CHAPTER 2

THE ELEMENTS OF BUSINESS MODELS

1. The business model

Let's start with a question: what do all businesses want? Well, that's an easy one, they all want success! However, 'How can a business achieve that success?' is a much harder question to answer. CIMA claims that one route to success is for '**businesses to meet the needs of customers, satisfy all the other stakeholders and deliver benefits for society at large**!'

Easy, right? Well, perhaps not!

Actually, the route to success can be taken one step at a time, and one of the very first steps to achieving success is for an organisation is to have a framework by which all aspects can be considered. That's where business models come in.

But what exactly is a business model?

At its simplest, a business model is **an organisation's plan for achieving its objectives**. Now, the objectives of an organisation will depend on the type of organisation it is; for a business, its objective may be to earn a profit or increase revenue, whilst for a charity it may be to expand its services to maximise the benefits it provides to society.

Let's look at the low-cost airline Ryanair. What could its main objective be? Well, the CEO, Michael O'Leary, is eligible for annual multi-million-pound bonuses if Ryanair's profits hit a certain level. So it seems safe to say that achieving a sizeable profit ranks highly on the list of the company's objectives! Not only for Michael, but other shareholders too.

But, the business model doesn't stop there, remember, it's is a plan to achieve objectives, so what is Ryanair's plan? It's based on cutting costs throughout every part of the business, and then being able to charge lower prices for flights than competitors. It then provides a lot of flights, so while profit margins are low, the volume ensures the company as a whole is very profitable. It also earns extra revenues charging for 'luxuries' such as being able to sit next to friends and family or putting large bags in the hold.

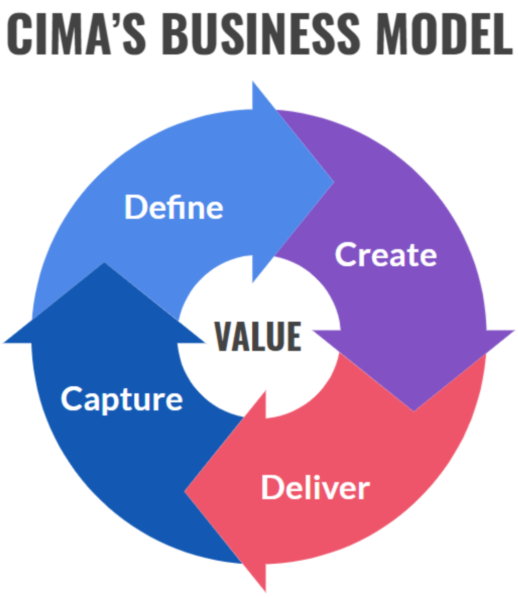
So, they have a business model based on low costs, low prices and high volumes. But that's just one successful business model.

Let's contrast that with Apple. Its aim is also primarily to achieve profit. However its business model is very different. It focuses on high quality, superb design and leading-edge innovation as a way to charge high prices. It's a very different model from Ryanair's, but it's very successful, too.

So, that's the crux of a business model. It answers the question "What's the over-riding approach the organisation is taking to make it successful?"

CIMA's approach to business models

CIMA have developed a framework to explain business models in more depth. Firstly, let's have a look at a diagram of CIMA's business model approach:



As you can see **value is at the centre of the model** and, around the outside are **four stages of the approach, starting with define and moving around the circle clockwise**.

Returning to Ryanair. Its **central value represents it's over-riding purpose**, which we might say is hitting profits targets. Each of the four stages represents a step that the company needs to consider to achieve that value.

Let's look at a brief introduction to those terms and consider what they might be for Ryanair:

- **Define value** – In this first stage, the organisation looks at **what they are creating (the goods or services for example) and who they are creating them for**.

  If we return to our Ryanair example, we've already seen that it is trying to create value for their shareholders in terms of profit and share price. But is that all? Well no, there will be a number of different groups it has to create value for, and the main one in their business model is customers. Ryanair has to ensure that it is offering competitively priced flights to destinations its customers want to travel to. There are other stakeholders too, such as suppliers, employees and governments, and the needs of those stakeholders also need to be considered and prioritised.

- **Create value** – Having defined the groups that value is being created for and what the value is, at this stage of the business model the organisation looks at **how it will deliver that value to those groups, what resources will need to be sourced and used**, **and how those inputs will be turned into the outputs required**.

  A key aspect of Ryanair's services from the customer's perspective is that they have the opportunity to purchase cheap tickets to destinations that they want to travel to. At this stage of the business model, Ryanair will look to see how it can make operational savings which can be used to keep the price of its services low. Amongst other things this could include: keeping staff numbers low, using online booking only, automated check-in and buying planes and fuel in bulk to obtain discounts.

- **Deliver value** - In this stage, **the created goods, services or experience now have to be delivered to the group they were created for** – those that were identified in the define value stage.

This is the operational stage, which, for Ryanair, would involve having the processes ready so that the customers would be able to purchase, board and travel on the aeroplanes, reaching their destination safely and hopefully with all their luggage! This would be provided in an economical, but efficient way.

- **Capture value** – After delivery, and once revenue has been received from the customer, it is time for the **surplus value (the value, financial and otherwise, that remains once costs have been subtracted)** to be shared between the organisation, the shareholders and the other stakeholders.

  So, let's imagine that Ryanair hit the profit levels it set for its CEO to get his bonus, it would be at this stage that the value created (in this case the surplus profits) would be shared with him (in the form of his bonus) and to other shareholders in the form of dividends. Strong long-term profits are also likely to increase the share price, which also adds value to shareholders.

We will explore each of these stages in greater detail throughout this chapter. But before we do, we have to look in more detail at the central focus of the model, 'value'.

2. Value

In business, the value of something is often reflected in its monetary value, for example, Ryanair offers tickets to customers at a low price which we might say is 'good value'. So, it may be a surprise to learn that, **in business terms, the concept of value isn't just about the price, or even costs and cash flow**. These are important ways of measuring value, of course, but not all things of value are paid for. For example, farmers value good weather so they can grow their crops, but they don't pay for it!

There are other ways a company can generate value:

Utility

Utility refers to **the satisfaction that customers get from their consumption of goods or services produced by the organisation**.

Ultimately the customer of Ryanair is getting satisfaction from arriving at their destination, and doing so quickly and cheaply.

Now, satisfaction might be higher if the seats were more spacious and comfortable, the food of gourmet quality and there were a selection of the latest cinema releases available on a large screen to watch during the flight. However, in Ryanair's case the extra costs of providing that is not worth the extra price that would have to be paid for their customer group. In fact, as Ryanair is a low budget airline, its customers' satisfaction will most likely increase as ticket prices decrease!

By focusing on the utility the customer gets, the organisation is trying to **create value in the form of delivering satisfaction by providing a product, service or experience for an identified stakeholder at an acceptable price**.

Shared value

The concept of value doesn't stop there; it also includes the idea of **shared value, which is the belief that a business can deliver both long-term shareholder value as well as providing a benefit to society**.

Let's look at Nestlé, the multinational food and drink processing conglomerate, as an example here as it is a shared value pioneer.

Nestlé has separated its shared value into two sections: priority and organisational. One of its priority areas is making sure its products are nutritious and deliver health benefits to the consumer. For a confectionery manufacturer it's, perhaps, a surprise, that Nestlé is aiming for health benefits for consumers. By doing so, though, it will drive important decisions about future products, and how to make them taste great whilst maximising health.

Its operationalising shared value areas focus on meeting societal needs with regard to its operations, so include making sure that its resources are used more efficiently, meaning there's no wastage which helps sustainability. Nestlé also ensure that conditions are improved its producers and farmers for local economic and social development.

With these policies, Nestlé is aiming to produce value for the business, consumers, employees and suppliers, as well as connected families and communities.

Value drivers

The concept of value also applies to value drivers. **A value driver is an activity that adds value to an organisation's goods or services**. Value drivers can be either tangible or intangible.

Tangible value drivers refer to a physical reason or quality for the added value. For example, Nike's trainers are made from tough, durable rubber, produced to high specifications to make a quality training shoe. They are the physical assets which give the product its value.

Intangible value drivers are non-physical. For example, Nike is a famous international brand; its logo is added to all of its products. While this doesn't improve the products physically, as we saw with tangible value drivers, it does add value in the eyes of the consumers who are willing to pay more to own a pair of Nike trainers, rather than an exactly comparable trainer minus Nike's logo.

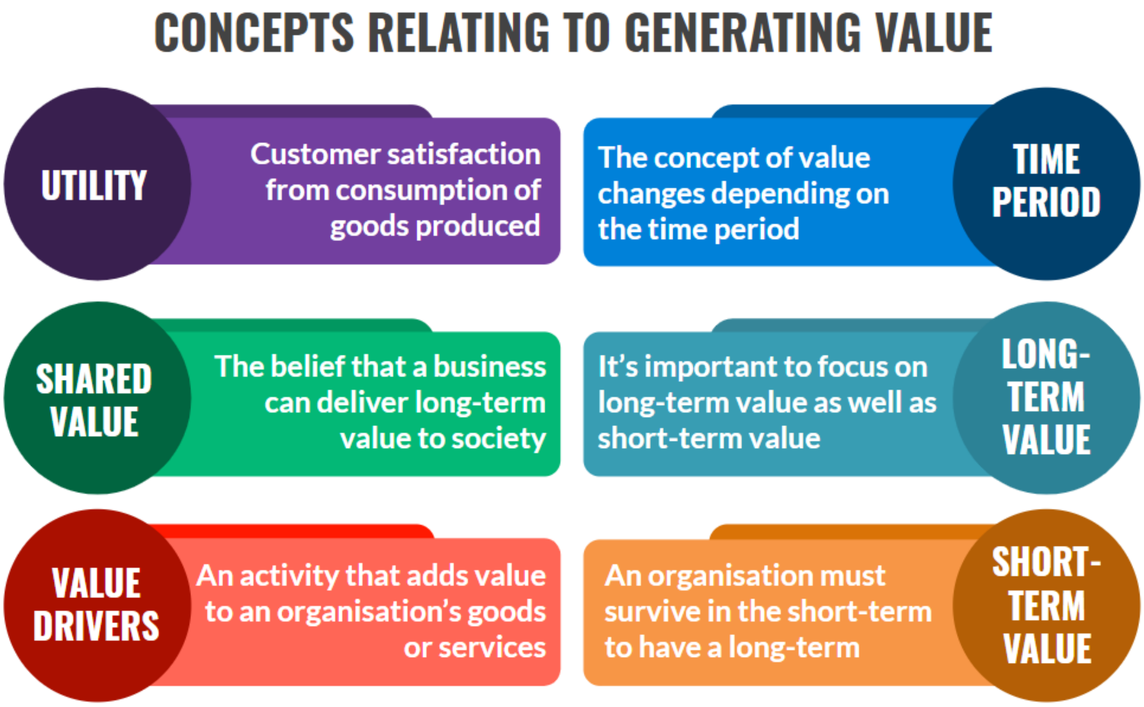
Time period

The concept of value also changes depending on the time period: past, present and the future. Past value is often used for financial reporting such as on balance sheets. Present value is often used for day-to-day operational management such as on budgets and future value is used for investment appraisals.

Long term and short term

Value covers both the short- and long-term prospects of the organisation. It is, of course, important that the organisation has to survive in the short term if the organisation is to have a 'long term', but it is important not just to focus on short-term value and risk undermining any long-term value.

In 2019 when Thomas Cook, the tour operator went into liquidation, it was operating a business model that had been extremely successful 20 years earlier, with a group of travel agents, hotels and aircraft which combined to provide package tour holidays. Firms such as Ryanair and AirBnb, combined with people researching and booking their own holidays online at lower cost, changed the industry though. Thomas Cook did not adapt to the change, and while in the short-term it continued to be profitable, in the long-term it needed a new business model to survive.



The importance of business models

So, why are business models important?

Reporting

Firstly, **some regulators require some organisations to present their business models when reporting to shareholders**. The UK Companies Act, for instance, requires organisations to include a strategic report as part of their annual report, and the business model should be at the centre of that report.

Better performance

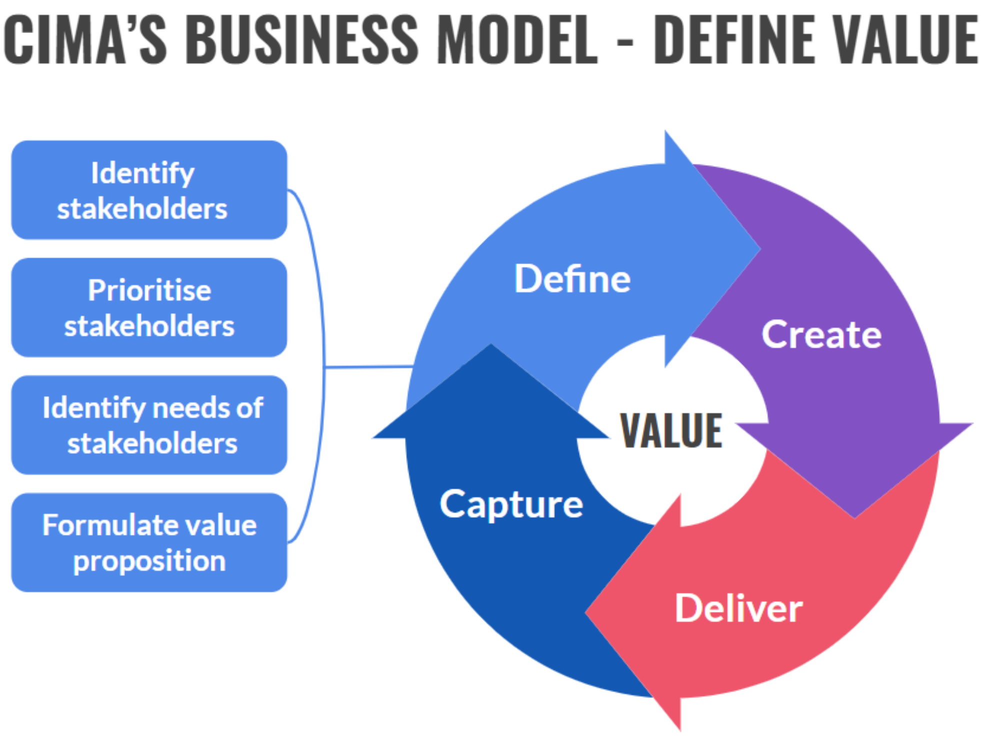
Secondly, even for organisations that aren't required to include business models in their reports to shareholders **CIMA suggests that organisations with business models perform better over the long term**, as "business models are the means by which the organisations create long-term value and sustained success."

Responding to industry disruption

And thirdly, just as with Thomas Cook, industries and businesses can change quickly. This is called 'disruption'. It often results from a new technological innovation which alters a traditional business model. Uber disrupting the taxi industry through the use of apps and driver-owned vehicles, is another example.

Organisations must ensure their business model continues to be appropriate by adapting it to the changing environment to ensure it continues to drive the company's success in the long term. Perhaps Thomas Cook would have survived had they changed their business model earlier!

3. Define value



Let's begin to explore the concept of business models in more detail. Before organisations can get to the process of creating value **they first have to define value**.

In this stage of the business model the organisation defines value by asking three questions:

- **Who they are creating value for?**
- **Who they are creating value with?**
- **Why are they creating value?**

So who are the people mentioned in these questions? Well, they are the stakeholders.

But what exactly are stakeholders?

Stakeholders are **any parties that have some kind of interest in the business and can either affect, or be affected by, the activities that it undertakes**.

Let's imagine a publicly funded school, who would the stakeholders be? Well, we would probably quickly come up with a list that included:

- Teachers
- Pupils
- The pupils' parents and families
- The administrative staff
- The local education authority

All these groups can clearly affect or be affected by the school's strategy and policies. So would this be it? No! It would also include:

- Teachers' unions – Who could organise a strike if they didn't agree with the school's policies
- Local businesses – Who may offer work experience or internships to pupils
- The wider community – House prices may be affected by a school with a great reputation, or a bad one!

- The local council – Who will run other services for pupils that will require collaboration with the school
- Other local schools - Who may be competitors, trying to achieve better results to attract more pupils
- Local media – Who will report, favourably or unfavourably on incidents at the school
- Exam boards – Schools must hold exams based on the rules of the exam boards they choose to use
- The government – Who decide how much of the national budget goes towards education

So there we go, a list of lots more stakeholders that you may not have immediately first thought of. However, this is still not an exhaustive list and the brief examples of how they may affect/be affected by the school are also not the only ways it could happen!

Exercise

Now let's turn our attention to the stakeholders of a business, rather than a not-for-profit. Spend some time examining who you think the stakeholders for a low-cost airline such as Ryanair would be.

As you do so, consider what those stakeholder's interest are.

Once you've finished, take a look through our list and see if there are any you missed.

Solution

Ryanair's stakeholders would include:

Stakeholder	Explanation
CEO	As of 2019 Michael O'Leary was the chief executive officer of Ryanair and also had a significant amount of shares, as a result O'Leary could both affect and be affected by Ryanair's strategy and policies.
Funders (e.g. Irish Air)	Irish Air provided a loan and equity to Ryanair in return for shares. As shareholders they would be interested in the performance of the company, which can be affected by the organisation's strategy and policies. Also, as shareholders, it will have voting rights which could shape the strategy and policies of Ryanair.
Trade Unions	Some of Ryanair's employees in certain countries, such as England and Italy, are eligible to join a union if they wish. Trade unions are able to affect the policies and strategy of Ryanair by taking strike action if they feel the strategy and policies of Ryanair are not fairly affecting their members.
Employees	Employees of any business can obviously be affected by an organisation's strategy and policies. Of course, depending on the position of the organisation they occupy, they can also affect the organisation itself.
Airports	How are airports stakeholders? Well they are really interested in the strategy and policies of Ryanair, because if Ryanair flies to them it will bring lots of revenue to the airports, both from Ryanair directly, and from their passengers.
Suppliers	Ryanair will have a multitude of different suppliers; from on-board food suppliers to the manufacturers or lessors of planes. All of them will be affected by Ryanair's strategy and policies, after all, what if Ryanair decided to use a competitor or double the number of planes they own?

Competitors	Competitors too will be affected by Ryanair's strategy and policy choices, for example, if Ryanair changed its pricing structure its low-cost competitors would have to respond and vice versa.
Customers	And lets not forget Ryanair's customers! If they chose not to use Ryanair any more they would dramatically affect Ryanair's strategies and policies! Let's imagine that Ryanair, a low cost airline, decided to change its policy to become a more expensive airline, offering its customers more extras, that may mean it would lose its existing customer base but possibly gain a new one. This is an extreme example but it demonstrates what an important group of stakeholders customers are!
Environmental groups	Organisations can face opposition by external pressure groups. In the case of Ryanair many environmental groups are unhappy with flights as it is a high polluting form of transport.
Charity partners	Ryanair has a number of charity organisations that it supports financially.

This is not an exhaustive list of all of Ryanair's stakeholders but hopefully it demonstrates the wide array of different individuals and groups that have to be considered when setting a strategy.

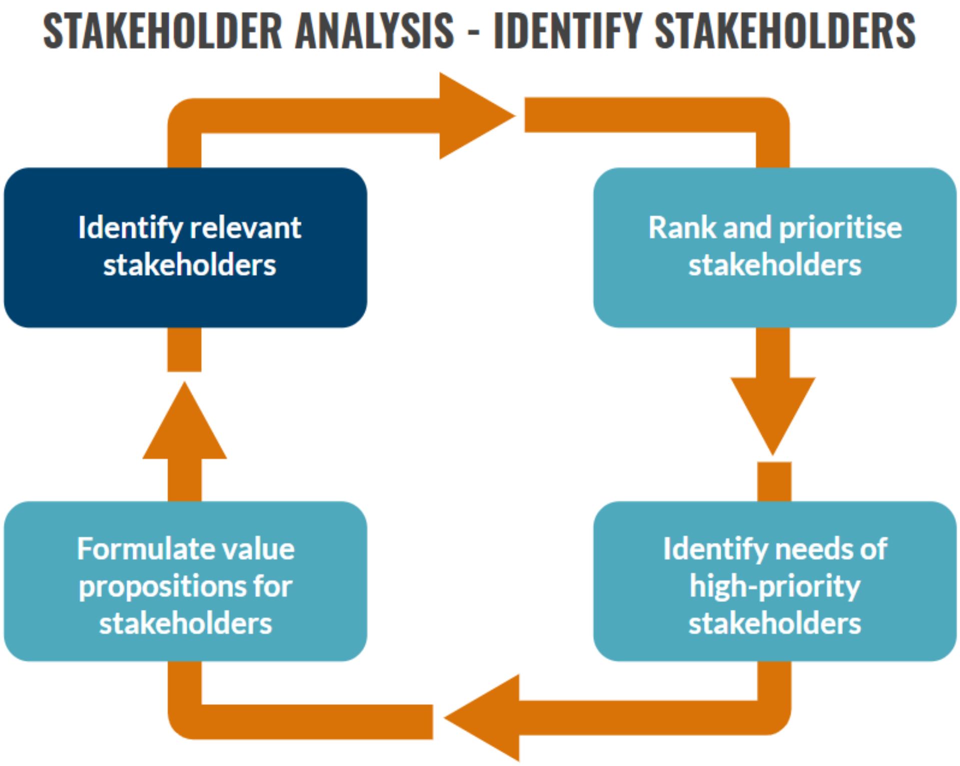
OK, so now we know what stakeholders are we can begin to answer the three questions we asked at the beginning of this section and start to define the concept of value.

The concept of value and stakeholder analysis

The define value stage involves the organisation understanding who they are creating value for, who they are doing it with and why they are doing it.

To help define value, an organisation could follow these four steps to analyse a company's stakeholders:

Step 1. Identify relevant stakeholders

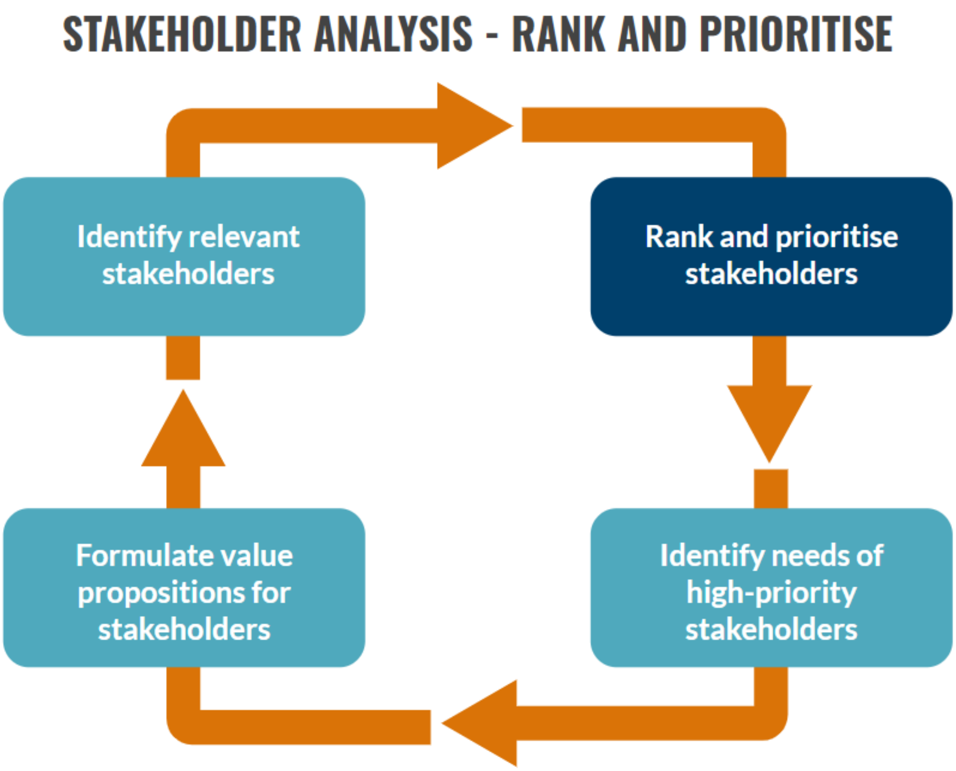


In step one, the organisation identifies the stakeholders who it will create value for and who it will create value with. These stakeholders will mainly be **customers and shareholders (for whom value is being created) and employees and suppliers (with whom value is being created)**, but as we've already seen, there are many different types of stakeholders to think about.

Let's think about our school example of which we've already identified a wide range of stakeholders, which stakeholders would the school be creating value for and with whom would they be creating it?

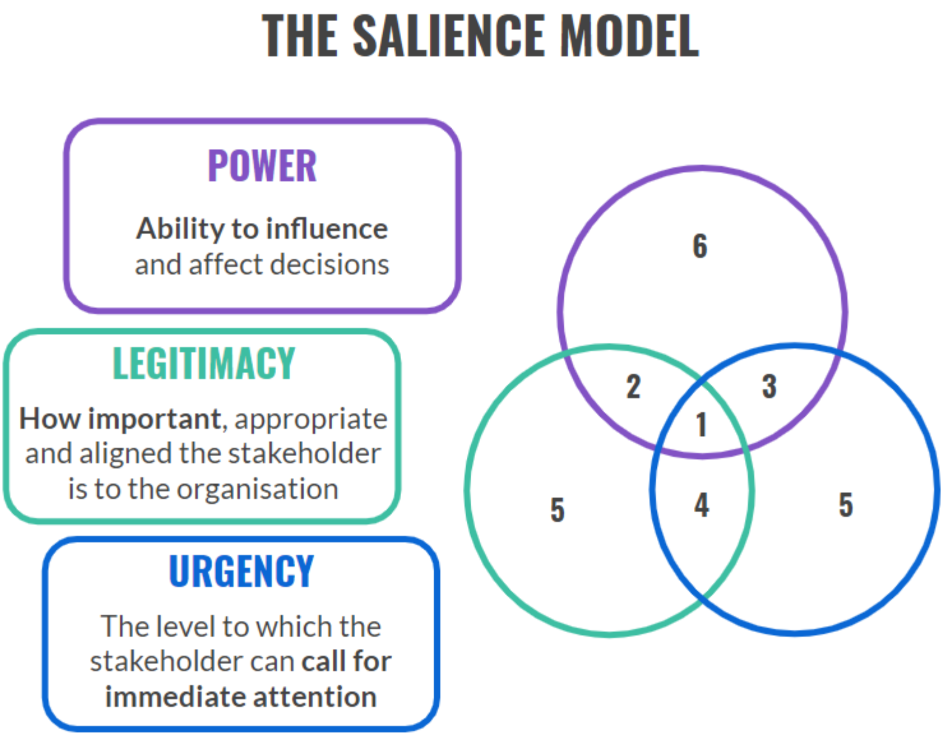
Value for:	Value with:
Pupils	Teachers
Parents and families	Local businesses
Teachers (salaries)	Board of governors
	Various suppliers
	Administrative staff

Step 2. Rank and prioritise the stakeholders



In this stage of the analysis, **the stakeholders of an organisation are ranked and prioritised in terms of the level of their power, urgency and legitimacy**.

A simple way to rank and view an organisation's stakeholders is to plot them on a Venn diagram, as in the illustration below. This is often referred to as the Power, Urgency, Legitimacy Model or Salience Model.



The stakeholder ranked as number 1, which here could be the regular customers of a profit-focused organisation, occupies the position at which all three circles overlap. Whereas the stakeholder ranked as number 5 in the urgency circle has no power or legitimacy, such as a recruitment agency that needs to send applications to the organisation by a certain date.

So we've discussed that stakeholders can be ranked using three factors: **power, legitimacy and urgency**, let's take a look at each of them in more detail, and see where the stakeholders from our school would feature.

Power

If stakeholders are characterised as having **power it means they are able to influence and affect the organisation**.

You may have noticed that this definition of power makes up one half of our overall definition of stakeholders, **any parties that can affect, or be affected by, an**

organisation's strategy and policies, but the focus here is only on those that can affect an organisation.

So who would have the power at a school? Well the teachers in senior positions have the ability to affect the policies of the school due to their position, as do the board of governors who would decide the strategic direction of the school.

A stakeholder who wouldn't have much power would be a dinner lady. This is because dinner ladies only work for the school on a part-time basis and their limited role means they would be unable to affect any policy or strategy changes.

An example of a business stakeholder with high power would be a repeat customer that placed large orders. This is because the business would try and retain the custom and would listen to requests made by these customers.

Legitimacy

The level of legitimacy a stakeholder has is defined by how important, appropriate and aligned the stakeholder is to the organisation.

Let's return to our school and imagine two companies are offering to supply the food for the school's lunch room. One is offering balanced healthy meals with fresh vegetables and fruit, the other food that they say pupils love; pizza, chips and desserts. Which supplier would be the most legitimate choice? Well, that would be the one most aligned with what the organisation is aiming to do. And as the school has a duty not just to try and get the best grades for their pupils but also to take care of them, that would be the supplier offering a healthy menu.

Urgency

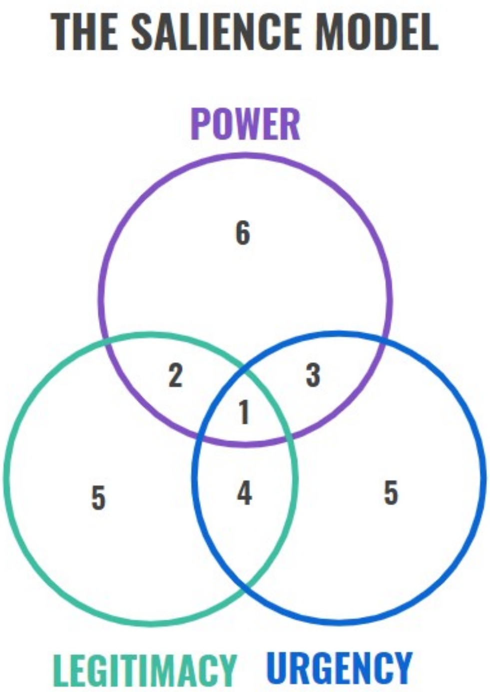
Urgency is defined as the level to which the stakeholder can call for immediate attention. This could be because the stakeholder's **requirements are time-sensitive** and have to be addressed instantly, for example, a tax authority demanding payment by a certain date. Or perhaps an organisation has such a **critical relationship** with a stakeholder that they have to address the issue, for example, if a pupil suddenly starts acting strangely and misses a lot of school, then the school would act quickly to find out the cause of this unusual behaviour. This is because of the duty the school have to each of their pupils.

The more of each of the three factors (power, legitimacy and urgency) a stakeholder has in regards to the project or organisation, the higher their ranking. An organisation would typically prioritise stakeholders that have all three criteria.

Exercise

Before we move on, look back to the stakeholders that were identified for Ryanair and aim to find one example of a stakeholder for each position in the salience model.

Try it yourself before looking through our solution. Go on, we know you're tempted to just read through the solution, but you'll learn a lot more if you try yourself first!



Solution

Position 1- Michael O'Leary would be a good example of a number 1 position in the salience model. He has the power to affect the company's policies and strategies, so satisfies the power criteria. His concerns are aligned with the company, so he also fulfils the legitimacy criteria. Also, because of the role O'Leary has, he could call for immediate attention, so he would also fulfil the urgency criteria.

Position 2 – Trade Unions' interests are not aligned with the company but their members, so they don't have legitimacy. However, if their members become dissatisfied they could affect the policies of Ryanair (Power) and any issues they raised would have to be responded to quickly by Ryanair, so as to ensure the situation didn't escalate.

Position 3 - In this position, the stakeholder has no urgency. For Ryanair, this could be the owner of buildings Ryanair lease from them – they have power due to their ownership of important buildings and legitimacy because both companies are likely to want the relationship to continue long-term.

Position 4 - Stakeholders occupying this role have no real power but urgent and legitimate concerns, so for Ryanair, this could mean a non-unionised member of staff who has legitimate safety concerns which the organisation should consider.

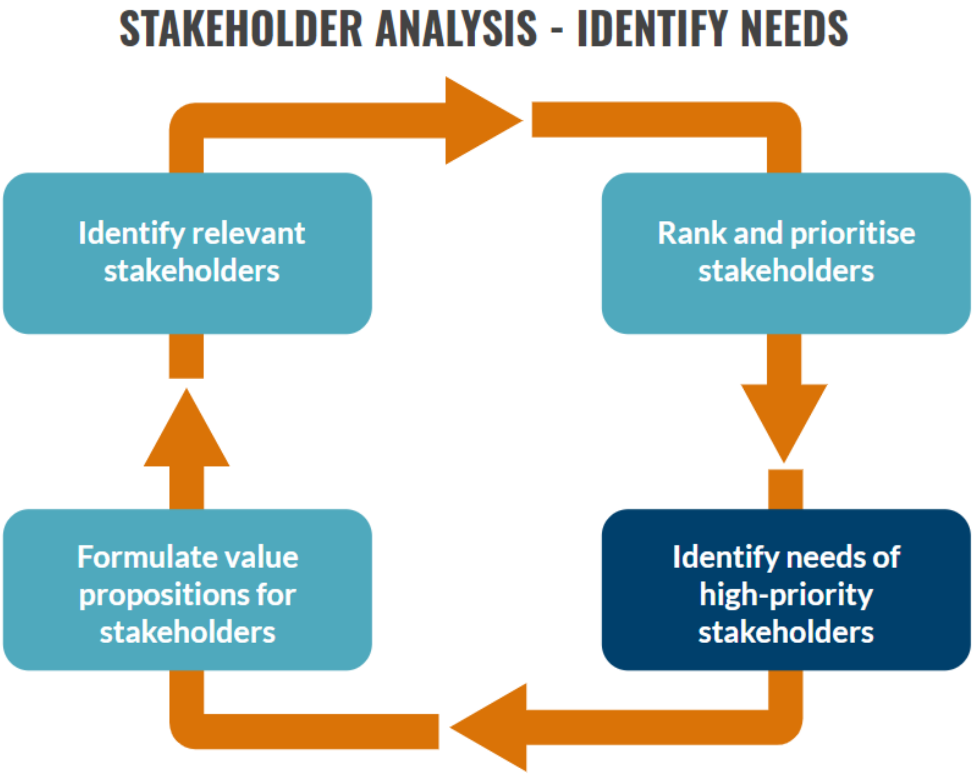
Position 5 – **Legitimacy** – An example of this could be the charity partners of Ryanair, whose interests are aligned but have no power or urgency to their claims.

Position 5- **Urgency** - An example of this could be a non-unionised staff member asking for a raise outside of the normal policies. They don't have any power and legitimacy, but they are being demanding and vocal.

Position 6 - These stakeholders have power but that is all. One example of this may be a government authority that has the power to impact Ryanair policies but has no current issues with Ryanair.

So here's a small example of positioning on the salience model. In the real world there would be far more stakeholders for each position!

Step 3. Find out the needs of the high-priority stakeholders



Once the stakeholders have been ranked and prioritised, an organisation can identify the needs of those stakeholders in a bid to make sure they are satisfied.

But what do we mean when we talk about needs? Well, for the pupils of our school it would an education that would prepare them for their exams or their working life.

The table below gives a general guide to what certain groups of stakeholders of a business may need.

Stakeholder	Needs of the stakeholder
Directors	Pay, bonus, overall performance, job security
Employees	Pay, bonus, personal performance, job security
Shareholders	Share price growth, dividend payments
Customers	Prices, quality, delivery times, assured supply
Suppliers	Assured custom, high prices
Financiers	Interest payments, ability to pay back loans
Government	Tax, law, wealth of nation
Pressure groups	Environment or other ethical issues, pricing, etc.

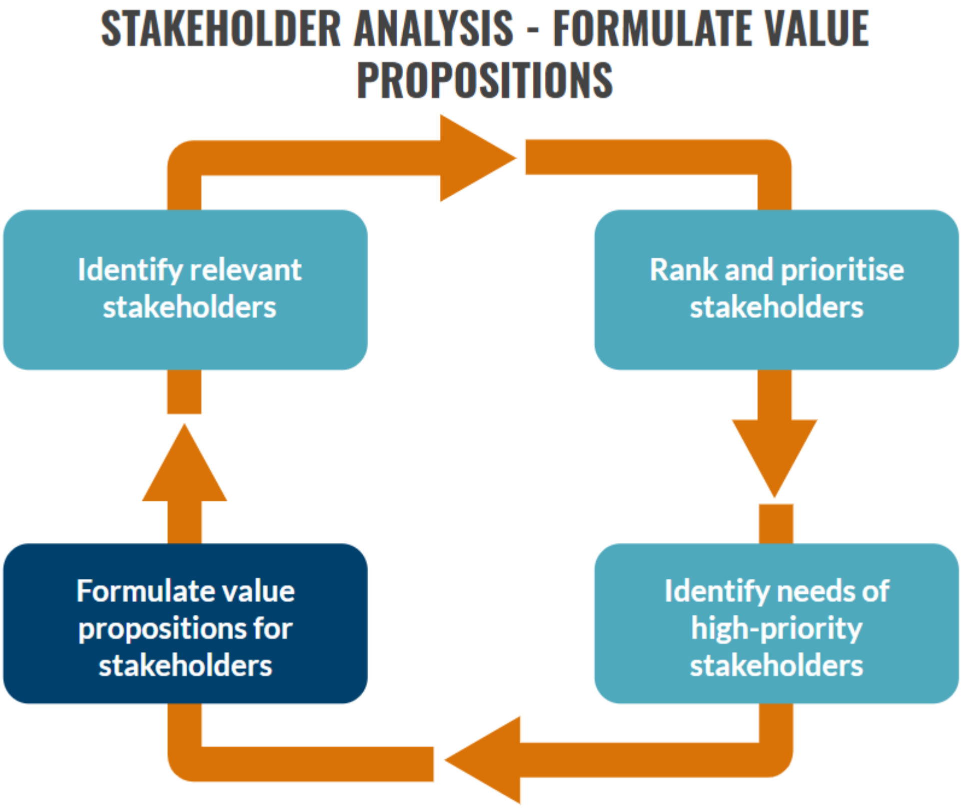
Step 4. Formulate value propositions for stakeholders

Once an organisation has identified the relevant stakeholders, ranked and prioritised them and identified their needs, it's time for the organisation to **formulate value propositions**. This is a **promise of value to be delivered, communicated and acknowledged to stakeholders**. These value propositions should meet the needs of the high priority stakeholders.

The value proposition for a school towards its pupils may be to meet the educational needs of it pupils in a safe and supportive environment.

In Step 2 we identified Ryanair's customers as one of its high priority stakeholders. Based on the understanding that its customers want cheap air fares, its value proposition to them may be the message that Ryanair is the a very cheap, but safe, airline. For its staff, it might be to provide a secure, fairly paid job, while for shareholders it might be to provide high returns on investment.

As we can see from these two examples, the value proposition for stakeholders changes depending on the needs of the stakeholders and the organisation.

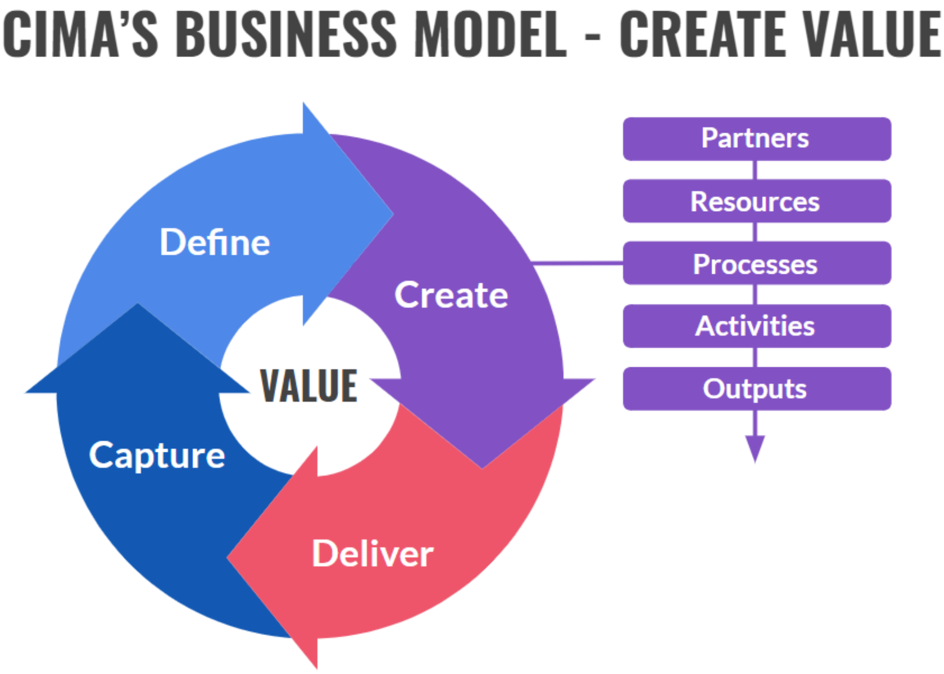


At the end of this stage the organisation will now know what to focus on when they move onto creating the value for the stakeholders.

4. Create value

So by this stage the organisation should know the stakeholders they are creating value for, the stakeholders they are creating value with and what the stakeholders want! And so now the organisation can begin to plan how they are going to create value.

There are five different features (partners, resources, processes, activities and outputs) that an organisation has to link together in order to create value.



The five features of value creation

1. Partners

Partners are the high-priority stakeholders; they are any group of stakeholders that organisations create value with, **typically employees and suppliers**. Partners help organisations gain access to resources, markets and technologies. These are then used by the organisation to produce goods, services or experiences.

If we return to Ryanair, there are a whole host of partners that help create value. For Ryanair the value would be delivered through providing cheap airfares. Obviously, there are the pilots who fly the planes and the cabin crew on-board who show customers to their seats. But there are also all of the other employees, such as the ground crew, HR team, marketing, and, of course, finance staff. Now, all these employees are not necessarily employed directly by Ryanair, the roles may be, outsourced and so the partners would be the companies that employ them.

But the partners wouldn't just stop with employees, it would also include the suppliers, such as Boeing who provide Ryanair's planes, right down the company who provides the ice for Ryanair's onboard drinks!

As the goal is to keep prices for customers low, Ryanair will aim to work with their partners to make services as efficient as possible, and aim to keep their costs down as far as is practical.

2. Resources

Having a strong relationship with partners means that organisations will be able to source the correct material and resources in the correct volume required and then manage them effectively. These **resources can take a variety of different forms, including; financial, physical, human, intellectual (things such as patents or licence agreements) and natural resources**.

So, what may be some of the resources for Ryanair? Well, a financial resource would be the loan financed by Irish Air which we saw in the first section. The finance team will be tasked with ensuring funding is used in the best way and interest paid as required.

The physical resources would be things such as the planes which they received from their partner Boeing. Those planes will need to be serviced, managed and organised in the most efficient way possible while also ensuring they meet all regulations.

3. Processes

So the organisation has its resources (also known as inputs) which it needs to convert into products and services (which are known as outputs). **At this stage, the organisations would have to design and set up the processes that will turn the resources into the goods**. Well-designed processes can mean that productivity, costs and quality are improved and can create better value.

There are a huge amount of processes that Ryanair have to undertake in order to deliver value including processes for: making bookings, checking-in passengers, managing the finances, organising people, scheduling planes and training staff. To add value these processes would be designed in a way that keep costs down, so, for instance, only allowing online booking to remove the costs of booking staff.

4. Activities

Now the resources have been acquired and the processes put in place, the **workforce can come together to undertake the processes**, e.g. take bookings, manage staff and look after the finances of the business.

5. Outputs

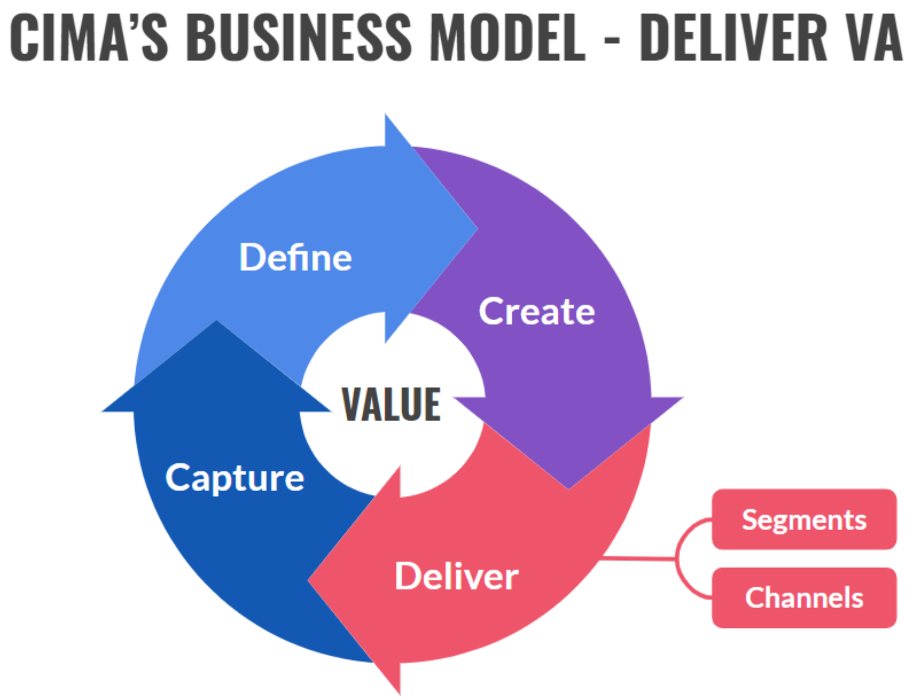
The **outputs** should now be created, and these **can be anything: products, services or experiences that aim to meet the value that the customers desire and which was defined in the very first stage of the business model**.

Of course, in the case of our Ryanair example, the outputs would be low cost flights, and, hopefully, happy customers and staff!

5. Deliver value

In the creating value stage, we looked at how an organisation produces its goods, products or services. But producing isn't enough! **The organisation will only earn its revenue when the consumer receives the products or use the services**. As such, it is vital that the organisation learns how to reach its customers.

As you can see from the diagram, there are two elements that we are looking at in this section:



Segments

Customer segments are different groups of people an organisation serves or is aiming to serve, and are divided up, for example, by gender or income level. **It is important organisations understand their customers so they can deliver them relevant messages**.

For example, Ryanair will typically sell to people on lower incomes who value low cost flights. However they might want to segment that market further. For example, students might be one target audience they might consider focusing on.

Channels

Channels are **the way that value is delivered to the customers**. Channels can include, retailers, distributors and increasingly the Internet. One example of this would be Ryanair's customers purchasing tickets directly from its website. That would be its sales channel.

Let's have a look at each of these in more detail.

Segments

To **get the different groups of customers, organisations divide their customer base using specific variables**. This process is known as **customer segmentation**. There are four main variables on which customer segmentation can be based.

Variables of customer segmentation	Examples
Geographic segmentation	By country or region, or perhaps qualities of an area such as climate
Demographic segmentation	Age, income, education level.
Psychographic segmentation	Focuses on the intrinsic traits the customer has and can range from values, attitudes and interest to lifestyles and opinions, so for example when going on holiday some people might value adventure, others safety, and others relaxation.
Behavioural segmentation	Similar to psychographic segmentation but focuses on specific reactions and how the customers act as well as the processes behind their decision making and purchases. So, for example, some people tend to make impulse purchases while others take their time to consider and weigh up the pros and cons prior to making a purchase.

The consultants Bain and Company suggested several ways that an organisation should carry out customer segmentation:

- **Divide the market into meaningful and measurable segments**, according to the needs of the customers, how they have acted in the past or their demographic profiles.

  Ryanair has customers all over Europe; it could easily segment its customers based on their country of residence. Now the airline can target those specific customers with information about Ryanair's services that will directly affect them and perhaps encourage them to purchase tickets.

- **Determine the profit potential** of each segment through analysis of the revenue received and costs spent on serving each segment.

Perhaps due to external factors, such as recession, Ryanair finds that one country has less disposable income than other segments while another is much higher.

- Then the organisations can **target the segments** according to their profit potential; after all, there's no point targeting an unprofitable segment!

  In the country where incomes are down they might decide to reduce prices or fly only to lower cost airports in that country (perhaps surprisingly, some airports actually pay Ryanair to fly to them!).

- **Measure the performance** of each of the segments so that the approach towards the segments can be changed when conditions dictate.

  If Ryanair continued to monitor these customer segments, they may find that conditions change. Perhaps the country's economy improves and air travel becomes more popular again and it adapts its flight policies accordingly.

- To make sure that the customer segmentation is as effective as possible Bain and Company also suggest that organisations **invest resources** so that the products, service, marketing and distribution can all be **tailored to suit the needs of the specific segments**. e.g. investment in planes, staff and marketing to launch into a new country.

Channels

Once their customer segmentation is understood, organisations can deliver value to the customer through a number of channels. **Traditionally these would have been the communication, distribution and sales channels**.

So to purchase tickets for an airline previous to the rise of digital technology, customers might have gone to go to a travel agency (the sales channel) to book a flight. This has changed with the growth of the Internet as Ryanair now sell tickets directly through its own website (which is now the sales channel).

Through developments in technology, however, **new channels have been opened up for organisations to connect with their customers**, such as social media and smartphones. These technological developments mean that customers also expect to be able to receive services through this new technology.

This simple example is supported by research undertaken by the computer software company the Oracle Corporation. It claims that the **vast majority of customers use**

two or more channels to browse for, research and purchase products, showing how important it is for organisations to operate a multi-channel approach.

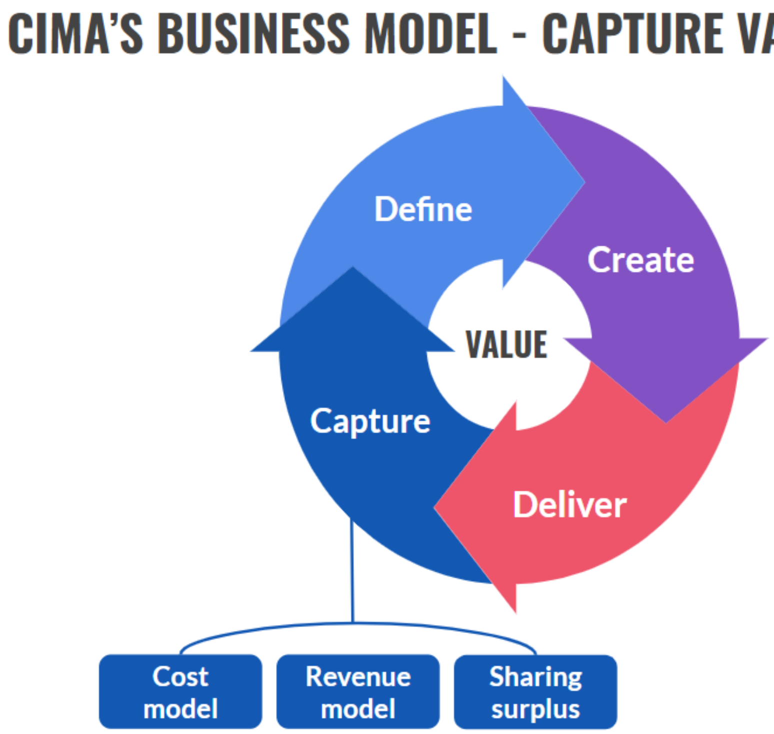
It is vital for this multi-channel approach to be integrated into businesses. Oracle suggests that **organisations must collect, clean, connect and transform customer data in order to drive personalisation seamlessly across the different channels**. For an airline, they might, for instance, allow customers access to their online account via a web browser, a mobile app and through a customer helpline. When people use their browser or app, they could use existing data on past purchases to make suggestions for locations they might be interested in, or tailor special offers specific to their needs.

6. Capture and store value

In the three previous stages represented by the business model, the organisation will have incurred costs. Just think how many costs Ryanair incurs to get its planes in the air; it has to pay for aircraft, employees, fuel and airport landings amongst many, many other costs.

However, they will have also earned revenue through ticket sales.

In this stage of the model, the organisation must now capture value. **Value can be captured when the revenue is greater than the costs of creating it, leaving a surplus**.



But who gets the surplus? Well, it has to be shared with the **stakeholders who have helped create and deliver the value but have yet to receive any value themselves**!

There are three main issues that affect the size of the surplus:

Cost model

The cost model refers to the costs that have been incurred by the organisation in creating and delivering value. There are **four factors that help establish the costs that are incurred**:

- **The efficiencies of the process** – For example, Ryanair run a low-cost model and so they have to run incredibly efficiently. If they don't, then costs will rise, and they won't be able to offer low-cost fares and will fail to offer the value proposition established in the define value stage.

- **The levels of activity** - For example, as Ryanair fill more seats on a plane their profits will rise.

- **The resources consumed during activities** – Unsurprisingly the amount and type of resources consumed during activities will affect the prices.

  In 2017 Ryanair ordered new Boeing planes with the aim of cutting its fuel consumption by 16%. By cutting resources used, Ryanair is trying to cut costs. It can then either pass those cost savings onto consumers in the form of cheaper tickets or have more surplus to share with stakeholders such as shareholders.

- **The price paid for resources**- In 2019 Ryanair released a profit warning because of rising fuel prices. The higher fuel prices rise the lower Ryanair's profits.

Revenues

We have already seen that revenue is only earned when the goods or services have been delivered to customers. **The price of the goods or services reflect the customer segment that has been targeted**. For example, a private jet company would not target customers that normally use Ryanair flights as the price of goods would not reflect the needs of the customers.

The **revenue collected will also be affected by**:

- **The market conditions at the time** – For example, in 2019 Ryanair announced a second profit warning due to high competition in its markets.

- **Any regulatory control in place** – For example, in 2019, the UK Government announced that an increase in airport passenger duty. A spokesperson for the flight industry claimed that the high duty was causing the British airline companies to be uncompetitive when compared to European airlines which weren't liable to pay such high levels of duty.

Sharing residual value

The third issue that affects the surplus is **sharing residual value**. Once the costs have been subtracted from the revenues, the **surplus value can be shared amongst the shareholders and other stakeholders**.

The stakeholders under consideration at this stage would be the:

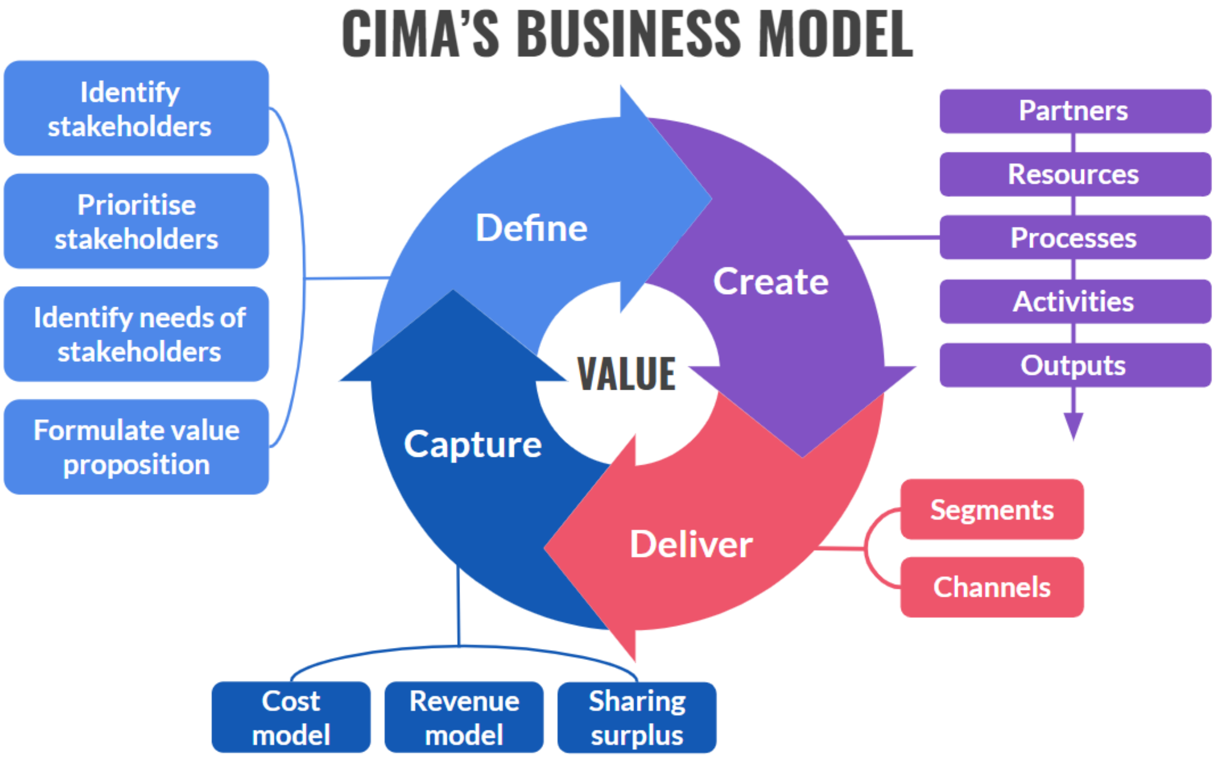
- **Government** - The surplus would be used to pay taxes

- **Shareholders** - The surplus would be used to pay dividends

- **Executive incentives** - The surplus would be used to pay for bonuses

- **Organisation** - The surplus would be retained for investment opportunities

7. The complete CIMA business model



And here we are, the CIMA business model in full.

We've used the example of a low cost airline as we've progressed through this chapter. But remember, the business model would be very different if we were considering a company providing flights on private jets; the way value is created is completely different and so the way value is created, delivered and captured is different too.

Each company therefore needs to understand and define its own business model, and keep that model up-to-date to ensure they remain competitive. It is one of the keys to success for any business!