model on revenue streams through advertisements.

Cost Structure The company enjoyed low entry barriers and hereby low initial costs. Content creation through blogging required, in its simplest form, solely a computer with internet access. Whereas incumbent news providers such as the New York Times and the Washington Post were employing several hundred editorial employees, the Huffington Post created a hyperlinking model, in which it benefited from this work, without shouldering any costs itself (Alterman 2008). The company has indeed been criticized of free riding, as it created a revenue stream for itself based on content from other news sources, for which it did not pay. Moreover, it employed a further mechanism for keeping costs low, namely publishing content created by unpaid bloggers. These choices led to the creation of a sharply cost-driven cost structure, and ensured the company's survival in its initial years.

9.4 Current Business Model

During the course of the past decade, the business model of the Huffington Post mainly developed due to the company's growth strategy, resulting from Arianna Huffington's vision for it to become a global media brand. Figure 9.2 comprises the main changes in the business model, which will be further discussed in the following. Figure 9.3 comprises an overview of the current business model of the Huffington Post.

Value Proposition In the meantime, the Huffington Post has expanded its news reach from politics to more varied fields. The platform became a general news provider, which combines professional, in-house news with a platform for blogging. Its topics range from news on economics to culture, entertainment, comedy and fashion.

Key Activities Enlarging its community, binding readers, and making the website more attractive for advertisers are key activities of the Huffington Post today. For

instance, the company established a user recognition system called HuffPost Badges in 2010, to increase the number of contributors. A year before, in 2009, HuffPost Social News was launched, which enabled an expansion into the Facebook community and hereby increased the website's appeal to advertisers. The Huffington Post also launched several apps, alongside with HuffPost Live, a web-based video-streaming network with daily live programs. HuffPost Live follows the same principles as Huffington Post, offering listeners the possibility to effortlessly post their thoughts on the news content, which supports reader loyalty and allows the company to obtain direct feedback. By placing its users at the heart of the platform, HuffPost Live is talking *with* users, not to them, hereby setting a new standard for social video discussions. Besides news aggregation, the Huffington Post still produces own original content, for which it won the Pulitzer Prize in 2012. To reinforce own content production, an in-house news service was established, supporting original reporting and investigative journalism. To enlarge the community, the Huffington Post started local versions of its website in the U.S. in 2008, as well as versions outside the U.S. from 2011.

Key Resources As in 2005, the team of bloggers and the editorial staff remain the company's key resources, beside the platform itself. The editorial staff increased up to 800 salaried editors and a team of up to 90,000 unpaid bloggers.

Key Partners Over the years, the company initiated several B2B partnerships. The collaboration with Facebook complements partnerships with international media companies, ensuring access to new markets and to the best journalists outside the U.S. Examples range from the partnership with Le Monde Group and Les Nouvelles Editions Indépendante in France, El Pais in Spain, Gruppo Editoriale L'Espresso in Italy, or Tomorrow Focus in Germany.

Customer Segments The company succeeded in enlarging its community across the Atlantic and the Pacific, with subsidiaries in Spain, Italy, France, Great Britain, Germany and Japan.

Customer Relationships By continuously improving its options for interaction and content co-creation, Huffington Post managed to maintain a highly involved community of readers, bloggers and guest authors.

Channels As mentioned in the key activities section, Huffington Post has enlarged its channels via HuffPost Live or HuffPost Social News, while still pursuing an online-only strategy.

Revenue Streams In 2010, the Huffington Post was in the black for the first time since its foundation five years before. Although the company does not publish financial data, experts estimate its revenue in 2014 at about 200 million US $, leading to a presumed net loss (Bercovici 2015; Pompeo 2014b), which results from the company's international expansion strategy. In order to strengthen its revenue

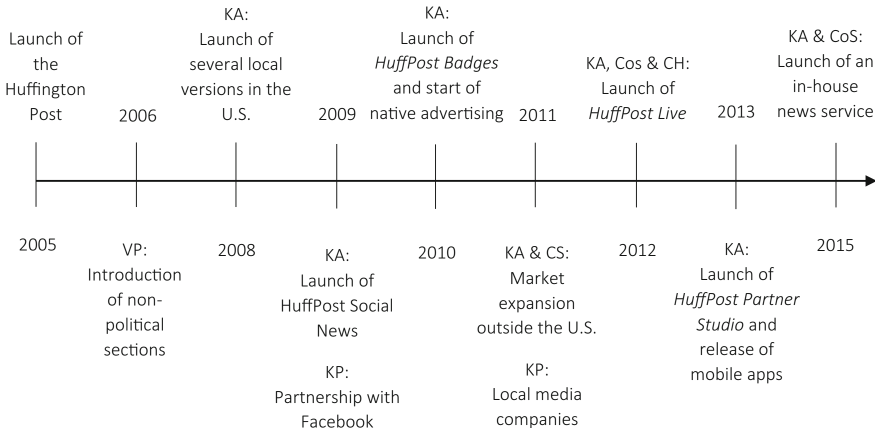

Fig. 9.2 Main changes in Huffington Post's business model across time. Source: own illustration

mechanisms and allow the international expansion, the Huffington Post experiments since 2010 with native advertising. Hereby, advertisers create or sponsor content intended to blend in with the editorial content.

Cost Structure Although bloggers still contribute through unpaid content, the launch of HuffPost Live and the international editions of the website resulted in considerable cost blocks, also due to increasing numbers of editorial staff. A further cost block remained comparably constant, as the company still pays subscription fees for news wires such as Reuters. However, some contracts with news agencies ended due to financial considerations, such as the one with Associated Press in 2014. By doing so, Huffington Post is able to save millions of dollars in fees and to gain increased control over its content (Fig. 9.3).

9.5 Industry Outline and Future Perspectives

Blodget (2010) and Tierney (2014) refer to Huffington Post's business model as an example of disruptive innovation that introduced social media in the newspaper industry. By providing a free and unpretentious news service, the company entered the low end of the market with a simpler, cheaper and at least just as convenient service as incumbent news providers. Like other disruptive innovations from various industries, the Huffington Post strives to improve and move upwards towards the middle and high-end news market.

<table>
<tr>
<td rowspan="2">Key Partners

Community and network of readers and bloggers

Arianna Huffington's network of well-renowned marketing partners

Newswires

Media companies and social media partners such as Facebook</td>
<td>Key Activities

News aggregation and editing

Creation of original content in non-political sections

Enlarging the community (HuffPost Social News, launch of mobile apps) and binding readers (e.g., HuffPost Badges)

Native advertising and launch of HuffPost Partner Studio

Developing video content (HuffPost Live)</td>
<td rowspan="2">Value Proposition

Online news platform with high readership engagement: connecting news, reader opinions, and expert comments</td>
<td>Customer Relationships

Close customer relations through news co-creation</td>
<td rowspan="2">Customer Segments

Readers

Bloggers

Advertisers</td>
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Direct, own channel via the Huffington Post website alongside with additional channels, such as HuffPost Live HuffPost Partner Studio</td>
</tr>
<tr>
<td colspan="3">Cost Structure

Cost-driven cost structure

Cost savings by aggregating news from other websites and content creation by users and unpaid bloggers

Increasing costs due to international expansion
Subscription fees to news wires</td>
<td colspan="2">Revenue Streams

Advertising revenues</td>
</tr>
</table>

Fig. 9.3 Overview of the Huffington Post's current business model (the aspects highlighted in *grey* did not undergo major changes across time). Source: own illustration, based on Osterwalder and Pigneur (2010)

According to a survey of the e-business guide eBizMBA, in 2015 the Huffington Post ranked number one among U.S. politics-oriented websites regarding monthly visitors, leaving behind competitors such as The Blaze or Drudge Report. Yet among Huffington Post's competitors, one can also find giants such as Google, acting as news aggregators. Google News hereby remains, since the market launch of Huffington Post, a considerable threat. More surprisingly, BuzzFeed, founded in

2006 by Huffington Post co-founder Jonah Peretti, competes for the newsreaders' attention. BuzzFeed was initially designed as an entertaining social site, yet developed in the past decade to a genuine news organization, embracing social media in a similar manner to Huffington Post. The microblogging service Twitter is a further example, providing immediate access to information created by loosely organized groups of people. The service has shown its significance in informing the world on social phenomena such as the Arab Spring or the Ukrainian revolution of 2013. This however signals Twitter's appropriateness to a rather different news approach than that envisioned by the Huffington Post.

Table 9.1 visualizes the number of unique visitors of the Huffington Post and of several of its U.S. competitors in April 2014 and April 2015, quantified by the digital performance measurement platform Compete. Regarding monthly visitors, the Huffington Post is preceded only by Twitter in both years. However, the Huffington Post's number of unique visitors in the U.S. declined by 4.9 % in the same timeframe. The Blaze and Drudge Report respectively lost even more than one fifth and nearly half of monthly visitors. At the same time, Techmeme's visitor number grew by five times, BuzzFeed more than doubled, and Twitter nearly doubled its visitor numbers. As the Huffington Post's business success depends on the number of visitors and contributors, new hip platforms may erode its market position, as Table 9.1 indicates.

For the readers of the above-mentioned websites, as well as for those of many others in the digital news industry, switching costs are practically close to zero. While this is beneficial for readers, news websites have to be prepared for sudden shifts in customer numbers. This is mainly because the platforms are not based on a subscription revenue model, and do not require registration on behalf of readers. This trend of high fluctuations is also likely to increase in the future. The Huffington Post hereby shows creativity in its efforts to bind readers, for instance through HuffPost Live or through its collaboration with Facebook. Yet Facebook is not only a partner, but may evolve into a powerful competitor, through its social news aggregator, FB Newswire. Currently, FB Newswire is powered by the social news agency Storyful, which aggregates and provides first-hand social news from

Table 9.1 Direct comparison of the Huffington Post and its competitors

	Unique visitors in the U.S. (April 2014)	Unique visitors in the U.S. (April 2015)	Variation in %
The Huffington Post	45,573,031	43,352,920	–4.9
The Blaze	7,007,838	5,523,607	–21.2
Drudge Report	4,117,547	2,199,607	–46.6
Google News	5,764,001	10,588,999	+183.7
Techmeme	38,848	199,006	+512.3
BuzzFeed	11,301,587	30,223,155	+267.4
Twitter	45,808,732	89,199,387	+194.7

Source: own illustration, based on Compete (2015a–f)

Facebook to journalists. If FB Newswire chooses to change its target customers, and primarily address news readers, it has the potential to become a threat for Huffington Post, particularly due to its much larger user base. Moreover, if FB Newswire will expand its sources for newsworthy content outside the Facebook community, it has the competitive potential to become the platform of choice for news consumption.

All of this shows the incredible speed at which customers are gained, and lost, in the world of digital news media. For Huffington Post, this is a signal that it has to permanently keep track of the fast-paced shifts in customer demand, intensified by other popular platforms and services.

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10 Making People Happy: The Case of the Walt Disney Company

The Walt Disney Company was founded by Walter and Roy Disney in Hollywood in 1923, initially under the name Disney Brother Cartoon Studio. Cartoons, or animated drawings, were a complex and expensive industrial product at that time, as one cartoon could contain thousands of different drawings. One year before the company was founded, only about one in five cinemas offered cartoons in their programs—yet Walt Disney saw a real market potential for this type of entertainment.

In the 1920s, after the depression following World War I had ended, the motion picture industry on a whole enjoyed an incredible boost. Before the Californian cartoon boom, almost all cartoon studios were located in New York. However, Walt Disney decided from early on to locate his studio in California, in line with the shift in live-action movie production from New York to Hollywood. His ability to perceive such emergent trends is just one of many examples, which distinguish Walt Disney from the incremental cartoon companies of the time. California, which employed half of all U.S. motion picture workers in 1921, grew to become a real cartoon cluster, employing around 88 % of all workers in 1937 (Scott 2005), particularly in Hollywood.

As regards other cartoonists, already in 1906 J. Stuart Blackton produced the very first animated movie, The Haunted Hotel. Yet Blackton gave up animation a few years later, in 1909, as he found it increasingly tedious. During the following years, Winsor McCay created his famous comic-strip characters, Little Nemo and Gertie the Trained Dinosaur. Although McCay's approach to animation achieved a high level of artistry, it was not commercially viable. In comparison to Walt Disney, Blackton and McCay produced only few films and failed national distribution for their products, due to insufficient operational techniques. Their work, however, represents a cornerstone in animation development.

The Bray-Hurd Process Company took up an important role in animation, made possible by own technical and operational innovations. The company, founded by John Randolph Bray and Earl Hurd in 1915, was able to rationalize animation production. In effect, the costs for animation decreased, as less frames were needed

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to produce a motion picture. Bray gave up drawing in 1915 in order to concentrate on the management of the studio—a decision Walt Disney also later adopted. However, due to shrinking revenues from animation, Bray's studio had to close down in 1927. Max Fleischer, who previously worked there, founded his own company in 1921, the Max Fleischer Studio. He created cartoon characters such as Betty Boop or Popeye the Sailor. Moreover, he produced a series called "Out of the Inkwell", which combined a cartoon figure with live action background, a principle Walt Disney reversed in his Alice Comedies later on. Fleischer's studio success declined, due to the imposition of censorship on animation and a changing target audience. In comparison to Fleischer's irreverent cartoon characters such as Betty Boop and Popeye, Disney's characters, and especially Mickey Mouse, were symbols of goodwill and provided easygoing entertainment for younger and elder generations alike.

Another famous cartoonist was Pat Sullivan, who created Felix the Cat, which became the world's best-known and most popular cartoon character by 1928. That is, until it was replaced by Mickey Mouse. The success of Felix the Cat series was reinforced by active promotion, the introduction of a line of merchandise as well as newspaper comic strips. Contrary to Walt Disney, Pat Sullivan refused to introduce technological innovations like sound or color, which led to the closing of his studio after his death in 1933. Table 10.1 gives an overview of the most influential animators around the time of Walt Disney's launch.

Sound and color represented the two major technological trends, which shaped the industry in the 1920s and 1930s, and led to the success of Walt Disney's business model. Movies and animated films were all silent at the beginning of the twentieth century, until the motion picture industry was disrupted by the introduction of sound by Warner Brothers. In 1927, the Warner Brothers company was urgently trying to prevent bankruptcy, when it decided to risk everything in order to pioneer the first sound movie, "The Jazz Singer". Walt Disney was aware that sound was the future of movies. A year later, he launched the first Mickey Mouse cartoon talkie, a fully synchronized sound cartoon called "Steamboat Willie". In response, previously hesitating studios also started to produce sound pictures.

Another industry development came from a company, which was trying to make a name for itself by creating motion pictures in color. In 1932, Technicolor

Table 10.1 Overview of the most influential animators around the time of the Disney Brother Cartoon Studio's introduction

Animator	Company lifespan	Major characters and innovations
James S. Blackton	1906–1909	Humorous Phases of Funny Faces, The Haunted Hotel
Winsor McCay	1910–1922	Little Nemo, Gertie the Trained Dinosaur
John R. Bray	1913–1927	The Artist's Dream, patent for cel animation
Pat Sullivan	1916–1933	Felix the Cat, merchandise
Max Fleischer	1921–1942	Out of the Inkwell, Betty Boop, Popeye

Source: own illustration based on Bryman (1997) and Finch (2011)

launched its three-color Technicolor process, but had difficulties in finding producers, as the previous, two-color printing rather disillusioned them. Technicolor therefore offered its exclusive rights to the three-color Technicolor process from 1932 to 1935 to Walt Disney, who hereby reached an overwhelming success. Again, Walt Disney was not only favored by fortune, but knew how to create these favorable circumstances himself.

Throughout the early years of the company, Walt Disney realized the significance of future trends like color or sound, and became one of the most prominent examples of how to build a successful business model around a brand-new technology. In contrast to all aforementioned cartoon studios, the Walt Disney Company still successfully operates today. Although Pat Sullivan started merchandising his cartoon characters and used active promotion like Disney, the company was not able to stay in business after Sullivan's death. Additionally, Disney was the first to produce a feature-length animated film against all public skepticism ("Snow White and the Seven Dwarfs", 1937), pioneered television shows and theme parks, alongside with running a merchandise business. The company massively diversified over the years. Starting as a small animation studio, Walt Disney evolved to a multinational media and entertainment group.

10.1 Founders

Walter (Walt) Elias Disney is known as the animator, who created an entertainment empire starting from a mouse—the Mickey Mouse. Although Disney's childhood was marked by hard work, he pursued his dream to become a cartoonist by joining the art institute of Kansas City, as well as the art academy in Chicago. Having inherited his father's entrepreneurial spirit, Walt Disney started his first business in commercial art in 1920, and his second one in 1922—both went bankrupt. However, these experiences did not hold the young entrepreneur back from staying in the creative industry. He moved to Hollywood, where he unsuccessfully applied for a job at live-action studios. Due to this setback, he turned to animation, the only field in which he had gained prior experience. When the company M. J. Winkler accepted his cartoon *Alice's Wonderland* in October 1923, the Disney Brothers company was finally founded.

Walt Disney has been metaphorically described as a gambler, willing to take risks and having a healthy portion of self-confidence regarding his ideas. He was always curious to try out new things: unlike his competitors, he was not afraid of technical innovations such as sound, color or television, but was one of the first to use them. Disney grew up in the Midwest, described as the most passionately American of the American regions, which gave him best insights into customer preferences. By offering moral, simple and innocent stories, he appealed to popular taste. He had an incredible instinct for judging customer demand, and was courageous enough to follow his instinct. Walt Disney was described to be a maverick, as well as diehard tinkerer (Schickel 1968), who, despite working with determination, was permanently self-displeased. He was obsessed by the quality of his movies and

wanted to bring these to outright technical perfection. Some referred to him as taking the search for perfection to absurd lengths. Disney appears to have been drawn more to the technical aspects of making movies, rather than to the artistic ones. He personally stopped drawing in 1927, and focused on providing the ideas and coordinating his employees.

In spite of Walt Disney's personal prominence, the company was in fact founded by himself together with his brother Roy. As Walt was the inventive visionary of the company, his brother was the financial wizard. Before joining the studio, Roy Disney worked as a teller at the First National Bank, and was familiar with financial issues. As Walt Disney did not have a way with money, Roy took up the role of the financial adviser. Without his help, Walt Disney would probably not have been able to live his dream. In comparison to his brother, Roy Disney had a more conservative approach to things, and in spite of his lack of creative talent, he was described as persevering and dedicated. The two Disney brothers were complementary business partners, and it might be the different personality traits, which made them such good business model pioneers as a team.

10.2 Market Demand

Before Disney, cartoon animation excessively relied on cartoon strip characters, chases, and trite topics in little visual quality. The tired gags were recycled weekly, and animation was losing the audience's attention. As animation methods became increasingly standardized, a new market entrant could only differentiate from competitors by creating non-stereotypical characters. The cartoons of the other studios being characterized by chaotic stories, Disney wanted something different: his films had clear storylines and the characters were invested with strong, unique personalities. Walt Disney, with his quality obsession, storytelling ability and interest towards innovation, not only offered different cartoons, but also continually improved their quality. Disney's offers finally made the weary moviegoer audience enthusiastic.

A further market demand can be summed up as entertainment for all generations. The film industry in Hollywood had the reputation of wickedness, of which it began to grow tired. Disney, through his family entertainment, was a contrast to this negative image. In comparison to the irreverent characters of Max Fleischer, Disney's cartoons were a symbol of goodwill (Santo 2007), with stories and characters aimed at subconscious, childlike facets of the human beings. In one of his quotes, Walt Disney says the following about the Mickey Mouse audience:

> [It] "is made up of [. . .] that deathless, precious, ageless, absolutely primitive remnant of something in every world-wracked human being, which makes us play with children's toys and laugh without self-consciousness at silly things, and sing in bathtubs, and dream and believe that our babies are uniquely beautiful."

Walt Disney's approach gave his cartoons an unprecedented authenticity and honesty—which, in turn, was exactly what moviegoers were expecting. He managed to create a new cartoon type that immediately found broad appeal.

10.3 Pioneer Business Model

The following describes the business model of the Disney Brother Cartoon Studio around 1923. Figure 10.1 correspondingly provides an overview of Disney's initial business model.

Value Proposition The value proposition was to make the audience genuinely happy. Walt Disney wanted to offer fine family entertainment, and to provide groundbreaking and perfectly performed productions. Moreover, the company delivered values of imagination and wholesomeness to its customers. Disney did not only sell products, but an ideology with values and culture, which was, now and then, also object of criticism. In spite of this, the Walt Disney Company offered a gift of creativity and magic through its shows, which delighted customers with childlike joy. In 1923, "Alice's Wonderland" was the company's first successfully launched cartoon. A series of 56 Alice Comedies followed until 1927.

Key Activities Producing the Alice Comedies was the key activity in the four years following the company's market launch. To accomplish this, directing and filming

<table>
<tr><td rowspan="2">Key Partners

Film distributor (M.J. Winkler)</td><td>Key Activities

Production of Alice Comedies: filming and animation

Continuous technological and artistic improvement</td><td rowspan="2">Value Proposition

Making people happy, through the very best family entertainment</td><td>Customer Relationships

Indirect customer relationships/ self-service</td><td rowspan="2">Customer Segments

Broad audiences, younger and elder audiences alike</td></tr>
<tr><td>Key Resources

Start-up capital

Secondhand camera

Creative capacity</td><td>Channels

Film distributor (M.J. Winkler)</td></tr>
<tr><td colspan="2">Cost Structure

Value-driven cost structure, with profits reinvested in quality improvements

Camera and additional technologies</td><td colspan="3">Revenue Streams

Sales of short films: $ 1,500 per Alice Comedy</td></tr>
</table>

Fig. 10.1 Overview of Disney Brother Cartoon Studio business model at the time of the company's launch. Source: own illustration, based on Osterwalder and Pigneur (2010)

were cornerstone activities, followed by adding animation. Due to Walt Disney's aspiration to improve the technical quality of his cartoons each time afresh, continuous improvement was a further key activity.

Key Resources For producing the Alice Comedies, significant starting capital was needed. As Walt Disney was not able to provide funding himself, he relied on his brother Roy. Financing was a well-settled family matter, yet not the only resource, on which the young company relied. As the short film "Alice's Wonderland" and the Alice Comedies combined live action with animation, the first actor, Virginia Davis, represented a further key resource. Due to cost considerations, Walt Disney hired people from the neighborhood as additional actors, and used a secondhand camera. Walt Disney himself did the animation direction, while his crew consisted of a few animators and helpers, who painted and inked the celluloids. As Disney realized that there are much better animators than himself, he hired Ub Iwerks to join his company in 1924.

Key Partners Essential partners for Disney were film distribution companies. For instance, as will be discussed in the channels section, Margaret Winkler, a renowned New York film distributor of the time, accepted Disney's cartoon "Alice's Wonderland" in 1923, and made it possible for the company to reach its audience.

Customer Segments Disney's customers were moviegoers. The main cartoon audience of the time were grown-ups looking for funny entertainment, and unlike today, going to the cinema as a family experience was not established yet. However, the comedy "Alice's Day at Sea" (1924) was perceived as unique and entertaining enough for all types of audiences, grown-ups and children alike. This created a new, much broader range of cartoon viewers.

Customer Relationships As the Disney Brother Cartoon Studio did not have direct customer contact, customer relationships can be described as self-service.

Channels Walt Disney's initial key activities did not encompass distribution, and thus the company could only reach customers indirectly, via third-party film distributors. In order to promote his short film "Alice's Wonderland", Walt Disney sent it to the film distributor Margaret Winkler, who accepted it and agreed to distribute the following 56 Alice Comedies during the following four years.

Revenue Streams For each film of the Alice series, the company earned 1,500 US $ (Stein 2011). Revenues were solely generated by film sales to distribution companies and cinemas, no additional revenue sources being available.

Cost Structure As Walt Disney was outright dedicated to continuously improving the quality of his movies and striving for technical perfection, the cost structure can be described as value-driven. Disney insisted on reinvesting revenues into

following projects and quality improvements. Two major cost blocks were the acquisition of a secondhand camera for 200 US $, and the salary of the actress Virginia Davis, of around $ 100 per month. In comparison, other employees were hired for a mere 10 US $ monthly. Thus, as Walt and Roy Disney did most of the work on their own, costs could be held at a relatively low level.

10.4 Current Business Model

The business model of the Disney Brother Cartoon Studio developed over the years, and the company took on its current name, Walt Disney Company, in 1986. Figure 10.2 comprises the successful evolution of the company's business model. It all began with the creation of Mickey Mouse and with the release of the first related cartoon talkie, Steamboat Willie, in 1928. The main changes within the business model will be explained in the following Fig. 10.3 summarizes the current business model of the Walt Disney Company.

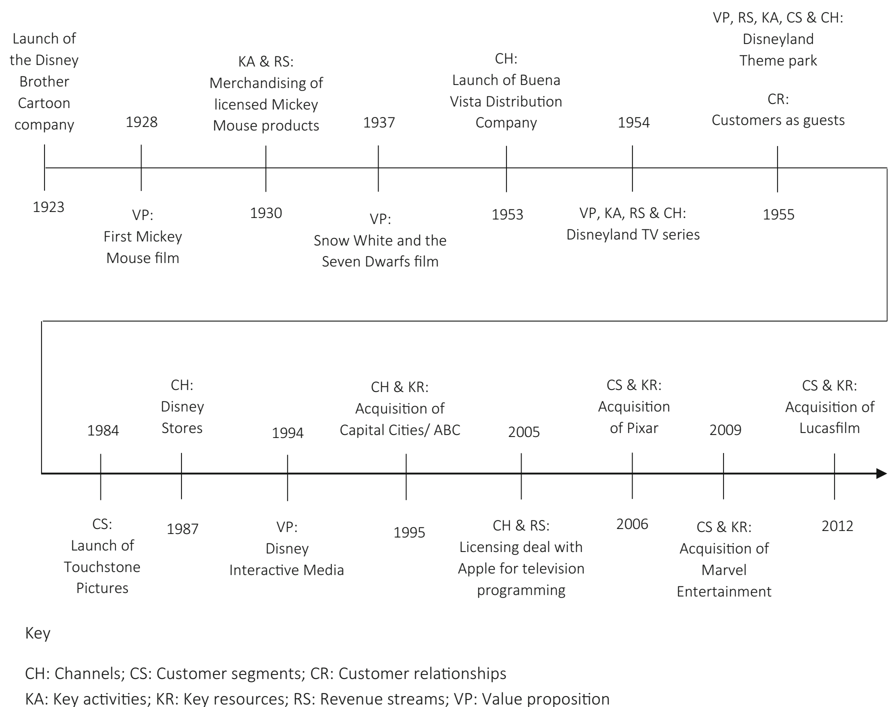

Fig. 10.2 Main changes in the Walt Disney Company's business model across time. Source: own illustration

Key Partners	Key Activities	Value Proposition	Customer Relationships	Customer Segments
Media Networks: Apple, Microsoft, Amazon Lovefilm, YouTube, Netflix Parks & Resorts: Coca-Cola Studio Entertainment: Cinemas, distributors and retailers Consumer Products: Licensees, publishers, retailers Interactive Media: Third-party developers, retailers and distributors	Protecting and preserving the brand Media Networks: Production and distribution Parks & Resorts: Offering a seamless experience Studio Entertainment: Production and distribution of live-action and animated motion pictures Consumer Products: Exploiting intellectual property through merchandise licenses Interactive Media: Development, production, and distribution of multi-platform games	Making people happy Quality entertainment *experiences* for the entire family	Customer contact via over 60 brands in various media and entertainment segments	Broad audiences, younger and elder audiences alike Family entertainment for all age groups Exemplary: Media Networks: e.g., Sports enthusiasts Parks & Resorts: Holiday travelers Studio Entertainment: Mature audiences
	Key Resources		**Channels**	
	Media Networks: Domestic broadcast network: TV and radio stations, equity interest in Hulu Parks & Resorts: Innovation capabilities, merchandise Studio Entertainment: Creative content: cartoon characters and animation technology Consumer Products: Intellectual property Interactive Media: Game developers		Media Networks: Television, radio, internet Parks & Resorts: Own website Studio Entertainment: Direct distribution under Walt Disney Pictures, Pixar, Marvel, Touchstone and Lucasfilm Consumer Products: Disney Stores, Online Shop Interactive Media: Disney.com, Disney on YouTube	

Cost Structure	Revenue Streams
Value driven cost structure: continuous innovation in entertainment Media Networks: Programming and production costs, costs of technical support, distribution costs and labor costs Parks & Resorts: Operating expenses including labor costs Studio Entertainment: Production, marketing and advertising costs Consumer Products: Costs of goods sold and distribution expenses, cost of product development Interactive Media: Costs of game development incurred by technological and human capital	Media Networks: Fees charged to cable, satellite and telecommunications service providers and television stations, advertising revenues, revenues from distribution and sales and of television programming Parks & Resorts: Revenues from admission tickets, food and beverage sales, merchandise, accommodations Studio Entertainment: Revenues from the distribution of films in theatrical, home entertainment and television markets, music distribution, stage play ticket sales and licenses from live entertainment events Consumer Products: Revenues from character licenses for consumer goods, merchandise sales at Disney stores and online, revenues from publishing children's books, magazines and comic books Interactive Media: Subscription fees and sales of multi-platform games

Fig. 10.3 Overview of the Walt Disney Company's current business model (the aspects highlighted in *grey* did not undergo major changes across time). Source: own illustration, based on Osterwalder and Pigneur (2010)

Value Proposition As the value proposition in 1923 was to offer the very best family entertainment, in time the company broadened it by providing fine entertainment *experiences* for the entire family. This is due to an enormous portfolio diversification resulting in five business segments, which shape the company's business model today: Media Networks, Parks and Resorts, Studio Entertainment, Consumer Products and Interactive Media.

Key Activities As soon as 1930, Disney started to merchandise its cartoon characters, such as Mickey Mouse, in books, comics magazines, records, watches or other licensed items, such as ice-cream products. The company's diversification strategy encouraged economies of scope, through operational and corporate relatedness and through synergies among the various business segments. As regards the know-how for creating synergies among its different businesses, Disney is one of the leading companies worldwide. The company also managed to establish global awareness of its products. Treating its theme park visitors as guests is one of Disney's mottos. Managing the travel arrangements has become an associated key activity of the Park and Resort business segment. The theme parks create a virtuous cycle for the company, as these both promote and are promoted by the Disney characters. Closely related, awarding licenses to third parties, who produce and sell character-related merchandise, represents a further key activity. Within the segments Media Networks and Studio Entertainment, Disney produces and distributes own programs. While the business segment Consumer Products is dedicated to merchandising, the segment Interactive Media creates, develops and distributes multi-platform games.

Key Resources A creative company such as Disney heavily relies on state of the art technologies, without which its artistic potential could not take form. The segment Studio Entertainment employs leading edge animation technology for producing creative content, such as the characters themselves and the worlds these inhabit. In the Media Networks segment, the domestic broadcast network with its eight own television stations and several radio stations, alongside with a 33 % equity interest in the entertainment platform Hulu are essential resources. The entire infrastructure at the company's theme parks, alongside with its marketing expertise, underline the business of the Parks and Resorts segment. Game developers complement the work of cartoonists in the Interactive Media segment, making Disney's offers available on a wide-ranging mix of channels. In 2014, around 180,000 employees and cast members worked for the Walt Disney Company.

Key Partners Besides in-house game development, the Interactive Media segment also collaborates with third-party developers. As regards the Consumer Products segment, key partners can be grouped in licensees, publishers and retailers. In order to distribute DVDs and Blu-rays, Disney collaborates with large retailers such as Walt-Mart. Online, it partners with streaming providers like Apple's iTunes Store, Amazon Lovefilm and Amazon Prime, Google Play or

Netflix. Such collaborations significantly help Disney to better understand and manage its market position in an industry, in which collaborators and competitors often are the same companies. For instance, Netflix is also a competitor of Disney, as the latter has a 33 % equity interest in the video-on-demand platform Hulu.

Customer Segments By diversifying its core business into five business segments and through inorganic company growth, Disney not only broadened, but also knew how to segment its customer base. Through the launch of Touchstone Pictures, Disney reached more mature customers. By acquiring Marvel and Lucasfilm, fans of Spider-Man, Iron Man, X-men, Star Wars or Indiana Jones, also became customers of Disney. Moreover, since the acquisition of Capital Cities/ABC Inc. in 1995, the company offers several customer-specific television channels. For instance, ABC Family provides content primarily for viewers aged between 14 and 40, and ESPN serves sports enthusiasts. Through its offers, Disney not only aims to reach people of all generations, but individuals with varied entertainment preferences.

Customer Relationships Since opening the very first Disneyland theme park in California in 1955, Walt Disney insisted on treating customers like guests, a motto to which the company adheres to this day. More recent efforts relate to product and service co-creation together with customers. These projects are designed to both increase the company's innovation capacity and customer loyalty.

Channels Due to the launch of Buena Vista Distribution in 1953, Disney was able to eliminate expensive distribution fees, making Buenavista a real milestone in the company's history. Nowadays, the media conglomerate connects with customers via television, radio, cinema and the internet, as well as in theme parks and licensed stores. Customer contact is done through a mix of over 60 brands in the film, internet, music, broadcasting, publishing and recreation industries.

Revenue Streams The company's revenues steadily increased in the past seven years from 36 billion US $ in 2009 to 52.5 US $ billion in 2015. Currently, more than 80 % of the revenues are generated through services. The business segment Media Networks, followed by the Parks and Resorts segment and by Studio Entertainment, generate the largest revenues. Within Media Networks, revenues result from fees charged to cable, satellite and telecommunications service providers and television stations. Additional revenue streams are sales of TV advertising time and sale and distribution of television programming. Revenue streams within the business segment Parks and Resorts come from admissions, food and beverage sales, merchandise sales, and hotel charges. The business segment Studio Entertainment earns by distributing recorded music and films in the theatrical, home entertainment and television markets. Additional sources of revenue are stage play ticket sales and licensing revenues from live entertainment events. Main revenue streams of the Consumer Products segment are licenses for the use of intellectual property on consumer merchandise, revenues from publishing

children's books, magazines and comic books, revenues from Disney Stores and online shopping sites. The fifth segment, Interactive Media, earns from the sales of multi-platform games to retailers and distributors, subscription fees, as well as by online advertising and sponsorships. Summing up, the company has several revenue streams, mainly usage fees, subscription fees, asset sales and licensing fees.

Cost Structure As the company always focused on innovation in entertainment, its cost structure remains highly value-driven. Today, the costs can be split up in a similar manner as the revenue streams, across the five business segments. Major cost blocks of the segment Media Networks are programming and production costs, as well as costs for technical support and distribution. As the employees of the Parks and Resorts segment largely make the Disney experience possible, labor costs create the main bulk of the operating expenses. Production, marketing and advertising are main cost-drivers in the segment of Studio Entertainment. The main cost block within the Consumer Products business are costs of goods sold, as well as distribution expenses. Product development raises the main costs in the segment of Interactive Media.

10.5 Industry Outline and Future Perspectives

According to a study of the Institute for Media and Communications Policy in Berlin (IfM), the Walt Disney Company is the third largest media group within the United States as regards 2014 revenues, preceded only by Google and Comcast. Media groups within this survey were companies, which produce or distribute journalistic content in mass media. As Google focuses on improving the ways people connect with information, it is not necessarily a direct competitor of Disney. However, Google has the potential to become one, if it chooses to broaden its media and entertainment segment. With its entirely cloud-based digital entertainment store Google Play, the company already distributes millions of songs and books, as well as thousands of movies. The significance of Google Play is increased by the trend towards watching movies and shows on the internet, rather than on TV. However, TV entertainment channels still represent one of Disney's specialties, which is where a weak spot is likely to arise in the future.

Up to present, the success of Disney was the result of its consistent corporate strategy, synergies among business segments, high dedication to customer service, all paired with the excellent entertainment experiences, which the company was able to create. And most of this was the result of a company culture with its roots in the personality of Walt Disney. He had a native talent not only for creating memorable characters and fascinating imaginary worlds, but also a thriving multi-enterprise, merging phantasy and reality. Capodagli and Jackson (2007) describe him as a great storyteller and an innovator, who built his empire upon a credo made up of four elements: first, dream beyond the boundaries of today, second, believe in sound values, third, dare to make a difference, and finally, go out and do it. Or, as Walt Disney himself once said, "If you can dream it, you can do it!"

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11 Entertainment on Demand: The Case of Netflix

The mass market introduction of the video player in the 1980s set the cornerstone for the U.S. movie rental business. With video shops opening in most communities, people were suddenly able to watch the latest movies at home on VHS tapes, instead of having to go to movie theaters.

As the number of U.S. movie rental stores more than tripled in a 3-year time frame, from 7,000 in 1983 to 25,000 stores by 1986 (Jones 2008), movie rental proved to be a profitable industry with low entry barriers. In the early 1990s, the industry was dominated by two giants, Blockbuster Video and Movie Gallery. Besides these large national rental chains, small mom-and-pop shops were ubiquitous. In 1997, about 75 % of the entire video rental business was operated by mom-and-pop shops, as these had ideal insights into customers' preferences. Yet the mom-and-pop stores were merely copying, on a small scale, the business models of Blockbuster and Movie Gallery. For this reason, when Netflix was introduced in 1997, the threat potential arose particularly from the two large competitors. In order to understand how Netflix differentiated from them, it is worthwhile to begin by having a look at their respective business models.

Blockbuster, Netflix's largest direct competitor, was founded in 1985 and was designed to become the "McDonald's of home video" (Greenberg 2008). This comparison emphasizes the company's value proposition, which was made up of three elements: Blockbuster enabled customers to watch hit movies straightaway, and in the comfort of their homes. Its business model was dominated by a network of brick-and-mortar stores, offering VHS movie rental services. Having to cope with the burden of high fixed costs, Blockbuster generated revenue by a pay-per-rental pricing model, and by additional fees for late movie return, which in spite of bothering customers, created more than 10 % of the chain's revenues (Debruyne 2014).

Movie Gallery was also launched in 1985, becoming the second largest North American home entertainment specialty retailer after Blockbuster. The movie rental chain operated under the brands Movie Gallery, Hollywood Video and Game Crazy, running own stores as well as employing a franchise system. The

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company's strategy was the aggressive expansion of its local stores. Between the business models of Blockbuster and Movie Gallery there were little noticeable differences, except perhaps the choice of store location: While the brand Movie Gallery was mostly present in rural areas, its associated brand, Hollywood Video, was often located in urban settings, in close proximity to Blockbuster stores. Around the turn of the millennium however, the business model of Movie Gallery became increasingly obsolete. This was mainly due to its unwillingness to react and adapt to competitors with new business models, Netflix being just one example. Wal-Mart, the rural area retail giant, soon also began to include video offers in its stores, and Redbox introduced the concept of video vending machines, offering its customers the new experience of fast and automated rental.

Confident in its market power, based on VHS movie rentals, Blockbuster initially viewed the start-up Netflix as a niche competitor and underestimated its disruptive potential. Netflix's main disruption came from introducing DVD technology to the market. The company started fueling a technological transition, which soon became unescapable for Blockbuster and for the other movie rental chains. Blockbuster only reluctantly started its own transition from VHS to DVDs, and tried, later on, to imitate the mail-delivery business model of Netflix. However, the VHS giant was handicapped by its cannibalization concerns regarding in-store rentals. In order to minimize cannibalization, online customers monthly received two coupons for free in-store rental when returning a movie rented online. Blockbuster tried to capture value from a modified version of Netflix's business model, but was too precautious in not causing damage to its brick-and-mortar stores. In contrast to Netflix, willing to take risky decisions, Blockbuster delayed difficult questions until it was too late. Heavily inert regarding both a shift from VHS to DVD technology, and its brick-and-mortar presence to a virtual one, Blockbuster only reacted in a fully defensive manner to the Netflix online rental business model. Between 2000 and 2006, Netflix and Blockbuster covered more than 95 % of all online video rentals. While the market share of Netflix was estimated at 85 %, Blockbuster controlled only around 10 % of all online rentals (Afanasyev 2008). Since 2008, Blockbuster's revenues started to steadily decrease, leading to its bankruptcy in September 2010. In comparison to Blockbuster and the other incumbents, Netflix realized from early on the disruptive power of both DVD technology and the internet, reinventing the movie rental logic and introducing a pioneering business model.

11.1 Founders

Reed Hastings and Marc Randolph started Netflix in 1997. Regarding the founding story, Randolph's and Hastings' versions somewhat differ. According to Hastings, he came up with the idea after being charged a late fee by Blockbuster. On his way to the gym, he realized that the revenue model of fitness studios, which charge membership fees instead of single-entry fees, was superior to the established model

in the movie rental business (Kaplan 2012). According to Randolph however, the initial idea for Netflix arose from conversations between the two. Randolph was fascinated by the potential of direct mailing, which led to the idea of mailing DVDs to customers. Although Randolph was the first CEO of Netflix, Hastings has exerted a more profound influence throughout the company's history. Randolph left Netflix in 2002, criticizing the lack of credit for his role in shaping the idea behind the company.

A decade and a half before Netflix was founded, in 1983, Reed Hastings, after having graduated from Bowdoin College with a degree in mathematics, joined the Peace Corps in order to teach mathematics to high school students in Swaziland. Hastings once mentioned that this experience helped him in becoming an entrepreneur, stating that "once you have hitchhiked across Africa with ten bucks in your pocket, starting a business doesn't seem too intimidating". In 1991, before graduating with a Master's degree in computer science from Stanford, he started his first company, Pure Software.

Within Pure Software, Hastings became acquainted with Netflix co-founder Marc Randolph. At the time, Randolph was a seasoned marketing professional. Before co-founding Netflix, he had gained a decade of marketing experience within various software firms, such as Borland Software, where he established a direct sales channel to customers. Similarly to Hastings, Randolph co-founded start-ups such as MacUser magazine or Microwarehouse, one of the larger mail-order suppliers for PC hard- and software. His experience at Microwarehouse can also be viewed as one of the likely reasons for the initial idea of starting a DVD mail business.

The two founders can be seen as entrepreneurial in spirit and drive. Moreover, they both worked in business fields, which were supportive for thinking out the logic of Netflix. Hastings' experience in IT and computer science, and Randolph's knowledge in marketing and e-commerce formed the cornerstones of the emergent business model.

11.2 Market Demand

Netflix is a company that reinterpreted business ideas and processes from other industries, and brought these to a field where it perceived an upcoming market demand. At the end of the 1990s, with more and more people owning a PC, and beginning to feel comfortable online, Hastings and Randolph saw an opportunity for improving the pattern of watching movies. They understood that customers did not necessarily like to drive back and forth to a video store in order to rent movies, and this insight was used by the two entrepreneurs as a new business prospect. Customers were neither fond of the late fees and due dates, nor of the limited selection of movies at traditional brick-and-mortar rental stores. Netflix again understood these unfulfilled customer demands.

11.3 Pioneer Business Model

In the following, the business model of Netflix at the time of its launch in 1997 is discussed, and visually summarized in Fig. 11.1.

Value Proposition Netflix was the first company to provide its customers DVDs via direct mail. The company offered a simpler and more convenient way of renting movies, compared to its traditional brick-and-mortar competitors such as Blockbuster, Movie Gallery or the numerous mom-and-pop stores. However, Netflix initially did not differentiate from incumbents by removing late fees.

Key Activities In order to be able to deliver DVDs to customers, the company's processes revolved around selecting and purchasing DVDs from retailers, as well as operating the warehouses. The delivery process involved several steps, warehouses opening at 4:00 a.m., as employees started unpacking and examining returns. New DVD orders were packed, presorted by zip codes in sorting machines and shipped during the afternoon. The company's focus on fast processes made it possible to ship an order within the next day after receiving it. Continuous process

<table>
<tr>
<td rowspan="2">Key Partners

U.S. postal service

DVD player manufacturers such as Sony and Toshiba</td>
<td>Key Activities

Selecting the movie offer and strengthening the value proposition

Warehouse management and continuous process improvement

Website operation and development</td>
<td rowspan="2">Value Proposition

State-of-the-art home movie experience due to DVD technology

Convenient movie rental with home ordering and delivery

Fast delivery and convenient return via direct mail

Substantial palette of movies</td>
<td>Customer Relationships

Self-service via the Netflix website</td>
<td rowspan="2">Customer Segments

Online-literate, convenience-seeking U.S. residents</td>
</tr>
<tr>
<td>Key Resources

DVD library of around 900 titles

Warehousing and distribution center</td>
<td>Channels

Company website (for customer registration, ordering and rating)

Direct mail (for delivery and return)</td>
</tr>
<tr>
<td colspan="3">Cost Structure

DVD acquisition costs

Handling costs (packaging and mailing costs)

Warehouse operation costs</td>
<td colspan="2">Revenue Streams

Pay-per-rental revenue model</td>
</tr>
</table>

Fig. 11.1 Overview of the Netflix business model at the time of the company's launch. Source: own illustration, based on Osterwalder and Pigneur (2010)

improvement was a major goal, each employee being expected to make individual contributions to process enhancement.

Key Resources For competing with the giants of the video rental industry, Netflix needed more than adequate processes and an innovative distribution logic, namely a vast product range. At the time of its market introduction, it started with a selection of around 900 DVDs. In order to enable DVD storage and distribution, Netflix initially relied on a distribution center in San Jose, California. Rather than being automated, the company's core activities at the distribution center were mainly accomplished by employees. This was largely because processes were still evolving and human power was, in those conditions, fast, flexible and less costly. In order to ensure that warehouse employees understood the service from a customer's perspective, and that they were able to suggest improvements, each employee received a subscription to the Netflix service.

Key Partners Netflix's main partner was the U.S. postal service, making next day deliveries possible. Netflix realized that its success depended on the success of the DVD industry on a whole. Thus, the company started a symbiotic cooperation with Sony and Toshiba, offering a free Netflix service with each DVD player sold. This significantly increased traffic to the Netflix website and boosted the company's popularity.

Customer Segments The DVD-by-mail business addressed innovative customers looking for a more convenient movie rental option. The potential customer base was restricted to people living in the U.S., since Netflix was operating exclusively on the domestic market. Netflix also heavily relied on its customers for marketing purposes, as word-of-mouth was the most significant marketing channel in the company's early days.

Customer Relationships Initially, the customer relationship can be described as self-service, as customers selected and ordered DVDs via the Netflix website, without having any personal interaction with company employees.

Channels Netflix relied on a two-channel strategy: while customer registration, movie ordering and rating were all performed online, product delivery and return were conducted via traditional mail. At the core of the pioneering business model of Netflix lies this two-channel innovation, making use of the online medium. The other value proposition elements, for instance the large movie variety or the convenience of ordering at any time of the day, are derived from this channel innovation.

Revenue Streams During its first two years on the market, the company experimented with the industry's traditional revenue generation model, operating as a pay-per-rental service, similarly to its brick-and-mortar competitors. For a

70-day rental, Netflix charged a set fee of 4 US $ per rented DVD, with the price for shipping amounting to around 2 US $. Customers additionally enjoyed decreasing prices for renting more than one DVD.

Cost Structure The main cost factors of the DVD-by-mail business were the costs for DVD acquisition, postage for shipping to customers and return, as well as the handling costs of the distribution center. The costs for DVD acquisition were fixed and independent from the number of consequent rentals, which was helpful for Netflix. This was possible due to the U.S. First Sale Doctrine, which allowed the buyer of a copyrighted work to subsequently sell and rent the material. Thus, Netflix was able to rent out bought movies without additional permission from the studios. Sending movies per mail only became possible due to the technological innovation of the DVD. Because of the much smaller size and lower weight of a DVD compared to a VHS, it was affordable and lucrative to mail DVDs for rental. For instance, while the postage costs for a VHS were 4 US $, these amounted to 37 cents for a DVD sent to the same destination (Niederhoff n.d.; Mason 2002).

11.4 Current Business Model

Figure 11.2 depicts the main changes in the business model during the past nearly two decades since the company's launch. The developments are subsequently explained hereinather.

Particularly the launch of the streaming service (video-on-demand service) led to changes in several business model blocks: partnerships, cost structure, key resources and key activities faced the biggest changes, and gained importance compared to the former business model. Figure 11.3 provides an overview of the current business model. The aspects highlighted in grey did not undergo major changes across time.

Value Proposition Since its launch, Netflix redefined its value proposition twice. First, the company switched to a subscription model in 1999, providing customers unlimited DVD rentals for a monthly fee, without due dates or additional late fees. Users were able to rent an unlimited number of DVDs per month, but only a limited number at a time. Hereby, Netflix introduced a form of flat rate for DVD rentals. Second, in 2007 Netflix did what it considered the next logical move, by launching its online movie streaming service. Furthermore, as an add-on to its value proposition, the company began to offer subscribers access to TV shows. Today, Netflix still operates the ebbing DVD-by-mail business in the U.S. market, while it offers streaming services in over 50 countries. Within its streaming business, the company provides movies and TV shows for subscribers anywhere, anytime and without commercials.

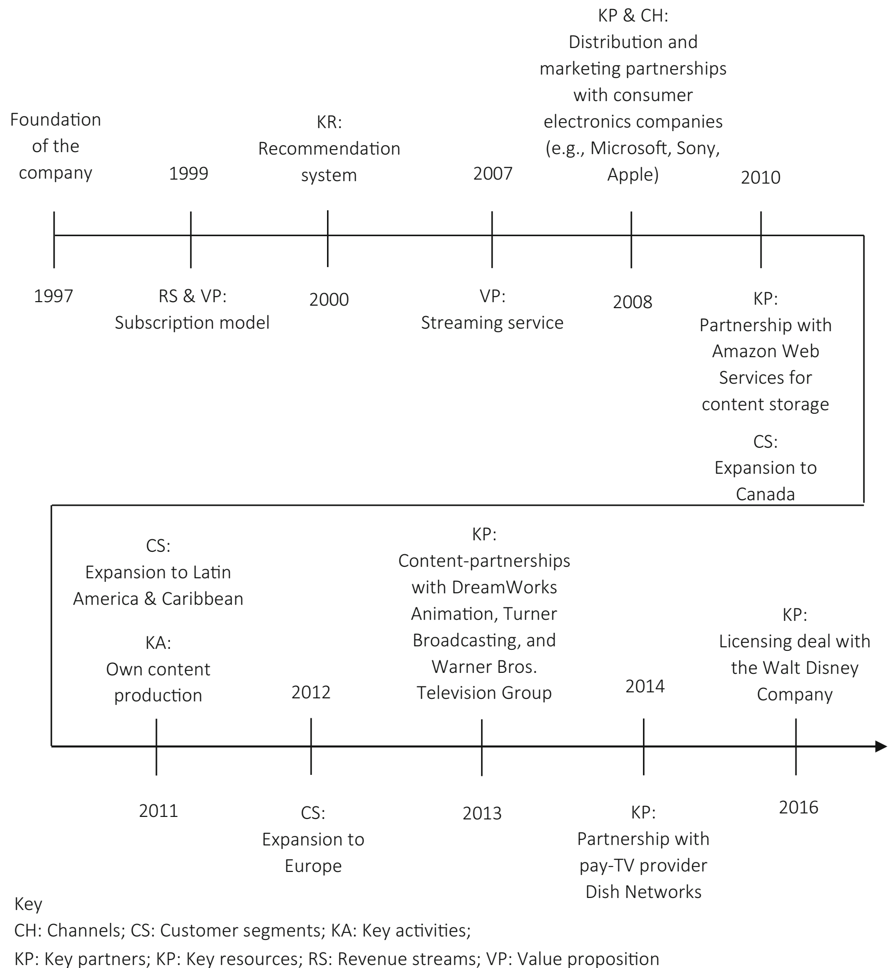

Fig. 11.2 Main changes in the business model of Netflix across time. Source: own illustration

Key Activities Today, the Netflix DVD-by-mail business still relies on efficient handling operations and on-time delivery. However, as streaming represents the main pillar of the company, and DVD-by-mail solely became a minor business, the following activities relate to streaming: The company's video-on-demand offer relies on two key activities: providing content and improving the platform. Netflix provides value via its own website, which acts as a content delivery platform. The company dedicates effort for improving audio and video quality, reducing re-buffering times, and ensuring permanent availability of its service to customers, particularly in peak times.

Key Partners	Key Activities	Value Proposition	Customer Relationships	Customer Segments
DVD-by-mail U.S. postal service Streaming Consumer electronics companies launching new products Content providers, such as DreamWorks Animation, TimeWarner Company, or the Walt Disney Company Cloud service providers, such as Amazon Web Services	DVD-by-mail Selecting the movie offer and strengthening the value proposition Warehouse management and continuous process improvement Website operation Streaming Ensuring permanent availability of a wide range of movie titles Producing and broadcasting original content	DVD-by-mail State-of-the-art home movie experience due to DVD technology Convenient movie rental with home ordering and delivery Eschewal of late fees DVD-flat rate Streaming Watching content anywhere, anytime without commercials	DVD-by-mail Self-service via the website Streaming Self-service via the website Additional personal assistance via telephone and online	DVD-by-mail Convenience-seeking U.S. residents Streaming International streaming customers from North and South America, Europe and Australia Mass market comprising both cineastes and bargain hunters
	Key Resources		**Channels**	
	DVD-by-mail Extensive DVD library and automated distribution centers Streaming Extensive database of movie titles and a global network for content delivery		DVD-by-mail Company website and direct mail Streaming Online channels (whether via website, app, or additional devices such as set top boxes)	

Cost Structure	Revenue Streams
DVD-by-mail DVD acquisition costs and handling costs (packaging and mailing costs) Streaming Licensing expenses and expenses for cloud storage services and streaming	DVD-by-mail & Streaming Monthly subscription model

Fig. 11.3 Overview of the current business model of Netflix (the aspects highlighted in *grey* did not undergo major changes across time). Source: own illustration, based on Osterwalder and Pigneur (2010)

Licensing content from broadcast networks, cable network providers and studios represents one of the key activities, alongside with original content creation. Interestingly, in contrast to the DVD rental business, the First Sale Doctrine does not apply to streaming, implying increased costs. Moreover, for each market in which Netflix operates, it requires licensing agreements with multiple movie

distributors. For differentiation reasons, the goal is to secure exclusive content rights against other streaming providers. Licensing agreements only last for a limited time: when license renewal is necessary, Netflix evaluates which titles are being viewed most often, and only in case of frequent streaming the license for the specific title is renewed. In addition, Netflix also successfully produces and broadcasts original content, such as the TV shows "House of Cards" or "Orange Is the New Black".

Key Resources Within the DVD-by-mail business, Netflix relies on its enormous DVD library and on its over 30 distribution centers in the U.S. DVD delivery is automated, machines and the distribution centers now being the key resources. On the other hand, the streaming business relies on the database of content available for streaming. Content streaming is secured by the content delivery network Open Connect, which is a server system globally storing content nearby customers. Servers have a capacity of about 100 terabytes of data, storing between 10,000 and 20,000 movies (Niccolai 2014). Moreover, the online platform is still an essential resource for the company's success. In order to attract and retain customers, Netflix relies heavily on recommendation technology, first introduced in 2000. Additionally, Netflix patented its rating algorithms and its movie queue, which saves movies selected by customers for later viewing.

Key Partners As in 1997, the U.S. Postal Service is still the key partner for the DVD-by-mail business. Within the streaming business, Netflix heavily relies on content providers such as DreamWorks Animation, TimeWarner Comapny, the pay-TV provider Dish Networks, or the Walt Disney Company. To support outbound streaming traffic, Netflix partners with internet service providers (ISPs) such as COX or Verizon. ISPs ensure trouble-free broadband access, and guarantee a high audio and video quality with reduced buffering times. Netflix also partners with Amazon Web Services (AWS) since 2010, in order to provide a globally seamless service. AWS provides storage and servers, which enable customers to stream Netflix content anywhere and anytime. In order to make streaming available to the broad array of different devices supported by Netflix, such as Playstation, Xbox, Apple devices, smart TVs, tablets, smartphones and PCs, partnerships with consumer electronic companies are required. This device variety allows the company to substantially increase customer numbers.

Customer Segments According to Falter and Thompson (2009), Netflix serves three customer segments: while the first one is solely composed of U.S. customers enjoying free home DVD delivery, the second comprises cineastes, and the third comprises bargain hunters. Customers of the DVD business continue to decrease, from almost seven million in 2012 to less than six million in 2014. In its streaming business, Netflix focuses mostly on younger generations, since these are not only familiar with online streaming, but also use a broader variety of devices, such as smartphones or tablets. Device variety increases streaming likelihood, regardless of the individual's location. With the start of the company's international expansion in

2010, Canada, Latin America or Germany also became part of the customer base. However, as of 2014, among the top five Netflix user countries, the U.S. ranks number one, with 67.2 % of total Netflix customers, followed by Canada with 4.6 %, and Mexico with 4.0 %. During the same year, the streaming service reported more than 63 million members, an increase of more than 23 % in comparison to 2013. International streaming members increased from almost 11 million in 2013 to 18 million in 2014. During the same one-year period, domestic streaming members increased from 33 to 39 million.

Customer Relationships Although customers still order DVDs via the company's website, and stream content online without direct interaction with Netflix employees, the company makes an effort towards establishing direct customer contact, by providing a hotline as well as the option of live chat with its service staff. Personal assistance and support are designed as a radar for better observing not only customer behavior, but also emergent problems with the platform. Also, by recording and analyzing customers' viewing behavior and search queues, the company is able to predict and recommend movies that customers are likely to enjoy. Thus, customer relationship management is another crucial activity for customer retention, and for differentiation from imitators.

Channels By introducing video-on-demand, Netflix innovated its business model by employing a channel innovation—while the internet was initially solely a channel for communication and ordering, it became the company's distribution channel as well.

Revenue Streams As the pay-per-rental model in the DVD-by-mail business was unsuccessful, the company switched to the subscription model in 1999, which was applied to both the DVD-by-mail and later on to the streaming service. Currently, Netflix offers three types of streaming membership plans, starting from 8.99 US $ per month in the U.S. Within the same domestic DVD segment, Netflix offers subscription services widely varying from about 5 US $ to over 40 US $ per month. In 2014, the company reported sales of over 5,504 million US $, resulting in 266 million US $ in net income. Despite the sustained increase in turnover shares coming from international streaming, in 2015, this segment reported losses. Netflix attempts to mitigate losses by moderate increases in monthly membership fees, continuing to pursue an add-free value proposition.

Cost Structure In its DVD-by-mail business, Netflix manages to keep postage costs low, by eliminating Saturday deliveries and employing a reduced delivery speed. In the streaming business, content costs form the largest cost block, and are increasing. Between 2010 and 2013, Netflix's streaming content obligations surged by seven times. The high costs within the streaming business result from expenses for content licensing, as the variety of movies and series is one distinguishing feature from competitors. Content licenses have a long-term, fixed cost nature with

license windows ranging from 6 months to 5 years. Conditions of licensing agreements also greatly vary from flat rates for unlimited streams, rates according to a service's overall subscribers, and finally to rates per stream.

11.5 Industry Outline and Future Perspectives

According to the market research firm MarketsandMarkets (2015), the global video-on-demand business is likely to grow from $ 25 billion in 2014 to over $ 61 billion in 2019. This incredible market surge attracts more and more competitors, increasing the pressure on incumbents. For consumers, this development has a two-sided implication: while the good news is that prices decrease while provider numbers increase, the bad news is that it becomes difficult to find a single provider, which offers access to all movies and series that a customer would like to watch.

Facing intense competition, Netflix competes on price, exclusivity, content range, and user experience in terms of personalization and compatibility with different devices. According to the company, its main competition originates not only from subscription streaming networks and pay-per-view streaming networks, but also from the DVD and video game segment, as well as from movie piracy, the latter being primarily an issue in developing nations. Netflix divides its main competitors into two groups: competitors for entertainment time and spending form the first group, so-called competitors-for-time. Competitors, which bid against Netflix for licensed material form the second group of competitors-for-content. This second group represents networks that try to secure exclusive content rights for their business, while bidding for licenses against each other. The competitors-for-content also represent the more critical group. Examples in this second group are Amazon Prime Instant Video, Hulu, Now TV, Viaplay, Clarovideo, and other emerging cable and broadcast networks. Nevertheless, the biggest long-term competitor-for-content remains HBO, one of the best-known pay-TV providers worldwide. HBO does not only bid against Netflix for licenses, but disposes of a global reach and a high technological capacity, leading Netflix to undertake high investments in content, technology, and marketing. As of 2014, Netflix managed to beat HBO in terms of subscription revenues, while it has not yet managed to reach the same profitability as the pay-TV giant.

Through its international expansion, Netflix faces competition from a multitude of local streaming providers. One example is Shomi by Rogers and Shaw, launched in 2014 by two Canadian telecommunications companies. For a similar subscription fee as Netflix, Shomi has a similar value proposition: a library of about 340 TV series and 1,200 movies, which can be watched on multiple devices. However, due to a slow streaming speed and limited availability solely to Rogers and Shaw customers, the service currently is less attractive than Netflix (Darbyshire 2014). Since Netflix becomes available in more European countries, the streaming providers in this region sharpen competition. Taking the German market as an

example, main competitors are Maxdome, Watchever, Videoload and Videobuster. While Maxdome and Watchever exclusively operate on a video-on-demand subscription model, Videobuster also offers a DVD-by-mail service. Videoload, powered by Deutsche Telekom, offers digital content based on a pay-per-rental and sales model. In this highly competitive landscape with similar business models, new entrants with limited financial resources find it difficult to finance the licenses for streaming content. Netflix, and other current video streaming companies are trying to create as many lock-in effects for their customers as possible, ranging from the variety of devices on which content can be streamed, to bait-and-hook offers, such as providing several initial months of free streaming.

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12 Passion for Music: The Case of Spotify

Spotify was founded in 2006 and launched its online platform in 2008. At the time, the digital music industry did not have one particular type of business model, but consisted of a variety of distinctive ones, all attempting to reach the same customer group of online music fans. The established market players were various music streaming services, internet radio stations, and peer-to-peer platforms.

The powerful changes in the music industry since the launch of the MP3 format in the early 1990s brought both benefits to consumers, and angst to the industry players, since music became extremely easy to share. The major record companies[1] suffered huge losses, as a series of illegal file sharing websites, also referred to as peer-to-peer-systems, emerged. Napster is one such example. Founded in 1999 as the first file-sharing service, which allowed non-commercial music trade, Napster reached about 60 million daily users at its peak in 2001. The company had to close down the same year, as it was sued by the music industry for violating copyright and related rights. In 2001 and 2002, the first alternatives to illegal file sharing materialized: iTunes and Rhapsody. Apple's iTunes was a free platform, where customers could buy songs or albums in order to listen to these on a computer or an iPod. Rhapsody chose to follow a different approach, its revenue model being based on a monthly fee, allowing users unlimited access to the platform's library.

Another business model emerged in 2005: Pandora Radio. The service allowed its users access to a completely customized online radio experience. Consumers were able to create a list of artists and songs of their choice, allowing Pandora to start and stream similar titles, based on about 450 distinct musical criteria. Although listeners could not directly choose titles, the concept worked well, as they enjoyed the element of surprise regarding upcoming songs.

From 2007 to 2010, a number of different music services entered the digital music market, out of which, Deezer and eMusic are two of the best known

[1] Among these were EMI, Polygram, Sony BMG Music Entertainment, Universal Music Group and Warner Music Group.

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on-demand services, besides Spotify. Deezer, a French provider, was the first legal on-demand music streaming service, offering its users free music, and the possibility of uploading own music and creating individual playlists, all based on a freemium revenue model. The business model of eMusic worked in a slightly different way. Users did not pay a monthly fee, but purchased a set number of downloads each month. All these streaming services can be split into three broad categories: subscription model (Rhapsody and initially Pandora), single item purchase model (iTunes, eMusic) and freemium model (Deezer).

Looking at the emergent business models from almost a decade ago, it becomes clear that Spotify was part of a group of evolving businesses, which experimented with different revenue logics and customer approaches. The business models based on subscriptions and freemium offers addressed an audience with shifting preferences, from owning music to being able to access music conveniently and fast. Although Deezer preceded Spotify as the first freemium music provider, the latter distinguished itself through the variety in titles and playlists, usage simplicity, close contact to social media and commitment towards long-term growth.

12.1 Founders

Spotify was founded by Daniel Ek and Martin Lorentzon, with Daniel Ek playing a prominent role in introducing and developing the company. Mark Zuckerberg famously commented, "[Ek] clearly is very forward-thinking on where he wants to go. He's very clear on the things he wants for the product and what he doesn't want". Born in Stockholm in 1983 in a family of musicians, Ek writes and plays music himself. Furthermore, he was regarded as a computer prodigy, because he was able to earn several thousand pounds a month from designing and hosting websites, while still in school (Lynskey 2013). After dropping out of an engineering course at Stockholm's Royal Institute of Technology, he founded his first company, Advertigo, in 1997. Martin Lorentzon had also been actively involved in the startup scene for several years before cofounding Spotify. He is said to have an eye for spotting emerging market trends and setting up the right team to turn his ideas into reality. Lorentzon founded Tradedoubler, which acquired Daniel Ek's company, Advertigo, in 2006. The two entrepreneurs together set up their next venture, Spotify, during the same year.

12.2 Market Demand

To Ek, the music industry's piracy issue was a challenge awaiting a solution. Even though the number of people listening to music reached a new peak in history, the industry was highly concerned about piracy. Although new business models were emerging, these were not quite capable of providing music as customers demanded it—fast, simple, for free and with a wide geographical reach. Ek's belief was that

music consumers were willing to do the right thing and respect intellectual property rights, but only if it was just as rewarding and much less of a hassle than doing the wrong thing, illegally downloading music (Lynskey 2013). What worked in favor of Spotify was Ek's principle that a successful business adapts to its customers, and does not urge them to change their own behavior. He once noted that "Spotify subscribers don't pay for content—they can get that for free through piracy—they pay for convenience".

Overall, music consumers demanded increased music access, rather than ownership. Spotify recognized the major disadvantages of the commonly used music listening services and turned these into its own advantages: iTunes for instance required customers to pay for each individual song and to synchronize songs among several devices. Online radios such as Pandora did not give the listener a say in the choice of songs. Listeners were able to choose the genre, but in the end had little influence on the songs played. Spotify fulfilled these unmet customer needs, by offering a large music palette, from which customers could freely choose. Even though the idea was not a wholly new one (with a freemium business model such as Deezer), Spotify was faster, easier to install and use, and more social than all previous platforms. It distinguished itself through the vastness of its music libraries and its deep integration into social media. Spotify allowed users to create and seamlessly share playlists, as well as to exchange music on social networks, such as Facebook and Twitter. Furthermore, Spotify made it easy for third-party application developers to create apps that, once integrated on the platform, offered users increased possibilities for discovering and sharing music.

12.3 Pioneer Business Model

The following section explores Spotify's business model at the time of the platform's launch in 2008, as summarized in Fig. 12.1.

Value Proposition Spotify's initial value proposition was simple and fast access to an incredibly vast musical library. This was made possible by employing a freemium (or two-tier subscription) model, consisting of a free ad-supported version, and a premium add-free version based on a monthly fee.

Key Activities For Spotify, it was of primal importance to convince major record labels of the future potential of its business model, and to negotiate practicable deals. The company's market success was based on offering customers a superior and wider palette of music titles as compared to competitors. Other than securing content and developing a feasible and easy-to-use online platform, promoting its unique business model was just as vital, representing a third key activity.

<table>
<tr>
<td rowspan="2">Key Partnerships

Major record labels and rights holders

Investors and venture capital groups</td>
<td>Key Activities

Negotiation for licensing contracts with record labels and rights holders

Platform development and improvement</td>
<td rowspan="2" colspan="2">Value Proposition

Simple and fast online access to a vast musical library</td>
<td>Customer Relationships

Automated online customer relationship, with personalization options

New users could join only via invitation from a current user</td>
<td rowspan="2">Customer Segments

Three-sided customer base:
- music and technology enthusiasts
- artists and record labels
- advertisers</td>
</tr>
<tr>
<td>Key Resources

Licensing agreements

IT capabilities and know-how for platform development and music content provision</td>
<td>Channels

Company-owned website</td>
</tr>
<tr>
<td colspan="3">Cost Structure

Royalties to record labels and rights holders (around 70% of total costs)

Bandwidth and additional operating costs</td>
<td colspan="3">Revenue Streams

Subscription payments from premium users

Advertising fees</td>
</tr>
</table>

Fig. 12.1 Overview of Spotify's business model at the time of the company's launch. Source: own illustration, based on Osterwalder and Pigneur (2010)

Key Resources Several resources made Spotify's business model possible: First, licensing agreements with rights holders[2] and with record labels allowed content provision. Second, the online platform ensured not only content delivery, but also speed and ease of access. The distinguishing mark of Spotify's platform laid in the combination of two different approaches for ensuring scalable music listening, partly streaming music from a central server, and partly using peer-to-peer (P2P) technology. Spotify utilized each individual computer, on which it was active, as a part-time server. Additionally, instead of "assembling" a song after full download, Spotify streamed each part of a track in sequence, leading to a fluent and fast music experience.

Key Partners Spotify relied on the support of the dominant rights holders and record labels in the market, such as Universal Music Group, Sony Music Entertainment, EMI Music, and the Warner Music Group. Without the support of these parties, the advent of Spotify's business model would not have been possible. Additionally, substantial financial backing came from private investors and venture

[2]Rights holders include labels, publishers, distributors, and independent artists themselves.

capital groups. For instance, several venture capital firms invested over $ 21 million in 2008, during the first financing round of Spotify.

Customer Segments In order to make the freemium business model work, Spotify relied on a three-sided customer base: music and technology enthusiasts, artists and music labels, as well as advertising companies. Without the last customer segment comprising of advertisers, the freemium business model would have not been possible.

Customer Relationships For ensuring a prime customer experience and long-term customer binding, Spotify introduced substantial personalization options, particularly with respect to music choice and selection. Additionally, in order to attract new customers, the company permitted new users to join the platform only via invitation by a current user.

Channels Spotify initially employed a single platform as channel for music distribution and customer communication. There have been significant developments to this initial state, which are discussed in the following section.

Revenue Streams Spotify created value by bringing together record labels and listeners, without itself holding music ownership. Since the beginning, the company had two revenue streams: subscription payments from premium users and advertising fees. Revenues generated from subscriptions were double the amount of revenues from advertisements. As a result, the company's long-term goal was to convert as many free users as possible into premium subscribers.

Cost Structure Spotify's largest cost blocks comprised of licensing expenses or royalties paid to rights holders, as well as bandwidth and additional operating costs. In 2008, Spotify's cost of sales amounted to 0.43 million €, about 70 % of which originated from licensing expenses to rights holders.

12.4 Current Business Model

Figure 12.2 provides an outline of the main changes in Spotify's business model over the past decade. It is noteworthy that its business model did not radically change, rather the company enhanced its value proposition and established promising partnerships with enterprises from diverse industries.

Music streaming, which evolved from addressing a niche audience to addressing the mass market, substantially changes music listening preferences and habits. The following section discusses Spotify's contribution to the changing industry landscape, alongside its current business model, as visualized in Fig. 12.3.

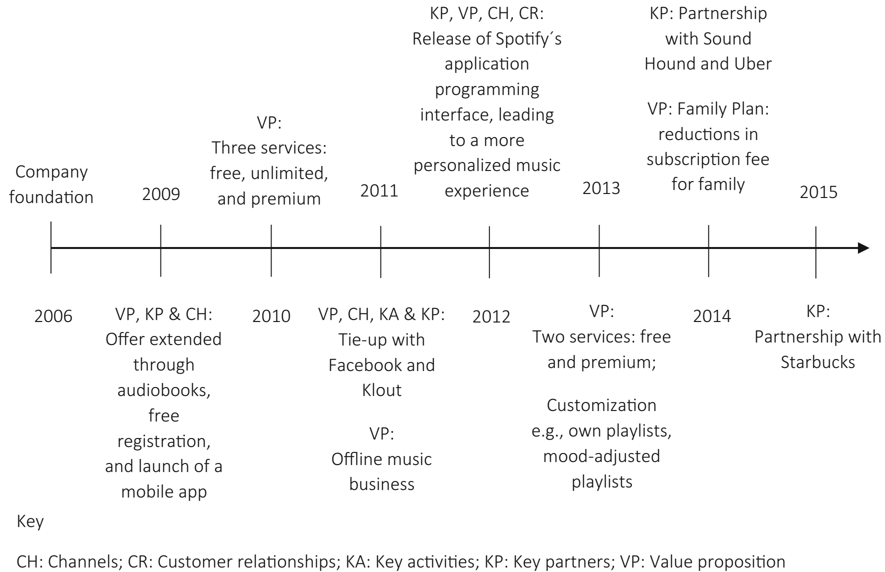

Fig. 12.2 Main changes in the business model of Spotify across time. Source: own illustration

Value Proposition In some geographical regions, Spotify's initial value proposition for non-paying customers was only a fraction of the value proposition for paying ones. In some countries, listeners using the free Spotify version were limited to a number of hours of music listening each month, and were only allowed to replay a song for a few times during the same period. This strategy was, however, ill-suited for a start-up facing increased competition. Spotify soon understood the frustrating effect of time limits on its non-paying customers, resulting in their reluctance to subscribe to the service. In turn, the company eliminated time restrictions and slightly increased the number of advertisements to be played on its platform. In essence, Spotify's initial value proposition of on-demand music access did not change over time, yet the company went a long way to improve it, for instance through add-ons. Since 2009, the value proposition was extended by providing audiobooks, a mobile app allowing multiple devices for music listening, and a family subscription plan, which made several individual subscriptions among family members obsolete. Additionally, Spotify increased its efforts to personalize the music experience, for example through mood-adjusted playlists. Interestingly, the value proposition extended to full-track downloads since 2009, enabled by Spotify's cooperation with the company 7Digital. In 2011, Spotify quit this partnership, in order to operate the pay per download service independently, which ensures a better competitive position in the offline music business. By providing iPod-compatible downloadable music tracks, Spotify also became a stronger competitor to Apple's iTunes.

<table>
<tr>
<td rowspan="2">Key Partnerships

Major record labels and rights holders

Investors and venture capital groups

App developers

Partnerships with established companies (such as Starbucks, Uber, SoundHound) for increasing customer reach</td>
<td>Key Activities

Ensuring music content rights and delivery via multiple channels

Analyzing customer preferences, and building a world-class recommendation system</td>
<td rowspan="2">Value Proposition

Simple and fast online access to a vast musical library

Free and premium accounts

Family subscription

Increased personalization (through apps) and social interaction (through partner websites)</td>
<td>Customer Relationships

Automated online customer relationship, with personalization options

Encouraging prosumers</td>
<td rowspan="2">Customer Segments

Three-sided customer base:
- music and technology enthusiasts
- artists and record labels
- advertisers</td>
</tr>
<tr>
<td>Key Resources

Licensing agreements

IT capabilities and know-how for platform development and music content provision</td>
<td>Channels

Company-owned platforms (both desktop and mobile)

Partner websites, such as Facebook</td>
</tr>
<tr>
<td colspan="3">Cost Structure

Royalties to record labels and rights holders (around 70% of total costs)

Bandwidth and additional operating costs</td>
<td colspan="2">Revenue Streams

Advertisement fees (about 10 %)

Subscription fees (about 90 %)</td>
</tr>
</table>

Fig. 12.3 Overview of Spotify's current business model (the aspects highlighted in *grey* did not undergo major changes across time). Source: own illustration, based on Osterwalder and Pigneur (2010)

Key Activities Besides ensuring music content rights and delivery via multiple channels, Spotify's key activities revolve around analyzing customer preferences. The company attempts to build the best music recommendation service worldwide, by combining computing power and human skills. Its efforts in this area are reflected in recent acquisitions, such as that of the music intelligence company Echo Nest.

Key Resources Spotify's key resources remain its platform and licenses from record labels and from other rights holders. As regards employees, their numbers grew substantially in a six-year period, from 23 in 2009 to over 1,300 in 2015, following the company's international expansion and value proposition diversification.

Key Partners Beside music rights holders, investors remain Spotify's key partner group. For instance, the company raised over half a billion US $ between 2008 and 2015, through seven major financing rounds. Spotify entered several partnerships with companies from various industries, primarily in order to increase its user base. The most prominent partnership is the one with Facebook, which started in 2011.

Spotify is integrated within the social network's platform, allowing Facebook users to stream music directly from the Facebook page and share songs and playlists with Facebook friends. Moreover, in order to attract new members and media attention, Spotify partnered with Klout in 2011, a website that ranks users according to their online social influence. Additionally, cooperations were started with well-known names such as Uber, SoundHound, or Starbucks. These new partnerships improved the value proposition primarily in terms of personalization and social interaction. Also essential for the growth of streaming services are partnerships with telecommunication companies. For example, in the German market, Deutsche Telekom, which previously operated an own music download service, became Spotify's key telecommunications partner. As Spotify released its own application-programming interface (API) in 2012, app developers became an additional group of partners, as these create complementary platform applications. Such applications invite users to discover new features and to share their experience with friends, which in turn leads to an increasingly personalized music experience. For instance, the application Moodagent enables users to search for appropriate music to one's mood. Additionally, applications such as The Guardian, Rolling Stone or Last.fm provide personalized recommendations based on previous music streaming behavior.

Customer Segments Spotify still serves three customers segments: music enthusiasts, artists and music labels, as well as advertisers. With regard to the first customer group changes can be observed: while in 2010 the number of free users was 15 times higher than the number of paying users, the ratio steadily decreased to seven in 2011, to five in 2012, and to three in 2014. At the beginning of 2016, Spotify had 30 million paying users, and over 70 million free users in around 60 countries across the world, the largest of which, by subscriber numbers, are the U.S. and the UK.

Customer Relationships By focusing on individualization and personalization, Spotify fuels an inter-industry shift from consumers to prosumers, who simultaneously consume, produce and distribute media. The Web 2.0 logic and the apps, which accompany the Spotify platform, make this possible. Users are no longer part of an anonymous mass, but become active participants on Spotify's own platform and on those of its partners.

Channels More than half of Spotify users stream music via mobile devices, such as smartphones or tablets. Additionally, since Spotify cooperates with social media platforms, it is able to reach users not only through its own channel, but through the channels of its media partners, such as Facebook. Some industry analysts refer to the dramatic increase in user numbers as "the Facebook effect".

Revenue Streams Interestingly, the company's advertising-related revenues currently only make up for around 10 % of its revenues, although it has over twice as many ad-sponsored users as premium ones. If a song is played by a premium

subscriber, the record label receives a higher fee from Spotify, than when the same song is played by an ad-sponsored Spotify user. For these reasons, the company's target is to increase the number of paying users. They do not only provide higher and more stable revenues for Spotify itself, but also for record labels, which in turn ensures a better bargaining power for Spotify. While the company's total revenues increased by 45 % up to 1.08 billion € from 2013 to 2014, this could still not compensate for a loss in amount of 165 million € in 2014.

Cost Structure Licensing costs are not necessarily the reason for Spotify's yearly losses, as this cost block remained proportionately stable, amounting to about 70 % of revenues in 2014. The losses can be explained by the high investments in service development, and by an eager international expansion strategy. The company accepted this trade-off, following its mission statement of making music available for an assortment of markets, instead of aiming only for short-term profits in mature, flourishing markets.

12.5 Industry Outline and Future Perspectives

During the first half of 2015, 60 % of the music industry revenues in Germany comprised of physical sales, mostly CD sales. Music downloads account for about 18 % of the revenues in this period, while the burgeoning streaming subscriptions account for almost 13 %. Thus, although CD sales still generate almost five times the revenue of streaming subscriptions, the trend towards streaming is rapidly gaining terrain. This is even easier to spot on a global scale, where CD sales only account for 46 % of 2014's revenues, another 46 % being gained through digital music services (downloads and streaming) and 8 % through performance rights and synchronization (e.g., advertising, film and game soundtracks).

Edgar Berger, the CEO of Sony Music, speaks of a threefold transition currently underway in the music industry: from physical to digital, from PCs to mobile and from downloads to streaming. He also mentions that the business model of streaming subscriptions is seminal to the music industry. In a similar vein, Stu Bergen, Warner Music's president, talks about his company's determination to experiment with new revenue sources and business models. This can also be recognized in the general competitive situation faced by Spotify. Ever since the platform's launch in 2008, competitor numbers have increased vastly. Current competitors can be divided into six categories: interactive personalized streaming services (on-demand), cloud-based music services, piracy file-sharing sites, video streaming platforms, non-interactive personalized web radios and passive internet radios or webcasters. In the following, each will be briefly discussed.

Deezer, BeatsMusic, Xbox Music, Grooveshark, Rhapsody, Youtube MusicKey, Napster, Aldi Life Musik, PlayStation Music, Musicload, rara, Rdio, simfy, and many more belong just like Spotify, to the category of interactive personalized streaming services (on-demand streaming services). All of these offer customers a

music library with unrestricted usage, based on variations of freemium, ad-supported revenue models. Interestingly, the retail discounter Aldi also engages in direct competition with Spotify, by offering its own discount streaming service Aldi Life Musik in cooperation with Napster. Whereas customers pay a monthly fee of around 9.99 € at Spotify, Apple, or Napster, Aldi offers its streaming service aligned with its discount business model at the bottom price of 7.99 € per month. Many industry analysts view the discounter's involvement as positive, highlighting Aldi's capacity of speeding up the transition towards music streaming on the mass market.

Cloud-based music services, such as Amazon Cloud Player, Google Play, and iTunes Match are a second group of competitors to Spotify. In general, these services act as online music storage options. Each platform offers its users a certain storage capacity, on which they can upload own music, buy additional songs and albums from the respective music store, and listen to music via several devices. In this way, Amazon, Google and Apple earn revenues from music sales and storage capacity.

Further, the ever-present competitors are piracy file-sharing or peer-to-peer sharing sites. Some of the most commonly known ones are the Pirate-Bay file-sharing hub, Shareaza and Morpheus.

Video streaming platforms refer to websites such as Youtube, Vevo, tape.tv, and Myvideo. There are essentially two business models in this category: The first one—an example of which is Youtube—allows its users to upload own content or discover original content without registration, whereas the second business model provides licensed music videos, which are not user-generated, and where consumers require registration. Both business models are ad-supported. Myvideo combines the two models, offering its users the possibility of accessing original content, as well as uploading own video material.

Non-interactive, personalized web radios, such as Pandora, Last.fm, and iTunes Radio, form the fifth group of competitors for Spotify's business model. The main difference from on-demand streaming services lies in the absence of interactivity, and in the primarily ad-supported revenue mechanism. Still today, passive internet radios and webcasters, including all traditional web radio stations and FM radios represent a sixth, less threatening competitor group. As listeners can only choose the station and not the content played, this represents a non-personalized and one-sided interaction between radio stations and consumers. The business models are either ad-supported or publicly funded.

Spotify is operating in a booming and heterogeneous industry, wherein several business models can be noticed. It remains to be seen, which of these companies, and in particular, which revenue models will win through. An increased number of mergers, acquisitions and cooperations is to be expected for music streaming services such as Spotify, as the companies are searching for increased differentiation from competitors.

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Part III

Service Business Model Pioneers

Democracy in Education: The Case of edX 13

The online learning platform edX is the result of Harvard University's and MIT's dedicated efforts in globally democratizing education. In 2012, when edX was launched, a number of other massive open online course (MOOC) providers started to operate, such as Coursera or Udacity, making edX part of a group of innovators in the MOOC domain.

According to a study from Ambient Insight, in 2011 over $ 35 billion were spent worldwide for e-learning initiatives alone. Resulting from large investments by universities, foundations and private companies, considerable MOOC offers finally started to materialize around 2012, as Fig. 13.1 shows.

Although, in essence, different MOOC providers share the same motivation to offer qualitative education, their business models subtly diverge from one another. Unlike edX, Coursera and Udacity are for-profit organizations. As well, there were initial notable differences regarding the number of partnering universities, and their actual implication in the MOOC offers. For instance, while both Coursera and Udacity were founded at Stanford, Coursera started from the very beginning collaborations with additional partners, such as Princeton, the University of Michigan, and the University of Pennsylvania. Udacity, on the other hand, initially solely relied on Stanford courses.

By the time edX was launched, the MIT had already accumulated over a decade of experience offering lecture notes, exams and course videos on demand via the internet. In comparison to Udacity and Coursera, edX evolved from the long-standing MIT open platform MITx, which in turn based on MIT's first online platform for professors, MIT Open Coursework, introduced in 2001. The roots of edX date more than a decade back from its market introduction, making the platform the pioneer among MOOC providers.

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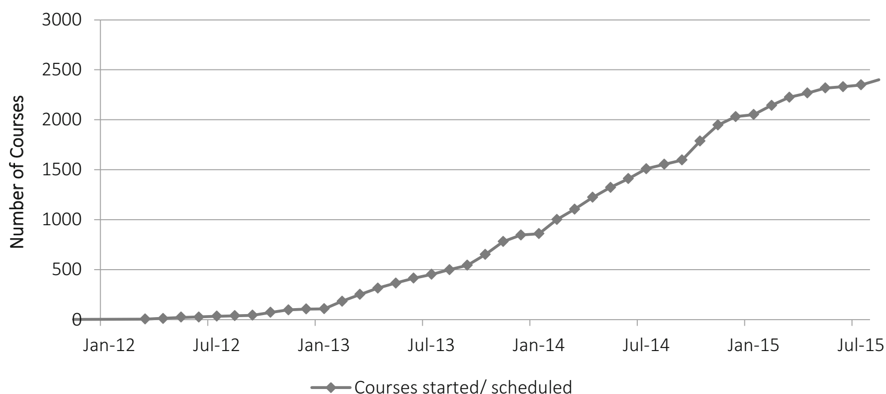

Fig. 13.1 Growth in the cumulative number of MOOC courses started/scheduled between 2012 and 2015. Source: Shah (2014)

13.1 Founders

Jointly founded by the MIT and Harvard University based on open-source technology, edX was designed to provide access to free online courses from both universities to a global audience. Two MIT professors played a major role in this endeavor: L. Rafael Reif and Anant Agarwal.

Before the launch of edX, MIT Provost L. Rafael Reif investigated the potential of online courses by overseeing the development of its predecessor, MITx. After half a decade of research for how to best transform classroom courses into online ones, Reif succeeded in launching MITx in December 2011, laying the foundation of edX. For this open-source learning platform, Reif received the Tribeca Disruptive Innovation Award. In 2012, he was elected MIT president.

Anant Agarwal, a computer science professor at MIT, is the current CEO of edX. With outstanding entrepreneurial skills, Agarwal previously launched several microprocessor companies and describes himself as truly impatient. This can be observed in his drive to get things done, even under challenging circumstances. When the nominated professors to hold the first edX course proposed a delay in the deadline, he chose to hold the course himself together with his team. 155,000 students from across the world took part in this course on circuits and electronics, and 7,157 completed it. In a subsequent TED talk, Agarwal mentioned that if he were to teach the same course each semester at the MIT, he would require 40 years of teaching in order to reach the same number of participating students. For its innovation capacity, former MIT president Susan Hockfield describes edX not only as work in progress, but also as an act of progress in itself.

13.2 Market Demand

According to a 2012 report by the U.S. Department of Education, tuition fees in the U.S. increased sharply during the past two decades. The average tuition fee for a 4-year course at a public university more than doubled between 1991 and 2012, from 3,350 US $ to 8,660 US $. This also applies to private universities, with fees increasing from 16,400 US $ in 1991 to 29,000 US $ in 2012. Due to the rising cost of higher education, the number of students enrolling in America's universities decreased by 2 % in 2012, for the first time since 1999 (The Economist 2014). However, this is not exclusively an American phenomenon. Fees soared in European countries too, such as Great Britain, with an annual tuition increase from 1,650 US $ in 1998 to 13,900 US $ in 2012. Hereby, MOOC providers hope to offer a solution to the market demand for affordable higher education in the U.S. and beyond.

In June 2012, a couple of months after the launch of edX, Udacity and Coursera, there was a total of already 1.5 million registered users on the three platforms. However, the three companies shared the startup characteristic that, although demand for their product had great potential, a clear plan on how to monetize it was lacking. MOOC providers were preoccupied with figuring out how to generate revenues, while simultaneously keeping the basic course access free to participants.

13.3 Pioneer Business Model

The following section analyzes the business model of edX at the time of the company's launch, as illustrated in Fig. 13.2.

Value Proposition From early on, edX aimed to offer education at unprecedented quality, access, and scale. The platform did not only start by offering lectures by two of the world's leading universities, but also improved lecture comprehensibility through integrated exercises with instant feedback, and by allowing participants to pause and replay lectures at any time. The aspects of edX access and scale conjointly refer to its global reach and free availability of MIT and Harvard lectures, derived from Anant Agarwal's vision that online learning is the ultimate democratizer.

Key Activities In order to offer benefits comparable to those of face-to-face lectures, edX had two primary activities: conveying course content and facilitating learning and knowledge accumulation through interactive learning tools. The platform also required constant improvement, not only for enhancing the learners' experiences and the quality of the learning process, but also for advancing collaboration with envisioned further partner universities and institutions.

Key Resources edX particularly benefited from the strong brand of Harvard and the MIT, which considerably eased market recognition. Not only the expert knowledge incorporated into the online lectures, but also the platform design proved to be

<table>
<tr>
<td rowspan="2">Key Partners

Harvard University

Massachusetts Institute of Technology (MIT)</td>
<td>Key Activities

Conveying course content and facilitating learning by employing interactive learning tools

Continuous improvement of the online platform</td>
<td rowspan="2">Value Proposition

Online university education at unprecedented quality, access, and scale</td>
<td>Customer Relationships

Self-service via online platform, with a community approach towards learning</td>
<td rowspan="2">Customer Segments

Learners (university and high school students, career changers, and employees looking to diversify their skills)

Founding universities</td>
</tr>
<tr>
<td>Key Resources

Expert knowledge

Platform design

Brand recognition of Harvard and the MIT</td>
<td>Channels

Communication and distribution channel: own platform</td>
</tr>
<tr>
<td colspan="3">Cost Structure

Maintenance, management, and development of the platform

Content creation

Marketing and administrative costs</td>
<td colspan="2">Revenue Streams

Certificate fees for completed courses</td>
</tr>
</table>

Fig. 13.2 Overview of the business model of edX at the time of the company's launch. Source: own illustration, based on Osterwalder and Pigneur (2010)

key resources. The website ensured an engaging and hands-on experience, in which the learner watched 5–7 minutes of a lecture, and consequently completed related exercises. In addition, the platform allowed learners to receive instant feedback on their answers.

Key Partners The founding institutions, Harvard and the MIT, were the most significant partners of the new venture, providing it with the required financial and human capital, as well as with infrastructure for starting operations.

Customer Segments edX's initial courses in engineering, technology and mathematics globally addressed interested people with access to the internet. Customer segments did not play a role, as online learning was designed to act as a democratizing force. With freely available online courses, edX attracted people with different occupations and lifestyles, from ambitious high school students to career changers, to employees looking to diversify their skills. However, edX facilitates between two groups of customers: learners and universities. Universities, as a second customer group, use the platform as a feedback and learning management system, and as a marketing opportunity. Through edX, the MIT and Harvard got the chance to prove their relevance and social significance, in times of changing requirements towards education.

Customer Relationships edX implemented a community approach to learning, allowing students to collaborate and mutually support each other through discussions and Q&A boards. This also allowed the company to receive valuable information on learning behaviors. By providing educational courses on an online platform, edX's customer relationship can be described as self-service.

Channels The double-sided platform in form of the edX website was the main channel by which universities interacted with learners. edX was also from the very beginning quite active on social media platforms such as Facebook, Twitter or Google+, in order to promote its courses.

Revenue Streams For setting up the edX spin-off, Harvard and the MIT jointly invested 60 million US $. As a non-profit organization, edX is constrained to reinvest any profit surplus into the further development of its course offer. By comparison, edX is the only MOOC provider acting as a non-profit, Coursera and Udacity being for-profit organizations. edX had no access to equity markets, which made financing a challenging task. Besides institutional donations, revenues were mainly captured through value-added services, particularly through certificates for completed courses.

Cost Structure The cost structure of edX largely consisted of the costs for platform management, maintenance, and development, as well as of marketing and administration costs. An additional important cost block were the costs associated with content and course creation.

13.4 Current Business Model

Figure 13.3 depicts the main developments in the business model of edX across time, which will be discussed in the following section.

Value Proposition Sensing that in some aspects, traditional education may be more immersive and effective than online offers, due to the latter's isolating effect on learners, edX started to implement blended learning concepts, which supplement online lectures through in-class interaction. While edX solely offered English-language courses in its beginning, it now offers non-English courses from universities in over 20 countries, including India, France, Hong Kong and Mexico. This significantly improves the platform's value proposition of reinventing access to education. In 2013, edX released the open-source platform Open edX, which powers its website and enables contributors worldwide to improve the platform and to create own MOOCs. Since 2014, edX has diversified its value proposition by providing courses for professional education. These are intended to help organizations improve their members' expertise and skill levels.

Key Activities Besides platform operation and maintenance, partner acquisitions and cooperation management, becoming financially self-sustaining is another key activity. For this purpose, edX is experimenting with alternatives for generating revenues, as will be discussed in the revenue streams section.

Key Resources In order to create value for both learners and partner institutions, edX relies on renowned professors teaching highly demanded courses in fields ranging from architecture to chemistry, to humanities and social sciences. Moreover, the interactive e-learning platform and the edX brand itself, supported by the brands of its partner universities, all remain essential to the company to this day.

Key Partners With an open-source platform in place, edX soon began to extend its partner network by including universities and further institutions. Currently, it collaborates with universities such as the University of California—Berkeley, Boston University, Cornell, Dartmouth, as well as international universities as the Technical University of Munich or the University of Tokyo. Late 2013, the company started a partnership with ten Chinese universities, for developing an own Chinese online education platform. In early 2014, Saudi Arabia became another partner country permitted to use the platform, receive content access and develop own courses

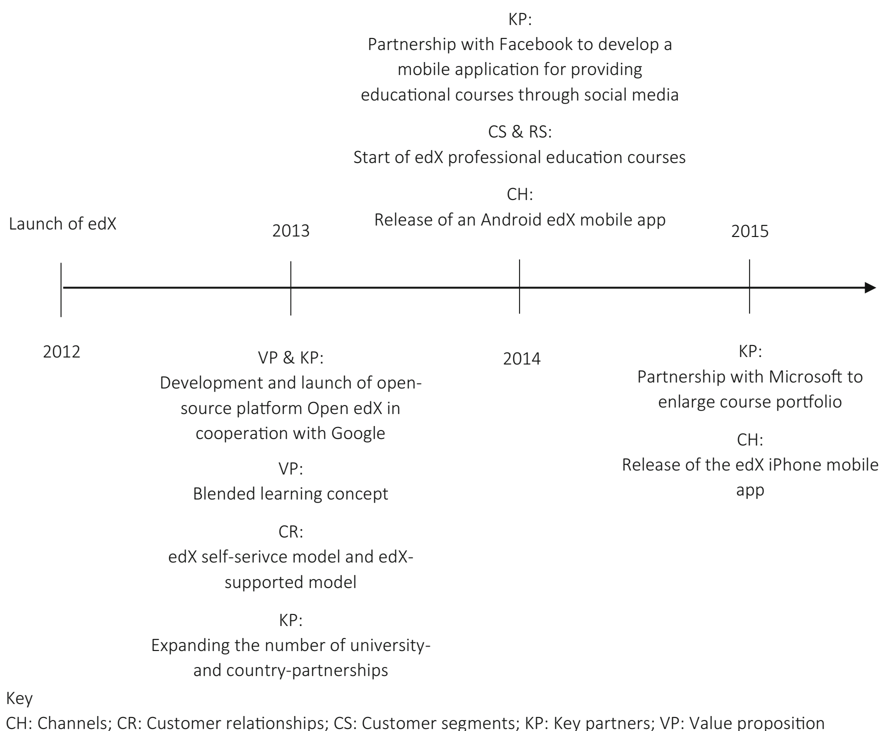

Fig. 13.3 Main changes in the business model of edX across time. Source: own illustration

based on edX open-source technology. Moreover, particularly developing nations play a major role in the future of edX—this is caused by the fact that in developing nations, educational demand greatly exceeds current supply. Country partnerships help edX to increase the number of courses and enlarge its community of users. Beside its country- and university-based cooperations, edX also collaborates with non-educational institutions from the IT field. Among others, the joint venture with Google established in 2013 is an example for further developing open-source educational solutions: Google supported edX in launching the open-source platform Open edX. Furthermore, edX entered a partnership with Facebook in 2014, to jointly develop a mobile app for providing educational offers via social media. In 2015, edX and Microsoft entered a partnership to offer free IT development courses via the edX platform, further expanding the value proposition of edX.

Key Partners	Key Activities	Value Proposition	Customer Relationships	Customer Segments
Harvard University Massachusetts Institute of Technology (MIT) Partner-countries and partner-universities from across the world Further institutions and companies	Conveying course content and facilitating learning by employing interactive learning tools Continuous improvement of the online platform Partner acquisition and cooperation management Ensuring financial self-sustainability	Online university education at unprecedented quality, access, and scale, including blended learning concepts (online and in-class participation) Professional online education	Self-service via online platform, with a community approach towards learning and in-class interaction Two types of affiliation models for universities: (1) university self-service model (2) edX-supported model	Learners (university and high school students, career changers, and employees looking to diversify their skills) Worldwide partner universities Companies interested in online professional education
	Key Resources		Channels	
	Expert knowledge Platform design Brand recognition of partner universities		Communication and distribution channels: own platform, mobile apps and in-class interaction	
Cost Structure		Revenue Streams		
Maintenance, management, and development of the platform Content creation Marketing and administrative costs		Certificate fees for completed courses Fees from executive education courses Recurring fees from universities employing the edX-licensed self-service model, and from universities employing the edX-supported model		

Fig. 13.4 Overview of the current business model of edX (the aspects highlighted in *grey* did not undergo major changes across time). Source: own illustration, based on Osterwalder and Pigneur (2010)

Customer Segments The company continues to follow its vision of global reach among diversified age groups: according to edX, its customers range from age 8 to 95, primarily including university or high school students and life-long learners. Moreover, with the launch of courses for professional education in 2014, edX got access to two new customer groups. On the one hand, individual professionals can enhance their knowledge to boost their careers. On the other hand, edX is active in the B2B market, where companies can use online courses in order to support learning within their organizations. edX serves customers around the globe, with more than 70 % coming from outside the U.S. Currently, the top five countries with most edX users are the U.S. (27.7 %), India (13 %), UK (4.2 %), Brazil (3.8 %), and Spain (2.7 %).

Customer Relationships The most significant development regarding customer relationships derives from the introduction of blended learning opportunities. Besides this, the combination of self-service, communities and course co-creation with partner universities did not undergo significant changes. In order to ease the work of partner universities, edX offers two types of affiliation models: the university self-service model and the edX-supported model. Within the self-service model, edX solely provides the platform, on which universities can independently develop and deliver courses. Within the edX-supported model, the company co-creates courses with its affiliate universities. Each university can choose the desired affiliation type, according to its own capabilities for creating and providing online courses.

Channels Over the years, edX has expanded its online channels to accommodate multiple devices, and diversified its marketing activities. For instance, in 2013 it established an online blog to inform its recent and potential customers about the latest news and courses. Since 2014, edX customers are also able to watch course videos via smartphones, through the release of an Android app in 2014, and an iPhone app in 2015 respectively.

Revenue Streams Since its very beginning edX has been searching for ways to better monetize its offers, in order to become less reliant on institutional funding. The organization has developed several additional revenue models, besides course diplomas. One model is the licensed self-service approach, by which universities design their own courses, while edX retains a portion of the generated revenues. Alternatively, edX co-creates new courses for a one-time fee and an additional 30 % of the recurring revenues. Besides these two revenue models generated from universities themselves, the platform also generates revenues from individuals and organizations, by offering courses for professionals in fields ranging from cybersecurity to accounting, to marketing and creative writing. Each executive education class costs about 500 US $ (Moore 2014).

Cost Structure Although edX has become a larger organization, its cost structure remained, in essence, the same. The main cost factors are those for course and content creation, as well as for IT, due to a higher complexity of the platform (Fig. 13.4).

13.5 Industry Outline and Future Perspectives

Online education faces a very dynamic market environment, caused by an increasing publicity in mass and social media. Its potential becomes more evident considering that only around 5 % of higher education institutions already implemented MOOC offers (Allen and Seamann 2013). Among the leading MOOC providers, Coursera has the largest portfolio, with over 1300 courses, as of 2015. In comparison, edX offers around 700 courses, Canvas Network almost 300 courses, FutureLearn around 200 and Udacity around 120 courses. However, universities are not the only providers of online learning solutions. For example, Udacity is aiming for the market of professional training, and works with well-known partners, such as Google or AT&T. In the professional education market, companies from various industries are likely to develop further MOOCs, just as SAP did through its openSAP initiative in May 2013. The online learning platform openSAP offers enterprise-based MOOCs, consisting of free courses on the latest SAP innovations.

Another ongoing development is the globalization of the online education market. For example, FutureLearn (U.K.), Open2Study (Australia), iversity (Germany), and Miriada (Spain) are significant market players in their own regions. In spite of MOOCs being, in essence quite homogenous, MOOC providers use several mechanisms to distinguish themselves from one another: while some providers, such as edX, define course start and finish date, MOOCs from other providers are available at any point in time. Most MOOC providers offer certifications for their courses for a fee. Some however, like Udacity or Udemy, implemented supplemental pricing systems, such as a monthly fee for additional personal support, reviews and verified certifications.

MOOC business models are currently rather experimental and undergo a high frequency of changes. According to Anant Agarwal, MOOCs still show several deficiencies, such as relatively low completion rates compared to traditional university courses, or the poor course quality of some providers. The challenge for MOOC providers is therefore to focus on solving these problems, while concurrently experimenting with new revenue logics and business model developments.

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14 Pioneer in the Skies: The Case of Southwest Airlines

Southwest Airlines is a somewhat different example of a business model pioneer. And indeed, one may ask if the company is a pioneer at all: neither was Southwest the first to offer intrastate flights on its home market, Texas, nor was it the first to experiment with low-cost flights. But while the other companies were merely experimenting, Southwest developed a business model, which proved its sustainability over the course of more than four decades. By starting operations in 1971, Southwest faced from the very beginning harsh competition from incumbent airlines. This inspired the young company to create its very own business model—and unlike its main competitors at the time, the airline remains profitable until today. Winning this race made Southwest a prime example of a pioneer in the low-cost airline industry.

At the time of Southwest's market introduction, two other Texas-based airlines operated intrastate Texas flights, yet only as addition to interstate ones: Braniff International Airways, founded in 1928, and Texas International Airlines, founded in 1947. Neither of the two initially offered discounted fares. A low-cost option was introduced in the 1970s by Texas International, in response to emerging competition from Southwest. Yet both Braniff and Texas International were not able to maintain market shares and left the market in 1986 and 1982 respectively. Braniff went bankrupt due to an excessive expansion and growth strategy based on false demand forecasts, leading to high costs at insufficient profits. In consequence of an unsuccessful merger with Continental in 1982, Texas International also had to leave the market.

Besides competing with the aforementioned local carriers, Southwest faced competition from large U.S. full-service carriers too. These included United Airlines (founded in 1927), American Airlines (founded in 1934), and Delta Air Lines (founded in 1928). In contrast to Southwest, which focused on short-haul and point-to-point-flights, these major airlines employed hub-and-spoke networks, and focused on long distance flights. These two different approaches to flight management were particularly significant before the industry's deregulation in 1978. Until then, the Civil Aeronautics Board (CAB) was able to impose uniformed flight fares

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for different airlines. Yet the CAB could only regulate domestic *interstate* air transport, so intrastate airlines like Southwest were not affected, and could thrive on the market. Due to the CAB regulations, compared to Southwest and to the other intrastate airlines, interstate airlines were not able to differentiate themselves through price. This was fuel for conflict and led to a series of lawsuits between Southwest and other incumbents, such as Braniff or Texas International, which felt threatened by the new low-cost competitor. For interstate airlines, aspects like in-flight amenities, corporate image and marketing became more and more important, yet this further increased their costs. Then again Southwest and other intrastate carriers were able to offer unmatched flight fares. In comparison to the major interstate airlines, which further focused on a hub-and-spoke system and on complex pricing models, Southwest seized the opportunity to expand its low-cost, point-to-point approach.

When Southwest entered the market, there were two other airlines experimenting with low-cost options a few states further, in California: Pacific Southwest Airlines (PSA) and Air California. PSA started its business in 1949, serving the dense corridor between San Francisco and Los Angeles. Its airplanes were rather old and inexpensive, so offering a ticket for 10 US $ was possible. Air California and PSA both represent precursors of Southwest's low-cost intrastate business model. However, larger competitors subsequently acquired both airlines: in 1988 U.S. Airways acquired PSA, and, a few years earlier, Air California was integrated into American Airlines. In contrast to PSA and Air California, Southwest is the first low-cost carrier, which has been independently successful until today, and the only U.S. airline that has been profitable every year since 1973, two years after its launch—in spite of oil crises and the September 11th attacks.

14.1 Founders

Southwest Airlines was founded in 1967 as Air Southwest Co., by Rollin W. King and Herbert D. Kelleher, and subsequently renamed Southwest Airlines in 1971, when it started to operate. According to the official version regarding the company's founding, Rollin W. King came up with the initial idea, while having a drink in a San Antonio bar with Herbert D. Kelleher. He drew, on a cocktail napkin, what became Southwest's triangular route system, connecting the three major Texan cities Dallas, Houston and San Antonio.

As a commercial pilot with a Harvard MBA, King's goal was to find a better way for people to fly. Since 1964, he owned a small charter airline company, called the Wild Goose Flying Service, which operated as an intrastate air taxi, yet never managed to reach profitability. However, this former experience did not hold King back from thinking about starting a scheduled carrier only focusing on Texas cities. Compared to the Wild Goose Flying Service attending small towns, Southwest Airlines was designed to serve the three largest Texan cities. After Southwest's launch, King became member of the flight crew and subsequently member of the board of directors until his retirement in 2006. Up to now, his role in Southwest

Airlines' founding days and consequent development is little known and largely disregarded.

After graduating in law from the New York University, Herbert D. Kelleher started his own firm, providing legal representation to a number of clients in the aviation business. One of them was Rollin King, which is how the cooperation between the two founders started. Gibson and Blackwell (1999) described Kelleher as an ideal example of the charismatic leader, with extraordinary communication skills, self-confidence, and enthusiasm. The success of Southwest Airlines is often attributed to his personal traits and excellent labor-management skills. Some analysts even ascribe Southwest Airlines' success more to Kelleher's eccentric and charismatic leadership, than to the company's business model. Primarily due to Kelleher's resolution and determination to accomplish his vision of a low-cost intrastate airline, Southwest was able to start its business in 1971, after facing a series of lawsuits during the previous years. His passionate and persistent commitment made the idea behind Southwest Airlines possible. He acted as Executive Chairman between 1978 and 2008, and served as President and CEO from 1981 until 2001. Not only King's former experience from his own small charter airline, but also Kelleher's juristic knowledge, tenacity and extraordinary energy made the business idea of Southwest Airlines possible.

14.2 Market Demand

The airline industry was undergoing subtle transformations during the 1960s and 1970s. Although most passengers were businesspersons, an increasing number of jet set and holiday travelers were boosting customer numbers. However, only 20 % of U.S. citizens flew with commercial airlines, as these were perceived as expensive. Additionally, passengers looking for a convenient way to cross distances that were too far to manage by car or train, and still not long haul, often had a problem: there were no flights available. In the contrary case, mid-haul flights were often unpunctual and too expensive. There was a high market demand for dependable, low-fare, short- and mid-haul flights. Incumbents such as Braniff and Texas International had rather poor service for intrastate travelers. As both airlines primarily flew interstate, air travel offered to intrastate customers was mainly the beginning or end-point of an interstate route. Long distance, full-route customers received better in-flight seating. Flight scheduling was an additional problem for intrastate passengers, as it favored long distance travelers, implying flying times that were often unpractical for short distance travelers. New routes, lower prices, adequate schedules for intrastate air travel and punctuality were the main unmet market demands at the beginning of the 1970s. King realized this from early on and envisioned an airline efficiently serving short distances—for lower fares than the incumbent airlines were prepared to offer.

14.3 Pioneer Business Model

This paragraph describes Southwest's business model at the time of its market introduction, as illustrated by Fig. 14.1.

Value Proposition The idea behind Southwest was to provide no-frills, cheap flights between Dallas, Houston and San Antonio, the three major Texan cities. King and Kelleher always aimed at offering a price below the cost of driving the same distance by car. The value proposition was, in its core, quite simple: no-frills, direct short-haul flights with frequent scheduling. But there was more to the company's market success than just this core proposition: the fun, easygoing experience provided by Southwest might be what customers enjoyed most about the company. Paired with convenient prices, this new value proposition came as something unexpected in the white-collar airline industry of the time. Southwest was a young, friendly, refreshing and exciting airline, marketing its drinks as "love potions", while the ticket machines were called the "love machines". According to Eckert (2014), Southwest differentiated itself from competitors by providing a simplified offer at an ideal cost-benefit ratio. This approach significantly diverged

<table>
<tr>
<td rowspan="2">Key Partners

Boeing aircraft manufacturer

Airport authorities

Workers' unions</td>
<td>Key Activities

Lean set of key activities

Direct, short-haul Texas flights in a point-to-point structure, serving secondary airports

Limited customer services</td>
<td rowspan="2">Value Proposition

Fast and convenient air transport between Dallas, Houston and San Antonio

No-frills, simplified flight offer at an ideal cost-benefit ratio with frequent scheduling

Fun and easygoing travel experience</td>
<td>Customer Relationships

Long-term customer binding, due to an excellent cost-benefit ratio</td>
<td rowspan="2">Customer Segments

Price-sensitive travelers (e.g., families, students), as well as business travelers between the three major Texan cities</td>
</tr>
<tr>
<td>Key Resources

Enthusiastic and motivated employees

Singular corporate culture

Standardized airplane fleet</td>
<td>Channels

Sales channel: direct ticket sales via own vending machines</td>
</tr>
<tr>
<td colspan="3">Cost Structure

Highly cost-driven cost structure, in which all elements of the business model are designed to save costs</td>
<td colspan="2">Revenue Streams

High volume of low-priced flight tickets</td>
</tr>
</table>

Fig. 14.1 Overview of Southwest Airlines' business model at the time of the company's start of operations. Source: own illustration, based on Osterwalder and Pigneur (2010)

from the one of incumbents, focusing on offering complex and high-end air travel services.

Key Activities Compared to incumbent airlines, Southwest employed a lean set of key activities, with the benefit of substantially reduced costs: the airline exclusively operated direct flights and initially only served three destinations. Distinctly aiming at reliability, Southwest reached this by only flying to secondary or small airports, where planes faced no long waiting times and achieved a better-than-average on-time performance. Additionally, secondary airports had lower airport and landing fees than conventional ones. With only one type of aircraft, Southwest could achieve greater efficiency as well as more operational flexibility. The company solely operated a fleet of Boeing 737 airplanes, which led to an increased bargaining power towards its supplier, reduced the number of repair parts and limited staff training to only this aircraft type. Board personnel knew all aircrafts just as well, enabling a more flexible usage of staff resources. On top of this, a number of services were deliberately left out: the company offered no meals, no assigned seating and no luggage transfer to connecting flights. Interestingly, what brought the company its competitive edge were primarily the activities, which it chose to thoroughly reduce or completely leave out of its basic value proposition.

Key Resources Southwest perceived employees as its key resource and treated them accordingly. Kelleher's dedication to employees is memorable, his philosophy being that the way employees are treated reflects in the way they treat customers. Kelleher also attached great importance to Southwest's culture, which was mainly shaped by his personality traits. Just like the founder, the culture was informal, cheerful, fun-loving and yet hard-working. Customers found it easy to understand and relate to the message behind Southwest, which brought it a crucial competitive advantage.

Key Partners Southwest established long-term, close relationships with its partners, such as the aircraft manufacturer Boeing, airport authorities, and the air traffic control. For instance, the company collaborated and exchanged views on process improvements with airport authorities on a regular basis. The unions formed another essential partner to Southwest. Instead of regarding these as adversaries, the airline decided to accept unions as legitimate representatives of employees and as fully valued partners. This kind of interaction with the unions resulted in exceptionally positive relations to employees. For example, there has been only one single 6-day strike in Southwest's history. In comparison, PSA's maintenance and operations personnel went on strike for one month in 1973, and its pilots for 53 days in 1980.

Customer Segments From the beginning, the company had a clear idea of whom it wants to reach. Kelleher intentionally wanted to attract travelers interested primarily in low prices, such as middle-income families and students. With its short-haul flights, Southwest's offers were interesting to people who mostly

travelled by car, bus or train. The frequent departures additionally attracted business flyers, as the same route was served several times during a day.

Customer Relationships For Kelleher, good relationships to employees ensured good relationships to customers. This guiding principle gave him the authenticity to motivate his employees in always being amicable and fair to customers. In the spirit of the company's culture, communication with customers was far less formal than in the case of incumbent airlines. Southwest on-board staff was known for joking with passengers. The airline also dedicated effort to answer each customer letter personally, instead of employing standard answers. Customer letters helped to monitor employees' performance, and individually examining each customer letter helped Southwest improve its overall performance.

Channels Of great significance to Southwest's low-cost business model was the fact that the company sold tickets mainly directly to travelers themselves, at automatic ticketing machines at the gate, and to a much lesser extent through travel agencies. This led to a competitive advantage by avoiding commission fees and other costs charged by third-party travel agencies.

Revenue Streams Regarding revenue stream generation, Southwest also followed a different approach than its competitors. Traditional airlines as well as many other low-cost carriers charged customers for luggage and ticket changes. In contrast, Southwest took the risk of rejecting such additional revenue streams, believing that a different revenue model would bring the company higher customer loyalty. Southwest employed a so-called "bags fly free"-policy, meaning that the first and second bag could be checked-in at no additional cost. Initially, there were no fees for changing or cancelling tickets, in order to offer customers maximum flexibility. A large part of the company's revenue was generated by optional ticket add-ons, for example the auto check-in. However, getting the revenue model right took time: during its first year of existence, the airline offered one-way tickets between Dallas and Houston for 20 US $. This led to a net loss of 3.75 million US $ at the end of 1971, yet Southwest saw no reason to give up, and continued to improve its revenue generation and cost structure.

Cost Structure The hub-and-spoke structure, on which full-service airlines operated, was intricate, leading to complex business processes and high costs. In contrast, Southwest focused on a point-to-point model, which enabled direct flights without intermediate stops, saving the trouble of managing expensive hub systems. By focusing on point-to-point flights, Southwest was able to minimize idle waiting time and thus to accelerate turnaround and aircraft utilization. Its strategy to only serve smaller airports near major metropolitan areas and medium-sized cities led to lower landing fees and terminal costs, as well as to lower fuel costs of idle planes waiting for clearance to land. Southwest unbundled the service packages offered by incumbent airlines, such as in-flight entertainment, meals and drinks, allowing menu-style pricing. For instance, assigned seats or alcoholic drinks were regarded

from the very beginning as extras, and priced individually, while the airline completely avoided selling food. Together, these cost-cutting strategies enabled Southwest to pass on its cost advantage to customers, in form of price advantages.

Figure 14.2 provides an overview of some of the most significant developments in Southwest Airlines' business model during the past five decades, which are subsequently discussed in Sect. 16.4

Value Proposition The company's value proposition incrementally began to evolve since the airline started expanding its route map in 1975. Initially only serving destinations in Texas, the airline started operating outside the state in 1979 and outside the U.S. in 2012. Currently, Southwest offers both short- and long-haul flights within and outside the U.S. By expanding its route system through long distance flights, Southwest is able to provide national and international destinations. The expansion of the company's route map was additionally supported by the acquisition of the airline AirTran in 2011.

Key Activities In essence, Southwest maintained its key activities, and these can be compiled in six areas: selling tickets at low prices, reliable and frequent departures, limited passenger service, highly productive processes at the ground and gate, high aircraft utilization, and the point-to-point model serving secondary airports. According to Hitt et al. (2013), Southwest's cost leadership strategy is based on the high integration of these activities, which makes it difficult especially for full-service competitors to imitate its low-cost business model. The overwhelming success of Southwest's business model motivated other airliners, such as Ryanair, Wizz or Norwegian, to adopt it, representing the industry standard for low-cost, no-frills airlines.

Key Resources Despite its growth, the airline has successfully maintained a unique culture of cheerfulness, fun loving and informality, alongside a positive attitude towards work. Cost considerations are still pivotal to the selection of key resources, as the airline for instance still relies on a standardized aircraft fleet. At the end of 2014, Southwest operated a fleet of 665 Boeing 737 aircrafts.

Key Partners The airline's key partners did not essentially change over time, the most important of which remained the aircraft manufacturer Boeing.

Customer Segments Southwest is nowadays able to reach a multitude of customers looking for both short- and long-distance domestic and international travelers. Yet in essence, the addressed customer segment did not change its passengers are still interested in low-fare, no-frills flying.

Customer Relationships Southwest has been successful in maintaining its unique customer relationship, by preserving its corporate culture despite massive corporate growth—an achievement, which cannot be taken for granted. To increase customer

loyalty, the airline was also one of the first to offer frequent flyer programs in 1987. As well, in response to customers disliking Southwest's first-come first-served policy, the company introduced a new boarding procedure in 2007, maintaining open seating while enabling passengers to reserve places in the waiting line, instead of having to arrive early at the airport. Actions such as these ensured its position as the American airline with the highest customer satisfaction rating 18 out of 21 times between 1995 and 2015, according to the American Customer Satisfaction Index (ACSI).

Channels By launching its online presence in 1995 and starting to sell tickets online a year later, the airline was among the first ones on the market to do so. This fact is especially noteworthy, as for instance Google did not even exist at that time. The internet has in the meantime become Southwest's major channel for selling tickets. As of 2014, 78 % of its flight revenues came from bookings via its online ticket sale services, for instance southwest.com, swabiz.com (for business travel), and airtran.com.

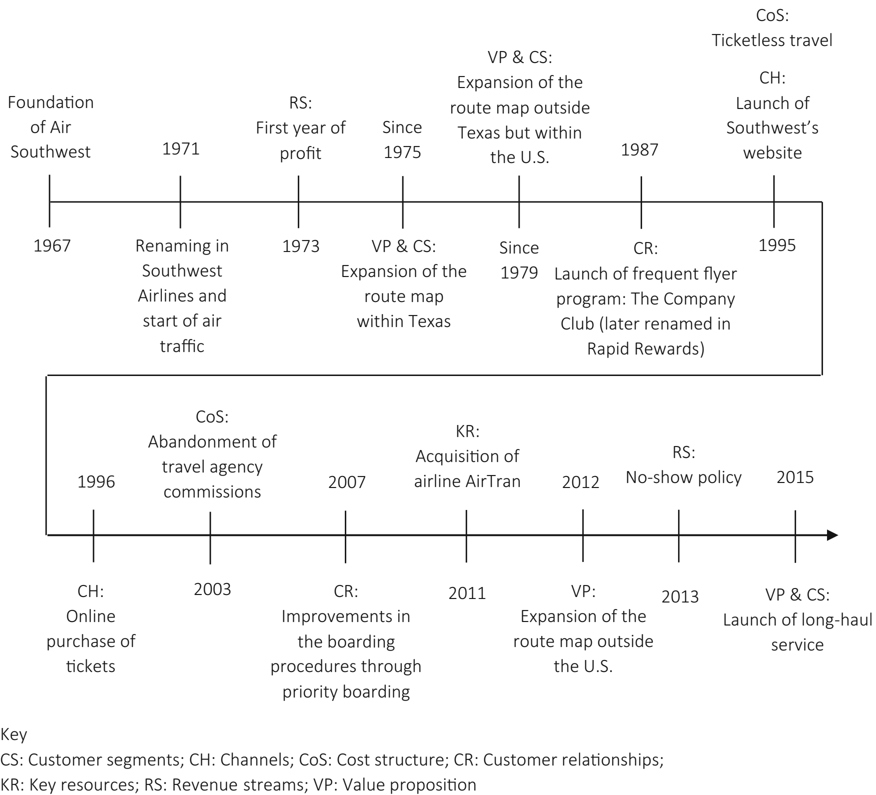

Fig. 14.2 Main developments in the business model of Southwest Airlines across time. Source: own illustration

Revenue Streams In 2014, Southwest reported 18.6 billion US $ in revenues (with a net income of 1.1 billion US $), ranking number six globally and number three in the U.S. In the same year Southwest was the second largest airline worldwide, with 130 million passengers, surpassed only by Delta Air Lines. More than 97 % of the Southwest's total revenues are generated by domestic operations. Over the course of time, the company has introduced additional chargeable add-on services to its low-fare ticket prices, such as the EarlyBird check-in, fees for the transport of pets or the so-called "no-show fees".

Cost Structure In comparison to other low-cost carriers and full-service airlines, Southwest reports very low flight costs per available seat mile. The reasons for the company's streamlined cost structure did not considerably change over time, with the significant exception of internet-derived benefits. By shifting to online sales in 1995, Southwest was able to reduce distribution costs and use the online medium to reshape its own cost structure. Additional cost savings were generated by establishing ticketless travel during the same year, in 1995. Distribution costs further decreased, as the airline eliminated traditional travel agency commissions in 2003. Southwest's main cost driver are labor expenses (about 33 % of total operating expenses), which represent a larger cost block than fuel costs (about 32 % of total operating expense) (Fig. 14.3).

Key Partners	Key Activities	Value Proposition	Customer Relationships	Customer Segments
Boeing aircraft manufacturer Airport authorities Workers' unions	Lean set of key activities Short- and long-haul flights, serving secondary airports Limited customer services Highly productive process at the ground and the gate	Fast and convenient air transport, both domestic and international No-frills, simplified flight offer at an ideal cost-benefit ratio with frequent scheduling Fun and easygoing travel experience	Long-term customer binding, due to excellent cost-benefit ratio	Mass market of private and business travelers
	Key Resources		**Channels**	
	Enthusiastic and motivated employees singular corporate culture		Sales channels: direct ticket sales online and via own vending machines	

Cost Structure	Revenue Streams
Highly cost-driven cost structure, in which all elements of the business model are designed to save costs	High volume of low-priced flight tickets (more than 97% total revenues generated by domestic operations) Chargeable add-on services, such as the EarlyBird check-in, business offers, or the so-called "no-show fees"

Fig. 14.3 Overview of Southwest Airlines' current business model (the aspects highlighted in *grey* did not undergo major changes across time). Source: own illustration, based on Osterwalder and Pigneur (2010)

14.4 Industry Outline and Future Perspectives

Current competitors primarily comprise low-cost carriers based in the U.S., operating nationally and internationally. Examples include JetBlue Airways, Virgin America, Spirit Airlines, and Allegiant Air. Table 14.1 compares the key figures of Southwest Airlines with those of its low-cost competitors. While Southwest leads regarding operating revenue and passenger numbers, the company was overtaken by Spirit Airlines regarding operating margin. Spirit Airlines' profitability can be explained on the one hand by the highest seat density per aircraft of all airlines, and on the other hand, by charging customers for all services, including for instance a glass of water, following the slogan "You get what you pay for".

Competitors of Southwest both include other low-cost carriers as well as substitutes to air travel such as bus, car and train travel. Due to low prices and the trend towards ecologically friendly travel, buses, trains and carsharing options such as Uber represent latent competitors. However, such substitutes only have a limited capacity to endanger the Southwest business model, as one of the key pillars of the company's success lays in offering flights for distances, which are less suited for bus, car or train travel, mainly due to time-reasons. For instance, Southwest does not offer flights connecting Boston to New York, a relatively short distance of around 300 kilometers, which is well covered by bus travel options.

New entrants in the low-cost segment constitute a more relevant group of likely competitors. However, the entry barriers in the airline industry are particularly high. First, there are high start-up costs, and second, airlines have to adhere to intense regulations in order to start a business. Moreover, the strong price competition between incumbents represents a significant entry barrier. Besides new entrants, established full-service airlines are a further competitor group. However, low-cost services offered from full-service airlines seldom turn out successful, due to inherent inertia among many full-service carriers and reluctance to lower own quality standards. One example of a failed entry is Continental Lite, which

Table 14.1 Selected data from U.S.-based low-cost carriers

	Operating revenue 2014 (million US $)	Operating margin 2014 (%)	Passengers 2014 (million)
Southwest Airlines	18.605	12.7	129.1
JetBlue Airways	5.817	8.9	32.8
Virgin America	1.490	6.5	6.5
Spirit Airlines	1.932	18.4	14
Allegiant Air	1.137	17.6	8.1

Source: own illustration based on company reports

attempted to imitate Southwest. Continental Lite was developed in 1993 by the full-service airline Continental Airlines, as a reaction to emerging low-cost carriers. In contrast to Southwest, Continental Lite included various services, such as baggage checking and seat assignments to diminish cannibalization of its full-service business model. The company ran a hybrid and conflicting business model, which failed, as it also kept a hub-and-spoke system with a point-to-point approach not competitive enough to match Southwest's infrastructure. Besides Continental, further airlines like United Airlines, U.S. Air and Delta Air Lines tried to compete with Southwest by establishing low-cost divisions, yet failed to do so effectively. Such examples show that even companies, which do not face entry barriers, find it difficult to copy the Southwest business model, with its interlinked system of operational, strategic and cultural elements.

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Part IV

Manufacturing Business Model Pioneers

15 Driving Against the Tide: The Case of Tesla Motors

The electric vehicle manufacturer Tesla Motors Inc. (Tesla) was founded in 2003, substantially increasing public attention towards electric mobility. Until the 1990s, automakers saw no pressing need to develop electric vehicle technology, largely due to low oil prices and facile environmental policies. By the turn of the millennium, some car manufacturers, for instance GM, made initial attempts to introduce environmentally friendly vehicles, such as the Chevrolet S-10 Electric. Such projects mostly failed, due to a lack of market driving factors. The most significant among them was the lack of performant batteries and infrastructural units like recharging stations, paired with a public policy not yet fully committed to supporting the development of electric vehicles. Some projects however succeeded: electric cars such as the Nissan Altra, and hybrid cars like the Toyota Prius and the Honda Insight found an incipient market of early adopters. The higher sales numbers of hybrid cars compared to purely electric models, were largely due to the higher performance of the former. As hybrids additionally have an internal combustion engine, these were able to reduce the hitherto biggest disadvantage of electric vehicles—the short travel range on one charge. However, compared to the market share of vehicles with internal combustion engine (ICE), the share of both hybrid and electric vehicles was still insignificant—not only in the U.S., but also in European markets such as Germany. For instance by 2009, 0.054 % of all cars in Germany were hybrid, while only 0.0035 % were purely electric. Incumbent car manufacturers continued to focus on ICE, rather than on alternative powertrain vehicles, and thus the development of sustainable business models for electromobility also played a subordinate role.

In a market, in which incumbents were doubtful about the acceptance of electric vehicles, new entrants with a sole focus on such models faced a hard time. The main entry barrier for new market players in the electromobility industry was the extremely high investment in production plants. Another critical requirement for entering the field was the immense technological know-how that was required. One further barrier was brand recognition, as vehicle buyers tend to choose manufacturers with whom they are already familiar. In spite of such hurdles, in 2008 when Tesla

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began serial production of its first model, the Roadster, it became the first company worldwide to manufacture serial electric sports cars. Tesla's high-performance battery electric vehicle (BEV) had an impressive travel range of up to 400 kilometers, which was double the range of other BEVs in the mid-2000s. Its performance was at least comparable to, if not exceeding, that of ICE vehicles. The time seemed right for setting in motion a worldwide transition towards electric mobility. This vision helped Tesla's founders to stubbornly persevere in introducing a new product, and a new business model in an industry dominated by giants.

15.1 Founders

Five Silicon Valley entrepreneurs and engineers—Martin Eberhard, Elon Musk, JB Straubel, Marc Tarpenning and Ian Wright—started the Tesla Motors venture in Palo Alto, California, in 2003. The founders had a variety of entrepreneurial skills, and managed to rally around them a team of automotive specialists. This was pivotal in the business of manufacturing and selling electric vehicles, as not only the required technological know-how was highly complex, but also the business field vastly new.

Martin Eberhard is a serial entrepreneur, who successfully launched a number of notable start-ups before Tesla. In his search for an environmentally friendly sports car, Eberhard came across the vehicle tzero of the company AC Propulsion. He licensed AC Propulsion's electric-drive-train technology and set the base for Tesla Motors, envisioning to tackle challenges such as global warming, and the U.S. dependence on Middle Eastern oil. Marc Tarpenning, a Berkley computer science graduate and close friend of Eberhard, brought in IT know-how, having previously worked as a developer for software and firmware products. As Eberhard and Tarpenning required substantial funding for their start-up, Elon Musk joined the team as key investor. Just as Eberhard, who served as Tesla's CEO until 2008, Musk saw electric vehicles as the best solution to reduce the U.S. energy dependence, and joined Tesla in 2004, to become its chairman. Musk had previously graduated in economics and physics, and reached an astonishing record of high-tech entrepreneurship: besides founding PayPal, he was engaged in founding SpaceX, dedicated to developing consumer space travel. JB Straubel, the current CTO of the company, had previously gathered entrepreneurial experience too. Ian Wright managed to set up two key partnerships for Tesla, with Lotus and AC Propulsion, yet left the firm only one year after its foundation, due to his diverging visions from the remaining founders.

15.2 Market Demand

The turn of the millennium brought increased public attention towards issues on environment protection and energy conservation. However, at the time of Tesla's launch, the market for purely electric cars was in the middle of a vicious circle: the

high e-vehicle prices triggered a low market demand, which, in consequence, led to a lower interest in investments and inhibited mass production. Hereby, one significant market demand was that for more affordable and effective electric transportation. But where could a start-up like Tesla begin to break the vicious circle? Eberhard noticed that many customers who drove a hybrid Toyota Prius, also had luxury sports cars in their driveways. As gas prices were close to an all-time low, the entrepreneur realized that people did not buy hybrids such as the Prius to save money on gas, but to make a statement about the environment. Tesla's founders came to believe that they could begin by addressing this niche market segment and only subsequently address the mass market through more affordable electric cars. If any Tesla could have a chance on the market, it first had to reach early adopters, in order to make electric vehicles desirable to the mainstream. Tesla's business model was therefore primarily triggered by an emergent demand for high-performance electric vehicles. At the same time, the founders envisioned the company's evolution towards mass-producing cost-effective models, and hereby providing an alternative to ICEs.

15.3 Pioneer Business Model

This section analyzes the business model at the time of Tesla's launch in 2003, as summarized in Fig. 15.1.

<table>
<tr><td rowspan="2">Key Partners

Supplier alliance for the chassis production with Lotus Engineering

Licensing of the powertrain technology of AC Propulsion</td><td>Key Activities

Developing, designing, manufacturing and optimizing the employed technologies for the Roadster model</td><td rowspan="2">Value Proposition

Electric, high-performance sports vehicle, which redefines electric mobility</td><td>Customer Relationships

Intention: Direct and consistent customer relationships</td><td rowspan="2">Customer Segments

High-end sports cars enthusiasts wanting to make a statement about the environment</td></tr>
<tr><td>Key Resources

License for the powertrain technology</td><td>Channels

Intention of solely direct sales via own Tesla Stores and online, as opposed to the established dealership model</td></tr>
<tr><td colspan="2">Cost Structure

Highly value-driven cost structure</td><td colspan="3">Revenue Streams

No own revenues until 2008 (funded solely through venture capital and additional investors)</td></tr>
</table>

Fig. 15.1 Overview of Tesla's business model at the time of the company's launch. Source: own illustration, based on Osterwalder and Pigneur (2010)

Value Proposition At the time of the company's launch, the Roadster was taking shape in its R&D and manufacturing labs. Tesla's engineers, developers and designers were working on building a vastly superior BEV, able to redefine the image of existing electric vehicles. It took Tesla over four years to realize this value proposition. In 2006, the first high-powered electric vehicle, the Tesla Roadster, was introduced to the public. Only in 2008, the Roadster was ready for serial production.

Key Activities Tesla's key activities at the time of its launch were dominated by developing, designing, redesigning and optimizing both the powertrain technology and the further architecture of the Roadster. Continuous improvement was the company's main task, particularly in what regards powertrain and its accompanying battery pack.

Key Resources As regards the large investments required by an automotive start-up, Elon Musk contributed with around $ 7.5 million in 2004, an asset, which was pivotal for the later development of Tesla. Yet financing alone did not suffice: another key resource was the license received from AC Propulsion for the powertrain technology of the tzero, which was successively refined for the Roadster.

Key Partners In its early days, Tesla heavily relied on strategic alliances with OEMs and suppliers. Its main partners were AC Propulsion and Lotus Engineering. The partnership with AC Propulsion was a prerequisite for obtaining access to the powertrain technology of the tzero. In designing and manufacturing the Roadster's chassis, Tesla collaborated with Lotus Engineering, as none of Tesla's founders had experience in building sports cars, for which however Lotus Engineering was well renowned.

Customer Segments As regards customers, chiefly two reasons led Tesla to enter the electric car market by clearly focusing on a single customer segment—the market niche of sports car buyers. First, its enormous investments in R&D, paired with high production costs, implied that only high-end early adopters were prepared to pay a premium price and came into question as a target customer group. A secondary reason also offers support for the company's choice of initially not diversifying its product portfolio to reach the mass market: as a new entrant, Tesla would have had minimal chances of being recognized as a viable alternative in the crowded economy market.

Customer Relationships Several years before the Roadster was revealed to the public, starting from the early days of its development, Tesla informed its potential customers about company news via an own blog. An essential difference between Tesla's business model and those of incumbent carmakers stems from two business model building blocks—customer relationships and delivery channels. Tesla's founding team was convinced that selling vehicles directly to customers, rather

than through dealerships, fits its product range and the addressed customer group in a much more meaningful manner, than the classical sales model could.

Channels The company planned to create a distribution model that was unusual in the car industry. As opposed to the common indirect distribution, where franchised dealerships were mainly responsible for sales and service, Tesla intended to create a direct-to-customer model, owning the downstream supply chain. Its determination to apply a direct channel model in the automotive industry is one key argument for Tesla's pioneering business model.

Revenue Streams As during its initial years Tesla's activities solely revolved around product development, the company did not earn revenues until 2008, when the first Roadsters were delivered to customers. In the period leading to 2008, the start-up was fully dependent on funding by investors and venture capitalists.

Cost Structure Particularly the company's above listed key activities, R&D and design, were its main cost drivers. As Elon Musk insisted on sourcing premium materials, parts and components for the $ 100,000 Tesla Roadster, the company's cost structure can be described as highly value-driven.

15.4 Current Business Model

Figure 15.2 provides an overview of the main changes in Tesla's business model since 2003, which will be discussed in the following.

Hereinafter, the current business model of Tesla will be analyzed, as illustrated in Fig. 15.3.

Value Proposition The main purpose of the Roadster was to prove the feasibility of a purely electric sports car. It was awarded the Best Product Design Award by the Industrial Designer Society of America, among many other recognitions for its truly innovative character. Tesla's subsequent product strategy bases on the stepwise introduction of more affordable models, such as the Model S in 2012 and the Model X in 2015. The limousine Model S became one of the three best-sold electric vehicles in the U.S., with a performance comparable to that of the Porsche 911 GTS, and at a lower price than that of the Roadster. The limousine marks the beginning of an era, in which Tesla tries to substantially extend its customer base. While the Roadster is a low-volume, highly exclusive vehicle, the models S and X are mid-volume, with price points starting around 70,000 US $. However, the real breakthrough in Tesla's product portfolio is expected with the Model 3, starting at 35,000 US $, already promoted as a high-volume car. The Model 3 is designed to make Tesla's vision of a worldwide transition towards electric mobility possible. A further reason showing Tesla's innovativeness relates to the charging options it

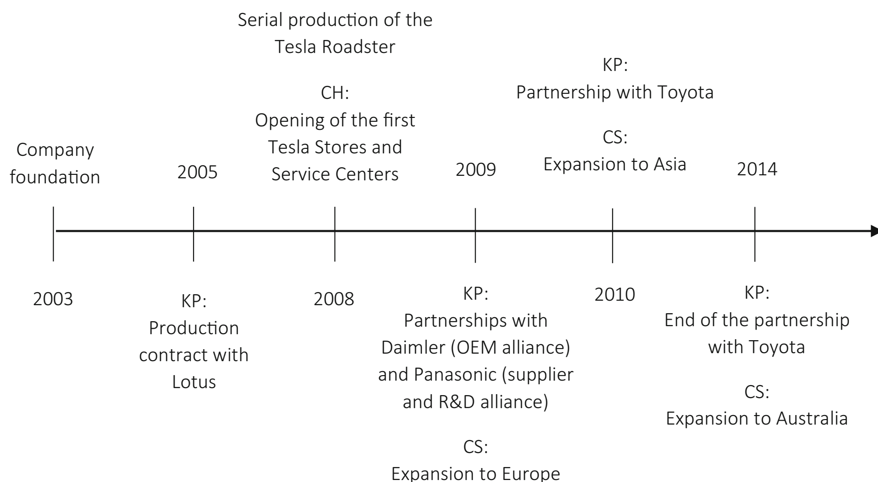

Fig. 15.2 Overview of the main changes in Tesla's business model across time. Source: own illustration

offers to its customers for free. The company implemented the largest fast charging network worldwide, each charging site enabling half a charge in 20 minutes. As of late 2015, there were more than 520 Tesla supercharging sites worldwide, 180 in Europe and around 50 in Germany—at each of them, customers can charge Tesla vehicles without paying any fee. Besides its value proposition comprising vehicles and a charging network, Tesla has the expertise to supply other automotive companies with electric vehicle technology, such as battery packs, powertrain components and stationary energy storage systems. Such B2B supply cooperations represent, in the short-term, a revenue diversification strategy, in order to sustain the production of its highly cost-intensive vehicles. Their long-term implications relate to sustainably increasing Tesla's market presence and bargaining power.

Key Activities The key activities are based on the company's efforts to take complete ownership of its supply chain. Tesla hereby performs a broad array of in-house activities, ranging from R&D and design, sourcing and production to sales and after-sales service. The high vertical integration is illustrated, for instance, by the fact that the battery for the electric powertrain is produced in-house. Moreover, through built-to-order, on demand vehicle production, the company is able to minimize inventories and capital lockup. Besides car production, Tesla offers service through company-owned centers, stores and with the help of mobile service technicians, known as the Tesla rangers. This approach sharply differs from the one of traditional U.S. manufacturers, who do not offer maintenance and repair services directly to customers, but through third-party providers.

Key Partners	Key Activities	Value Proposition	Customer Relationships	Customer Segments
R&D and supply alliances, for instance with Panasonic and Daimler	Broad array of in-house activities: R&D and design, sourcing and production, sales and after-sales services Built-to-order, on demand vehicle production **Key Resources** State of the art manufacturing facilities Expertise and intellectual property (however, open licenses)	Electric, high-performance vehicles (including limousines and a sports model), which redefine electric mobility Worldwide largest fast charging network, offering free charging B2B: Electric vehicle powertrain components	Direct and consistent customer relationships with extensive personal assistance **Channels** Direct sales approach via own Tesla Stores and online, as opposed to the established dealership model	Consumer market: ecofriendly individuals - High-end sports car market - Luxury vehicle limousine market - Mass market consumers B2B market: OEMs

Cost Structure	Revenue Streams
Highly value-driven cost structure (state of the art R&D and manufacturing) Minimized inventories through built-to-order principle, yet rising manufacturing and R&D costs, resulting from the rising demand for its Model S	Automotive sales (amounting to about 99.8 % of total sales, including vehicle, options and related sales, as well as powertrain components) Development services (amounting to about 0.2 % of total sales, including sales of powertrain components and systems for partner OEMs)

Fig. 15.3 Overview of Tesla's current business model (the aspects highlighted in *grey* did not undergo major changes across time). Source: own illustration, based on Osterwalder and Pigneur (2010)

Key Resources Concurrent with the company growth, staff numbers increased to over 10,000 full-time employees at the end of 2014. The company's manufacturing expertise, state of the art robotics and intellectual property represent further key activities, reflected in patents for the integration of battery cells, battery packs, power electronics, the engine and gearbox. Tesla again surprises its competitors and the automotive industry in general, by opening up most of its patents and providing free licenses to many of its employed technologies. This also represents an argument for Tesla's pioneering role in the automotive industry. Currently, the company is headquartered in the technology cluster Palo Alto, has a development center in Hawthorne, owns a manufacturing plant with leading edge technology in Fremont, and an assembly facility in Tilburg, Netherlands. Tesla is also underway to establish its Gigafactory in Reno, Nevada, a massive battery manufacturing facility. The Gigafactory is designed to integrate several production stages within one location, improve collaboration with suppliers (for instance with Panasonic), and reduce the cost of batteries by 30 %, hereby enabling the production of Model 3. As well, the Gigafactory is expected to be powered solely through renewable energy. Beside

expertise and technological resources, Tesla's image plays a key role in the company's development: Tesla and electromobility have become synonyms, and no other OEM better represents the emergence of a new public environmental awareness. Tesla's image is also reflected in its brand value of almost $ 1.2 billion, which already represents a quarter of that of General Motors. All of this, in spite of the fact that Tesla is still awaiting its first profitable year.

Key Partners As one of the smaller automotive manufacturers, Tesla required support from the big names of the industry. The company joined partnerships with both Daimler and Toyota, providing the two manufacturers with R&D support on electric vehicles. Regarding the cooperation with Daimler, Tesla developed and delivered battery packs and rechargers for the Smart Fortwo Electric Drive, and for the pilot run of the A-Class Electric Drive. For the B-Class Electric Drive, Tesla designed, developed and supplied the entire electric powertrain and battery pack. In return, Daimler provided funding and represented an endorsement for Tesla's quality. During the International Automotive Fair (IAA) in Frankfurt in 2013, Daimler promoted its electric Mercedes B-Class with the slogan "Tesla inside". The partnerships with Daimler and Toyota also enabled Tesla to increase its purchasing power regarding basic component parts, as these can be purchased together. However, Toyota and Tesla ceased their contract in 2014, due to the small sales figures of Toyota's electric version of the RAV 4 SUV, for which Tesla produced the battery pack. One of the pivotal partnerships for Tesla has been the one with the Japanese electronics conglomerate Panasonic. Since 2009, Panasonic supplies Tesla with lithium-ion battery cells, while the two companies have begun to jointly develop nickel-based lithium-ion battery cells. Up to present, Tesla primarily formed R&D and purchasing alliances.

Customer Segments Currently, the company serves two customers segments: individuals and partner OEMs. In the main B2C market, Tesla especially targets customers wishing to buy a radically innovative and environmentally friendly vehicle. Until the serial launch of its Model 3, the company still serves a niche market. Its vehicles are available in around 40 countries, prime markets being the U.S., Norway and China.

Customer Relationships Tesla managed to reach cult-like customer loyalty. While its products and their inherent message provide the company with credibility, customer relationships complete the picture. For instance in 2014, Tesla retroactively extended the warranty of all Model S vehicles to eight years, matching this warranty to that of the integrated battery. Actions such as these reinsure customers that Tesla believes in the quality it offers and dedicates unprecedented attention towards its customers. As it also controls the online ordering and buying process of its vehicles, Tesla can easily ensure that customer experience is internally managed and consistent. Furthermore, by selling directly to customers, it is able to create a seamless buying experience, which in turn results in exceptional customer relationships.

Channels Striving to show its commitment towards customers and to receive fast feedback, Tesla does not see any value added by dealerships in its market segment. The company chose a direct sales approach, which is still highly unusual in the automotive industry—and troublesome to implement, particularly in North America. In 48 U.S. states, direct car sales through the OEMs themselves are restricted, or prohibited by law. For instance in Texas, customers willing to purchase a Tesla are only able to visit showrooms to experience its models, but have to order the vehicles online or in a different state. The company accepted this trade-off and strives to make the buying experience rewarding to customers, by offering extensive and consistent support.

Revenue Streams The total number of Tesla vehicles sold exponentially increased from 3,100 in 2012 to 35,000 in 2014, and to over 70,000 in late 2015. While in 2014 Tesla's total revenues amounted 3.2 billion US $, the company had to accept a net loss of 294 million US $, largely due to rising manufacturing and R&D costs, resulting from the increasing demand for its Model S. Payments from customers are generally made within a week before vehicle delivery, beginning with the confirmation of the delivery date. During the same year, automotive sales (including vehicle, options and related sales, as well as powertrain components) amounted to 99.8 % of total sales. The remaining 0.2 % were generated by development services, such as those for powertrain components and systems for partner OEMs. Two years before, in 2012, 93.3 % of sales were generated by automotive sales, showing that development services play a minor and recently decreasing role in Tesla's revenue model. Regarding revenue generation per geographic area, the U.S. market generated about 46 % of sales in 2014, followed by China with 15 %, and Norway with 13 %.

Cost Structure By counting on its outstanding reputation, word-of-mouth publicity and social media as advertising channel, and by avoiding large-scale advertising campaigns, Tesla has comparably little spending on marketing to other car manufacturers. For instance, competitor Nissan spent 25 million US $ for advertising its electric Nissan Leaf model in 2012. Tesla mainly uses its stores for advertising and cleverly employs social media platforms, which have a high impact while keeping costs low. Savings are hereby poured into R&D. As it still is one of the smallest manufacturers in the industry, Tesla cannot enjoy the same economies of scale as giants such as Toyota or Volkswagen. However, by establishing partnerships with other OEMs, Tesla tries to counteract the size disadvantages and decrease its purchasing prices.

15.5 Industry Outline and Future Perspectives

According to a projection by Statista (2015), global sales figures of electric vehicles will increase from 480,000 in 2015 to 10 million in 2020. This expected development shows that the electric vehicle market is becoming lucrative, attracting more

and more competitors. Currently, Tesla mainly competes with electric models from Nissan, Ford and BMW.

Multi-industry businesses as Google and Apple already design own driverless electric cars, the Google Car or the Apple iCar, and are expected to engage in direct competition with Tesla beginning with 2020. Yet Elon Musk describes the current competitor situation in different terms, drawing attention to a much larger, non-electric competitor group: “Our true competition is not the small trickle of non-Tesla electric cars being produced, but rather the enormous flood of gasoline cars pouring out of the world’s factories every day.”

Another interesting competitor group for the entire automotive industry arises through the increasing availability of car sharing services, such as Uber or Zipcar. Considering lifetime ownership costs of a vehicle, it is already more economical for many city dwellers to use ride sharing services for short distance travel. Although car sharing might gain in popularity and car sales would decrease, Tesla, as other OEMs, has the chance to switch its target customer group. Instead of B2C sales, car-sharing services might become Tesla customers. This is particularly relevant, as Tesla’s vision is to lead the worldwide transition towards electric mobility.

Through its high investments in the development of electric mobility, regarding both vehicles themselves and charging options, Tesla contributes to a key technology of the future. The company broke with conventions by selling vehicles directly to customers, and opening its patents and technologies to the public. However, despite ambitious targets towards emission reduction and environmental consciousness, there are still obstacles inhibiting electric vehicle development, some regarding customer behavior, others relating to the vehicle prices or to aspects such as long-term sustainability of the battery packs for electric vehicles. Thus, it remains open for debate whether Tesla is able to lead a wide-reaching transition toward electric mobility, by releasing economically affordable and dependable electric vehicles, suitable for daily use on short and long distances alike.

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Managing Complexity: The Case of Siemens 16

Werner von Siemens revolutionized the communication medium of the nineteenth century, and astonished Europe, by making communication at an unprecedented speed possible. In his home country, Germany, his company became well renowned due to its successful completion of a telegraph line between Berlin and Frankfurt on the Main in 1849. In comparison to earlier inventors active in the field of telegraphy, Werner von Siemens managed to establish a company based on complex international projects in the modern sense. For this reason, Siemens & Halske, later Siemens AG, is viewed as a business model pioneer in international project business.

The origins of Siemens AG date back to 1847, when Werner von Siemens and Johann Georg Halske founded the Berlin-based Telegraphen Bau-Anstalt Siemens & Halske. A year later, the company started to engage in the project business, through the construction of the first telegraph line between Berlin and Frankfurt on the Main. At this time, Germany was mainly an agricultural country, with preliminary industrial activities. Yet transformations in politics, industry and society were underway, and about to comprehensively reshape the landscape of the mid-nineteenth century.

Beginning with the 1830s, the Industrial Revolution turned Germany from a widely agricultural country to one of the leading industrial nations of the world. Within the first phase of the Industrial Revolution, railway construction and the accelerated production speed in heavy manufacturing and machine engineering changed the German economy dramatically. Machines increasingly replaced traditional handcraft manufacturing methods. Relying on steam engines, coal and iron production increased rapidly, and factories in the modern sense were established. Improvements in transportation, due to railways and steamships, were accompanied by improvements in message transmission. Electrical telegraphy was a communications innovation, which, among other significant applications, also became relevant for railway signaling.

Several scientists took an active part in the invention and development of electrical telegraphy, among whom Werner von Siemens played a leading role. He succeeded in improving the pointer telegraph of the Englishman Wheatstone

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and tasked Johann Georg Halske with its practical completion. In 1847, the Telegraphen Bau-Anstalt Siemens & Halske was born. For awarding the construction rights for the electrical telegraph line between Berlin and Frankfurt on the Main, the Prussian government evaluated the telegraph systems of several inventors. Nine companies participated in this open competition: Brettchen, Drescher, Fardely, Kramer, Leonhardt, Maneri, Moltrecht, Robinson, and Siemens & Halske. Siemens' pointer telegraph was awarded the contract, setting the cornerstone for the future success story. As will be discussed below, on the one hand, Siemens & Halske benefited from favorable economic and political circumstances; on the other hand, it actively co-created a period of revolutionary changes, through its product innovations and their substantial social and economic implications.

16.1 Founders

Werner von Siemens and Johann Georg Halske founded the Telegraphen Bau-Anstalt Siemens & Halske in Berlin in October 1847. Werner's venturesome brothers, Wilhelm and Carl, also joined the undertaking, founding subsidiaries in England and Russia to support the project business.

Ernst Werner Siemens was born near Hanover in 1816, later receiving hereditary nobility in 1888 from emperor Friedrich III. Since youth, Siemens was fascinated by the multinational company of the Fugger family, and was keen on founding a comparable global enterprise—a "Weltgeschäft à la Fugger". Siemens joined the Prussian engineering corps in 1834, as he was interested in a technical career, and left the military five years later, in order to work on his newly founded company. He had an inborn instinct to practically utilize his acquired scientific knowledge and passion for mathematics, physics and chemistry, which he later described as the foundations of his latter success. Despite the fact that establishing a project business in the field of telegraphy entailed high risks, Werner von Siemens was often described as the rather cautious type of entrepreneur.

Johann Georg Halske was a man of action, who wanted to understand how physical principles can be implemented to achieve practical advantages. Halske was described as meticulously precise, with an eye for detail and artful design, aiming to turn every customer order into a perfect masterpiece. This made him one of the most recognized precision mechanics in the Berlin of the nineteenth century. It is during the meetings of the Physical Society in Berlin, where he met Werner von Siemens. After being part of the Siemens & Halske company for two decades, he left in 1867, as the projects on submarine cables became rather hazardous.

Carl and Wilhelm Siemens joined Siemens & Halske a couple of years after the company was founded, in 1849 and 1850 respectively. Both were described as venturesome, and took charge of the international subsidiaries in England and Russia. Wilhelm Siemens was in charge of the first transatlantic cable, set in 1874. Carl Siemens initiated large-scale telegraphy projects in Russia, contributing to the establishment of the international company Siemens AG.

16.2 Market Demand

The political and economic developments of the nineteenth century were calling for more rapid means of communication. Since neither Wheatstone's pointer telegraph nor the optical telegraphy technology were satisfactorily, there was a state demand for improving the communication technologies. By the March-Revolution in Berlin in 1848, the Prussian governmental authorities realized the necessity of secure and fast signaling. Electrical telegraphy was supposed to remove the outdated and faulty optical telegraphy. Due to security reasons, the Prussian government envisioned an underground telegraph line. Out of all companies competing for the job, only Siemens & Halske was able to satisfy this demand, also due to Siemens's idea to insulate cables with gutta-percha. Thus, Siemens & Halske fulfilled the demand for more reliant telegraphy, which was of primal importance for communication and in railway traffic.

16.3 Pioneer Business Model

The following paragraph describes the business model of Siemens & Halske in 1848, at the time of its first project, while Fig. 16.1 provides a summarized overview hereof.

Value Proposition The value proposition of Siemens & Halske was in first line a technological innovation, as Werner von Siemens managed to substantially

<table>
<tr>
<td rowspan="2">Key Partners

Supplier Fonrobert & Pruckner (underground telegraph wires)

Members of the Physical Society in Berlin</td>
<td>Key Activities

Artisan production of pointer telegraphs and telegraph lines

Market analyses

Customer relationship management</td>
<td rowspan="2">Value Proposition

Reliable and fast telegraphy, with applications in communication and transportation</td>
<td>Customer Relationships

Long-term customer relationships envisioned, extensive support of key customers</td>
<td rowspan="2">Customer Segments

The Prussian government and subsequently major industrial enterprises in Germany, England, and Russia</td>
</tr>
<tr>
<td>Key Resources

Start-up capital

Patent for the pointer telegraph innovation</td>
<td>Channels

Direct customer contact</td>
</tr>
<tr>
<td colspan="2">Cost Structure

Cost-driven cost structure: primarily material and labor costs</td>
<td colspan="3">Revenue Streams

Revenues from the completion of the telegraphy network between Berlin and Frankfurt on the Main</td>
</tr>
</table>

Fig. 16.1 Overview of the Siemens & Halske project business model of at the time of the company's launch. Source: own illustration, based on Osterwalder and Pigneur (2010)

improve the formerly unreliable telegraph technology and to establish entire telegraph networks, starting with the telegraph line between Frankfurt on the Main and Berlin in 1849.

Key Activities Even before the launch of his company, Werner von Siemens conducted market analyses about expectable orders for his telegraphs. The company's key activities related to artisan production of pointer telegraphs and telegraph lines. For the Berlin—Frankfurt line, the cables had to be insulated below ground, a time-consuming and strenuous task. Focusing on the reliability of the telegraph network, Werner von Siemens' motto was to advertise through achievements, rather than through words. In order to attract follow-up project jobs, Siemens & Halske also established and cultivated contacts to clients, activities, which can be interpreted as the precursors of today's customer relationship management.

Key Resources As Werner von Siemens did not have much of the starting capital himself, he borrowed a substantial sum from his cousin Johann Georg Siemens, who got a six-year participation right in return. Making sure to only hire the most experienced workers for the telegraph line construction, Siemens & Halske started in 1947 with a fast-growing team of three employees. Besides relying on qualified labor and significant financial resources, the company ensured that the design of its newly invented pointer telegraph was patented by the Prussian Patent Office. In comparison, Siemens AG now has more than 56,000 patents worldwide.

Key Partners Siemens & Halske primarily collaborated with the rubber goods company Fonrobert & Pruckner, which produced and insulated the underground wires for the electrical telegraph line. Since Werner von Siemens and Johann Halske both were members of the Physical Society in Berlin, they were in permanent contact to scholars, scientists and professors, with whom they shared ideas, discussed inventions and future projects. Comparable to the professional networks of today, the Physical Society in Berlin provided Siemens & Halske with a platform for highlighting their achievements and receiving public visibility.

Customer Segments Siemens & Halske had a narrow, yet powerful clientele. The company's first customer was the Prussian government. Initially only building telegraph lines for military and governmental purposes, Siemens & Halske was able to expand beyond this governmental customer segment. Gradually, telegraphy was used not only by railroad administrations for signaling, but also by operating companies for economic purposes. Even before the company's foundation, Werner and Wilhelm Siemens established business contacts in Germany, England and Russia, by merchandizing Werner's innovations.

Customer Relationships According to Decurtins (2002), cultivating strong and close relationships with business contacts was essential for setting a foothold in the industry. Siemens & Halske already had a solid starting point, due to Werner von

Siemens' role as serving officer and advisory member of the military Prussian commission of telegraphy. Yet beside these favorable initial circumstances, Werner von Siemens dedicated constant effort in sustaining and widely developing his business contacts.

Channels Werner von Siemens understood that a contract with the Prussian Army significantly increased his chances of gaining new clients and expanding his business. From this viewpoint, the Prussian Army was a customer and acted as a channel at the same time.

Revenue Streams In its first years, the company's single revenue source was the construction of telegraph lines. As business contacts had already been established before the company was founded, orders and revenues were secure and business risks initially low. Siemens & Halske generated revenues amounting to 10,300 marks in 1848 (Dittler 2014). One year later, a supreme return on sales of 77.5 % was possible, with sales revenues of 58,100 marks and a profit of 45,000 marks.

Cost Structure Due to the artisan production of pointer telegraphs, Siemens & Halske did not require heavy machinery, diminishing its expenses for starting the business. One the other hand, labor and material costs became major cost blocks. Due to the innovative nature of the telegraph business, and to the company's permanent concern for high quality, the cost structure can be described as value-driven.

16.4 Current Business Model

Based on the telegraph project business, Siemens & Halske, and its successor, Siemens AG, founded in 1887, widely developed and expanded the project business, and the corresponding business model, the most relevant changes being comprised in Fig. 16.2 and discussed in the following.

Value Proposition Since foundation, Siemens & Halske expanded into diverse fields of activity. The company's diversification strategy started around the end of the nineteenth century, with the manufacturing of generators, motors, electric lights or streetcars. In comparison to all its German competitors in the field of electrical engineering, as well as to giants such as General Electric and Westinghouse focusing on electric current distribution, Siemens & Halske differentiated by resorting to the entire range of electrical manufacturing. Moreover, by establishing the construction enterprise Siemens Bauunion in 1921, the firm got access to large-scale building projects, while in 1925, Siemens & Halske entered the healthcare market. Today, Siemens AG is a high-technology company providing complete solutions through customer-tailored projects in digitalization, automation and electrification. While the company still creates value for customers by delivering projects, what has changed since its early days is the complexity, the reach and the technology employed and sold through the project business. Moreover, beside

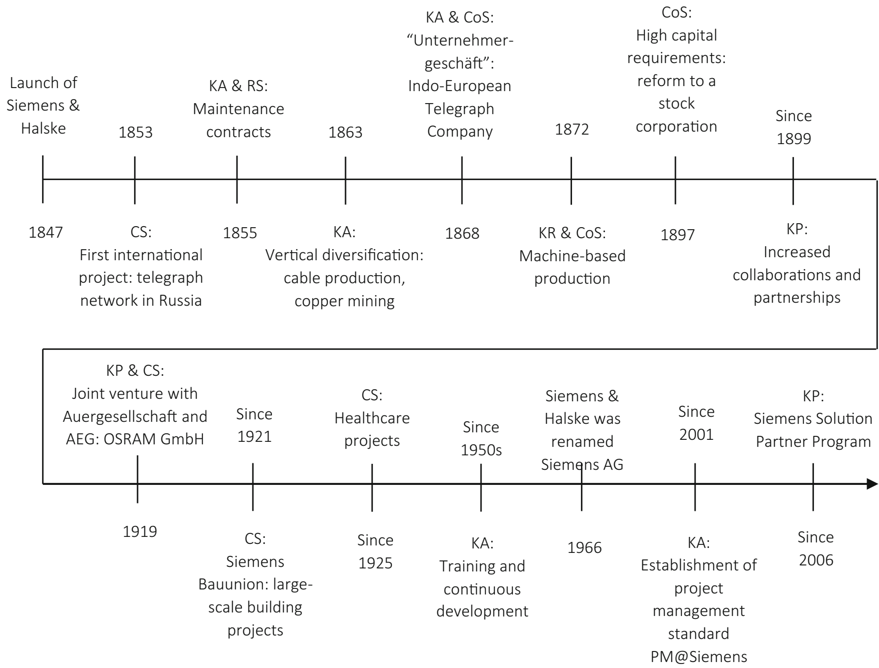

Fig. 16.2 Main changes in the business model of Siemens & Halske/Siemens AG across time. Source: own illustration

remaining active along the electricity production value chain, its main focus is on digitalization, which has the highest market growth among the three segments. The company is aiming at creating webs of systems for its clients, as an industrial application of the Internet of Things.

Key Activities At the turn of the nineteenth century, Siemens, already a multi-divisional enterprise, was the pioneer of international decentralization, already 20 years before DuPont or General Motors in the U.S., whose innovative achievements regarding decentralization are widely stressed (Kocka 1971). At that time, as today, each Siemens unit was in charge of own projects. Nowadays, key account management accompanies the project management itself. The significance of the latter led to the establishment of a company-wide standard, PM@Siemens. This 12-level framework covers the end-to-end project lifecycle with key milestones, quality gates, deliverables and key achievements. Since proficient and experienced managers are vital for project business success, the PM@Siemens-Academy is responsible for training and certifying project managers. As well, project business requires support on behalf of the R&D and financial service departments. Since major projects are only possible through high

<table>
<tr>
<td rowspan="2">Key Partners

Global partner network comprising of a variety of market players (e.g., machine builders and other manufacturers, IT companies, distributors and consultants)

Over 1 000 partnerships with universities, research institutes and expert groups worldwide

Over 1 100 certified solution partners

Network of over 90 000 suppliers worldwide</td>
<td>Key Activities

Project management (by applying the company-wide standard PM@Siemens: end-to-end project lifecycle including key milestones, quality gates, deliverables and key achievements)

Extensive, customer-tailored R&D activities

Financial services</td>
<td rowspan="2">Value Proposition

Customer-tailored projects in the fields of mechanical and plant engineering, energy, healthcare, infrastructure and mobility, automation and digitalization technologies</td>
<td>Customer Relationships

Key account management

High customer involvement in project-related, strategic decision-making processes</td>
<td rowspan="2">Customer Segments

B2B customers around the world:
- Americas
- Europe, Commonwealth of Independent States, Africa and Middle East
- Asia and Australia</td>
</tr>
<tr>
<td>Key Resources

Project team and management (project managers perceived as temporary entrepreneurs)</td>
<td>Channels

Team selling approaches</td>
</tr>
<tr>
<td colspan="2">Cost Structure

Project business is enormously capital-intensive

Sales and administrative costs</td>
<td colspan="3">Revenue Streams

Combination of revenues from customized goods and services

Revenues through project financing</td>
</tr>
</table>

Fig. 16.3 Overview of the current project business model of Siemens AG (the aspects highlighted in *grey* did not undergo major changes across time). Source: own illustration, based on Osterwalder and Pigneur (2010)

financial involvement, Siemens Financial Services provides leasing solutions, project financing and capital to its customers. Major project proposals often require several years of preparation, before Siemens makes a final proposal. During this phase, the company develops the structural and infrastructural logic of the project, and determines its financial viability.

Key Resources In 2015, around 348,000 employees worked for Siemens worldwide, and over 60 % of these work in manufacturing and services, where project management is one of the main career pathways. Project managers initiate, negotiate, plan, construct and deliver the components of a project. In 2011, about 15,000 project managers worked at Siemens, delivering value to customers worldwide. The company perceives project managers as temporary entrepreneurs, which emphasizes their flexibility and level of responsibility. Another key resource for Siemens are its 32,100 R&D employees, who total up to almost a tenth of all its employees worldwide.

Key Partners Siemens has a global partner network comprising a variety of market players, such as machine builders, manufacturers, IT companies, distributors, integrators and consultants. R&D having nowadays reached an unprecedented depth and scope, the company established around 1,000 partnerships with universities, research institutes and other expert groups worldwide. Moreover, during the past 15 years, it also established over 1,000 cooperations in Sillicon Valley alone. As Siemens operates global projects across various industries, it currently relies on a network of over 90,000 global suppliers. Having started with a single partnership in the field of R&D in 1847 with the Physical Society in Berlin, the company enormously broadened and intensified its cooperations, according to its strategic objectives. In 1899, Siemens & Halske and its later competitor AEG jointly improved rapid transit railway operations. Since over a century ago, Siemens & Halske established partnerships with further manufacturing companies, such as AEG or Krupp, and launched the joint venture company OSRAM GmbH with Auergesellschaft and AEG in 1919. As regards more recent developments, Siemens partnered with train manufacturer Bombardier in 2010, for delivering high speed trains for the German Railway. In order to help create more sustainable and livable cities, Siemens and the German Society for International Collaboration started cooperating in 2012. For handling projects in areas, in which its expertise or capacity does not suffice, Siemens established the Solution Partner Program. This program includes over 1,000 certified solution partners in about 60 countries, who are in charge of implementing solutions for Siemens' customers.

Customer Segments Siemens & Halske's first international project started only 6 years after the company was founded, through the establishment of a telegraph network in Russia. In comparison to its early days almost 170 years ago, Siemens now serves customers around the globe, fulfilling Werner von Siemens' initial vision of a "Weltgeschäft", a world business.

Customer Relationships Just as in 1847, projects may last from several months to several years, making sustainable customer relationships essential for long-term success. Professional key account management is hereby crucial. Key customers are involved in strategic decision-making processes, which increases project transparency and speed.

Channels Siemens relies mostly on direct own channels and personal contact to reach key customers. The company has an own global sales force, serving customers on-site around the world. Whereas its project customers generally use buying center approaches, Siemens employs team selling strategies. As a buying center consists of different professions and roles, Siemens' team selling also relies on members with diverse backgrounds, from engineers, to marketing professionals, finance specialists and account managers.

Revenue Streams Revenues from projects imply a combination of revenues from customized products and services. The latter include for instance technical

maintenance, consulting or financial services. Siemens & Halske offered the first maintenance services for the telegraph lines in Russia as soon as 1855. Financial services were already established in 1868, when the so-called "Unternehmergeschäft" was started, during the construction of the Indo-European telegraph line. Currently, Siemens does not account the share of revenue from project business in its annual report. However, according to an analysis run by the company in 2004 and analyses of the Association for Project Management from 2010, it manages more than 50 % of the gross value of sales as projects, totaling around 15 billion € in 2004 and 32.5 billion € in 2010.

Cost Structure As soon as 1897, the family-run business was reformed into a stock corporation, due to the increasing capital requirements of conducting project business. Today, project business is still enormously capital-intensive, as major proposals often require expert teams to dedicate several years of research before finalizing the contract outline. Siemens strives to reduce costs, for instance by continuously improving project management standards. Major cost blocks are the cost of sales and administrative expenses, alongside with expenses for R&D (Fig. 16.3).

16.5 Industry Outline and Future Perspectives

Due to its mixed portfolio and global activities, Siemens AG competes with a vast number of companies, the foremost of which is the U.S.-based conglomerate General Electric (GE). Other leading companies competing with Siemens in special business areas are, for example, ABB in automation technology and Bombardier in mobility.

As a diversified multinational technology group with nine divisions in the core fields of electrification, automation, and digitalization, Siemens AG is facing likely competition both on a global and national scale, as well as on divisional and corporate level. In order to become a serious competitor for Siemens on a whole, a multinational technology conglomerate has to arise. Mergers and acquisitions make this possible: for instance, by the expected merger of Hitachi and Mitsubishi Heavy Industries, as the companies already cooperated in their bid for Alstom and have previously initiated discussions on a possible merger.

Moreover, Siemens AG will likely face competition from conglomerates in emerging markets, for instance from India's largest construction and engineering conglomerate Larsen & Toubro, also operating in electricity, electronics, and IT. The Indian Tata Group would also become a competitor of Siemens, if it chooses to increase its strategic focus on project business and electrical engineering. Besides competition on a corporate level, Siemens faces new competitors on divisional levels as well. For instance, in the field of mobility, Siemens AG might be facing competition from Chinese train manufacturers China North (CNR) and China South Locomotive and Rolling Stock Corporation (CSR), which merged into

CRRC Corporation in December 2014. As the Chinese railway market growth is slowing down, the new corporation strives for orders outside China, and thus might become a competitor of the mobility division of Siemens AG. Regarding the division Building Technologies, the company GIRA, offering modern intelligent building technology products, services and solutions, might also become a serious competitor. Since 2013, GIRA tries to make a name for itself in the B2C segment, rather than solely focusing on B2B customers. By creating public awareness of GIRA's smart building technologies, customers—commercial and private—might switch their building technologies provider. However, GIRA is still a much smaller company than the Building Technologies division of Siemens: GIRA generated revenues of 156.6 million € in 2014, whereas Siemens' division generated 5.557 million €.

Another field of competition will emerge around the phenomenon Industry 4.0, as the internet has found its way into the production hall. Triggered by the internet, the so-called fourth industrial revolution focuses on the establishment of products and production processes, which are able to transfer information to one another. Siemens dedicates an entire new division to this phenomenon, the Siemens Digital Factory. As Industry 4.0 topic has become a major contemporary trend, more and more companies, but also countries such as U.S., India or China are focusing on developing and implementing such technologies. Since advanced simulation-software is a major keystone for Industry 4.0, Siemens has to primarily consider its strategic positioning regarding IT firms such as Google, IBM, Microsoft, or SAP.

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17 Key Learnings: How to Start a Pioneering Business Model?

Having investigated 14 pioneering business models, we now move on to synthetize the key insights provided by the companies, which may provide inspiration for practitioners interested in learning from well-established business models.

At the time of their launch, the pioneers ventured to bring newness to the world by developing coherent and original business models. Today, most of them face questions of a different nature, some of which concern the numerous imitators that make an effort to cultivate and develop the business models introduced by the pioneers. In response, besides striving to keep the competitiveness of their business models, some of the pioneers shifted their strategic orientation to either make the most of their well-renowned brand in the short-term, as The Body Shop does, or to attract mass consumers for their initially niche products, as Starbucks did. However, nearly all business model pioneers discussed in this book kept their orientation towards the abilities and values, which helped them break the mold in the first place. So what can be learned from the pioneers, beside how to create an internally consistent and unusual business model?

The diverging strategies of the *retail pioneers* for drawing a solid customer base show that a multitude of approaches is suitable in this industry, provided there is a stable fit between the business and its target customers. Both Aldi and Starbucks are part of non-premium industries. While Aldi chose an unparalleled focus on costs and rigorously eliminated all additional cost drivers, Starbucks chose the diverging approach and saw its products as part of a more extensive value proposition, the Italian café experience. Starbucks created a service from a product, being at the time of its launch one of the first authentic coffee houses in the U.S. Starbucks related its products to the Italian culture of conviviality, and showed how culture plays a significant role in the marketing of consumer products. Although Starbucks is, at its core, a coffee retailer, the company does not simply sell products, but provides an emotional state: convivial, social and relaxed. Similarly, The Body Shop began by addressing a niche customer group, unconventional women interested in functional beauty products. By building a business with a higher purpose, that of helping to abolish animal testing in the cosmetics industry, as well as

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through social and ecological engagement, the company managed to sustainably draw an increasing customer base, and is one of the forerunners of social business.

Now a retail giant in the IT industry, Dell began shortly after its launch to target a most profitable customer group, B2B customers, while recognizing which product characteristics are essential. Customers were interested in price, performance and customization options of the PCs, which the industry incumbents could not provide in the same manner as Dell, due to the established indirect distribution. By rethinking the distribution channels, Dell pioneered a direct distribution model that has afterwards been employed in various industries, even in the automotive industry through Tesla. Amazon created a fully new marketspace in the online medium, and set the stepping stone for a number of online retailers. By choosing to start in a retail branch with virtually nonexistent online competition, book retail, Amazon was able to build a brand and step by step extend the product range sold on its platform, developing from a specialist to a generalist.

From the heterogeneous group of *pioneers in media and entertainment*, Google provides insight into the importance of recognizing who the key customers are, and shows how to develop a business model starting from this customer group. Unlike previous search engines, Google focused on providing relevant results for search customers, as opposed to heavily advertised results. For a multi-sided platform like that of Google, it is important to first establish the adequate value proposition for the primary customer group, and only in second place, crystalize the revenue model from the second customer group, advertisers in Google's case. Providing from the outset a compelling value proposition for the primary customer group helps to increase the numbers in the second customer group. This logic is now widely used by a variety of e-business models, particularly in mobile infotainment apps. With a different aim in mind, namely that of providing not only a compelling and interesting news medium, but also helping readers to take a proactive role in news interpretation, Huffington Post is one of the pioneers of interactive journalism. The company helped bloggers to receive public recognition for their work, and helped to create a self-sustaining blogging community.

What is striking about Disney, the next company discussed in the media and entertainment industry, is its focus on state-of-the art technologies at the time of its launch. The use of sound and color, paired with creative and heartfelt stories and characters, helped the company build a business model as an animation studio, and use this business model as the base for creating a media empire. Like no other company, Disney shows the importance of creating and profiting from synergies between its departments Media Networks, Parks & Resorts, Studio Entertainment, Consumer Products and Interactive Media. Similarly to Disney, Netflix employed an innovative technology at the time of its launch, the DVD, to establish a pioneering business model in the movie rental industry, the DVD-by-mail business. A decade later, the company departed from the initial value proposition and distribution channel, to focus on its streaming business model. Besides distribution content, Netflix nowadays creates own content, showing an unceasing ability for rethinking its business model. Another emerging player in the media industry, Spotify, started its business model with a basic question: how to convince music

listeners to stop downloading pirated music? By first persuading major record labels of its potential, and then providing customers with a free-of-charge and simple alternative to pirated music, Spotify managed to raise awareness in a wide array of geographical locations, and to start a comprehensive expansion strategy.

The *service pioneers* demonstrate that focusing on the core customer issue, in disregard of established business models, can help companies become creative regarding the way of solving basic customer problems. The examples of edX and Southwest best illustrate this: by relying on cooperations with renowned universities and distributing course content online, edX helps democratize higher education in areas where it is not available or is too expensive. On the other hand, Southwest was able to create a new offer for a new customer group by gaining, as soon as the 1970s, holiday travelers as air travel customers. The company mainly achieved this by being extremely cost-driven in its operations, and original in its customer communication.

Finally, among the *manufacturing pioneers*, Tesla managed to create widespread awareness of its electric Roadster vehicle and subsequent limousines, at a time when e-mobility is only slowly and unevenly gaining terrain. The company marketed its products from the very beginning as exclusive, triggering the interest of more and more customers for its upcoming mass market models. A key learning from Tesla is not to expect the mass market to adopt radically new technologies, but to slowly familiarize customers groups with technologies, which have previously been tested by customers interested in exclusive products. Finally, Siemens in its earlier days introduced an own approach to bringing a new and complex technology to the market, by focusing on providing solutions rather than products, together with ensuring that customers understand the significance of the technology. Siemens hereby helped set the base for customer relationship management.

All business model pioneers discussed so far provide answers beyond that of how to start an innovative business in their respective industries. The companies offer insights into how to create sustainable and coherent business models, while providing strategic inspiration on questions regarding customers, value creation and value capture.