

**WYDZIAŁ PRZEDSIĘBIORCZOŚCI I ZARZĄDZANIA**  
**KIERUNEK: ZARZĄDZANIE**  
**SPECJALNOŚĆ: ZARZĄDZANIE BIZNESEM**

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**Business model concept and application**

**Koncepcja modelu biznesowego i jej zastosowanie**

**Praca licencjacka**

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## PODZIĘKOWANIA

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## INTRODUCTION

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The following thesis will cover the topic of business model concept and its application in enterprises.

The concept of business model has been widely studied by management science scholars. They refer to business model as to the way a company creates value for customers and captures value in monetary form for itself. The origins of business model concept emerged in writings of Peter Drucker. Nonetheless, the notion of business model has really gained on importance with development of Internet-connected-technology businesses and the burst of the dot.com stock market bubble in 2000/2001. Spectacularly successful companies such as eBay, Amazon, Apple, Zara and Dell are commonly known examples of business model innovation. Their great triumph has been assigned to the novel ways they used new technologies not only to improve their operations, but mainly to design new business models. The innovative business models helped those companies transform their industries as well as became the drivers of change and long-term competitive advantage. Business leaders started to understand that while product, service, marketing and operational innovations are components of growth, real growth can be accomplished by applying innovative thinking to the way companies do business and drive revenues. The business world seems to have embraced the fact that business model innovation is vital to creating new and differentiating value. Therefore, the main aim of the thesis is to discuss the concept of business model and to identify and evaluate business models in the selected global and Polish enterprises.

In order to achieve the main, the following specific objectives will be addressed:

1. To present the concepts of value chain, innovation and business model
2. To identify the basis of competitive advantage based on the business model innovation
3. To identify types of business models and innovations applied by the selected global and Polish companies
4. To evaluate business models in the companies under research



The implementation of the above objectives will enable responses to the following research questions:

1. What are major approaches to business models?
2. What is the business model innovation?
3. What types of business models and innovations are applied by the companies under research?
4. What are strengths and weaknesses of the business models studied? What is their innovative value?

In this thesis I would like to clarify the major approached to business models, define business model innovation, identify types of business models and innovations that are applied in the companies under research, indicate strengths and weaknesses of the business models studied and determine their innovative value.

In chapter one of the thesis concept of value chain will be discussed. The notion of value, value added and their application in management will be explored in detail.

Chapter two includes different approaches to innovation as well as dwell on types of innovation, innovation processes and managing innovation. What is more, at the end of this chapter I will present how innovation should be measured in empirical research.

Innovative business modeling will be the main topic of my fourth chapter. In this part I will show origin and definitions of business model concept and then I will confer components and typologies of business models. Having reviewed that, I wish to treat about business model innovation based on the information and communication technologies and business models and competitive advantage.

The fifth chapter will be giving an sight into business model innovation in selected companies. It will specify the research methodology including selection criteria, research methods and sources of data. Furthermore, in this chapter I will characterize the research sample and identify business models in companies under analysis. At the end of this chapter I wish to evaluate the business models and their innovative value in the companies under research.



The sources of data include secondary from literature review, reports, corporate web pages and primary data from the interviews with employees of the Polish companies under research. Main research methods and tools include desk research, interview, own observations as webpage user, and case study.



## 1. THE CONCEPT OF VALUE CHAIN

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### 1.1. THE NOTION OF VALUE AND VALUE ADDED AND THEIR APPLICATION IN MANAGEMENT

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The term “value” seems to be the key to understanding reasons behind business as businesses exists to deliver value to customer and create value for stakeholders. Value is commonly understood as the worth benefits streaming from ownership. It describes utility of a good or service as well as the purchasing power of goods and services. To be more precise, “value is a relative worth, importance or utility” (Barringer, 2006, p.446). Value is a conception, explicit or implicit that defines what an individual or a group regards as desirable (Rue, 2007). Therefore, goods and services may represent different value for individuals depending on their needs and resources. In marketing, value is often viewed as a perceived ability to meet customers’ needs or wants estimated by customers eagerness to pay for it (Woodside *et al.*, 2008). Thus, the value of a good or a service is dependent on its worth to customer rather than its intrinsic value. In the end, businesses are called into existence to deliver value. In the long-term, businesses survive only as long as they succeed in the effort to create value, deliver it and capture value for themselves.

It seems logical that businesses are called into existence to deliver value. However, to deliver value, businesses need to create it in the first place. Primarily, value creation constitutes of performing activities that increase the value of goods or services to consumers (Dollinger *et al.*, 2003). It occurs when “the company has the resources and capabilities to produce a product of service that is desired by market participants” (Dollinger, 2003, p.190). “Value creation means performing activities that are believed to increase the value of goods and services to customers” (Hill, 2005, p.705). In other words, creating value for customers means providing products and services that they would find useful, desired and valuable.

Nonetheless, it is not enough for companies to deliver value to customers. They also need to capture value in monetary form for themselves. Capturing value happens when the price charged covers the full cost of production and generates returns on investment. It is necessary



that a company captures value of its creation. Otherwise, “the company fails to preserve as a sustainable business” (Dollinger, 2003, p.190).

Creating value for investors constitutes an incentive and a primary purpose of business. It entails delivering consistently as high as possible returns on capital. According to free market rules, to be able to reach that goal companies need to generate revenue growth and sustain attractive profit margins. They can achieve that if they succeed in delivering value for customers. As a result, there exists a strong interdependence between value creation for shareholders and customers.

In the process of value creation value-added is generated. Value-added indicates an enhancement to a product or an entity (Fernández, 2002, p. 4-8). It is the difference between the cost of materials purchased and the price at which goods produced from these materials are sold. Companies seek to provide value-added in their products to distinguish themselves. Following this logic, value-added becomes a means of protection from commoditization and help in maintaining profit margins.

According to Kaplan and Norton intangible assets and value creation activities are interconnected through a corporate strategy (2004, p. 29-32) . Thus, to focus on value creation an organization needs to adopt a long-term, board perspective and assign its resources to achievement of future goals.

The term value-added should not be mistaken for economic value added as in economics, the term economic value-added has a different meaning. In economics, economic value added is shortened to an acronym EVA. It expresses the capacity to create value in monetary terms as the difference between net operating profit and the invested capital charge. EVA is a ratio used as a measurement of return superiority a company is able to gains or on invested capital above the baseline return expected by the investment community. The economic value-added attempts to determine how much more valuable a company is at the end of a period than it was at the start of it (Ehrbar, 1998, p. 8).

To summarize, value creation should be treated as the priority of every business entity. Creating value for shareholders secures accessibility to investment capital. The





investment capital, on the other hand, allows for preserving competitive advantage, growth , expansion and innovation.

## 1.2. THE IDEA AND ELEMENTS OF VALUE CHAIN

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The value chain explains how business models emerge and develop. To be more exact, a value chain is a model developed by an academic researcher that many businesses and entrepreneurs use to identify opportunities to enhance their competitive strategies (Barringer, 2006). Rue (2007) explains that a value added chain is a process by which a business combines the raw materials, labor, technology into a finished product, markets the product and distributes the product. Hughes (2009) advocates that the value chain is a string of activities that moves a product from the raw material stage, through manufacturing and distribution and ultimately to the end user. Hughes (2009) believes that every company's business consists of collection of activities undertaken in the course of designing, producing, marketing, delivering and supporting its product or services. All the various activities that a company performs internally combine to form a value chain. It is called the value chain, because the underlying intent of a company's activities is to do things that ultimately create value for buyers. All those researchers agree that the value chain also identifies the primary activities that create customer value and the related support activities. The researchers mentioned above developed their understanding of the value chain from the value chain concept that was first described and popularized by Michael Porter in his best seller "Competitive Advantage: Creating and Sustaining Superior Performance" in 1985.

Originally, Michael E. Porter (1995, p. 36) stated that "a firm's value chain and the way it performs individual activities are a reflection of its history, its strategy, its approach to implementing its strategy and underlying economics of activities themselves". Hence, the idea of value chain plays an important role in management science. The value chain is a string of activities that moves a product from the raw material stage, through manufacturing and distribution, and eventually to the end users.

According to Porter (1985, p. 36) "differences among competitors in value chain are a key source of competitive advantage". What is more, Porter claims that value chains vary among firms in the same industry for reasons such as different product lines, buyers, geographic areas and distribution channels. He stressed that businesses are profitable providing that the value they



commend exceed the costs engaged in creating (Porter, 1985). Fulfilling the goal of creation value for customers that exceeds the costs of running the business is the primary task of a generic strategy. In Porter's view, the value not the costs should be used to comprehensively analyzed a firm's competitive position (Porter, 1985). A company's value chain also includes an allowance for profit because a markup over the cost of performing a firm's value creating activities is customarily a part of the price (or total cost) borne by buyers. Unless a company succeeds in creating and delivering sufficient value to buyers to produce an attractive profit, it will not be profitable. Lack of profitability means going out of business as profitability is the basic requirement for company's long-term survival on the market.

Porter explains that a value chain displays total value and consists of value activities and margin (Porter, 1985). He believes that value activities are physically and technologically distinct activities performed by a company. They are building blocks that altogether create a company's business model. What is more, Porter thought that value chain activities are discrete building blocks of competitive advantage. How the activities are interconnected with their economics determines a company's economic effectiveness. The manner in which activities are performed determines their contribution to buyers' needs and therefore differentiation.

According to Michael Porter (1985) the value creation activities or operations can be categorized as primary activities and support activities. The primary activities have to do with the physical creation, sale and service of a product of a service, while the support activities provide reinforcement for the primary activities. As the product moved through the different stages of a value chain, separates parts of the firm that add value or happen not to add value at each stage. If a firm wants to implement its strategy efficiently, it must manage these activities efficiently and in a manner that is consistent with its strategy (Biernat, 2005).



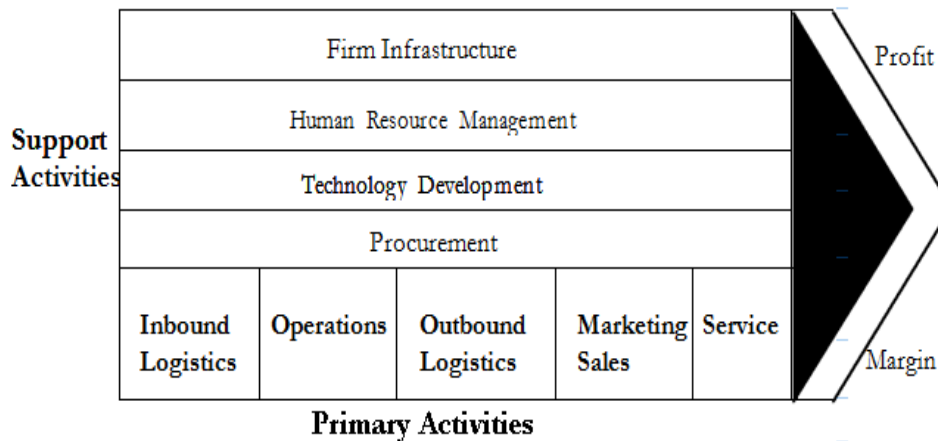


EXHIBIT 1. A REPRESENTATIVE COMPANY VALUE CHAIN (PEARCE ET AL., 2005, P. 160).

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### IDENTIFYING VALUE CHAIN ACTIVITIES

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To identify separate value chain activities, the activities that are technologically and strategically distinct need to be isolated. It is noteworthy that value activities and accounting activities are usually not the same.

### PRIMARY ACTIVITIES

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Primary activities have to do with the design, creation, and delivery of the product (Porter, 1985). The primary activities in the value chain are broken into four functions: inbound logistics, operations, outbound logistics as well as marketing and sales. As the primary activities one should consider the activities involved in the physical creation of the product as production and those engaged in marketing, delivery and after-sale service as marketing. It is important that effective production reduces the costs of creating value for example by realizing scale economies. Also, it can add value by increasing product quality for example by reducing the number of defective products. As a result, premium pricing is facilitated.

There are five categories of primary activities involved in competing in any industry. They are as follows: inbound logistics, operations, outbound logistics, marketing and sales and services. According to Porter (1985, p. 39) “each category is divisible into a number of distinct activities that depend on the particular industry and firm’s strategy”.



To start with the first element of primary activities, the inbound logistics are activities, costs and assets associated with purchasing fuel, energy, raw materials, parts and components, merchandise, and consumable items from vendors. Inbound logistics are hold accountable for receiving, storing, materials handling, warehousing, inventory control, vehicle scheduling and returns to suppliers (Porter, 1985). A term supply chain management is often used to describe inbound logistics.

Operations are activities, costs and assets associated with converting input into final product form (e.g. machining, packaging, assembly, equipment maintenance, testing, printing and facility operations, quality assurance, environment protection) (Porter, 1985).

Outbound logistics are the activities, costs and assets dealing with physically distributing the product to buyers e.g. finished goods warehousing, order picking, packaging, shipping, material handling, delivery vehicle operation, order processing, scheduling, establishing and maintaining a network of dealers and distributors (Porter, 1985). Very often the term distribution is used to describe outbound logistics.

Marketing and sales involves activities, costs and assets associated to sales force efforts, advertising and promotion, market research and planning and the dealer/distributor support. Basically, marketing and sales are supposed to induce and facilitate buyer to purchase the product through advertising, sales force, quoting, channel election, channel relations and pricing (Porter, 1985). What is more, this part of the value chain is also supposed to be responsible for providing assistance to buyers, such as installation, spare parts delivery, maintenance and repair, technological assistance, buyer inquires and complaints. Efficient marketing is another element that helps to reduce the production costs for example by generating the volume scale allowing scale economies. What is more, “efficient marketing can add value by assisting in product customization according to customers’ needs and differentiating it from competitive products” (Hill, 2001, p. 379).

## SUPPORT ACTIVITIES

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The support activities of the value chain provide inputs that allow the primary activities to occur. The support activities are broken into: procurement, technology development, human resource management and infrastructure.



The material management function of support activities is in charge of transmission of physical material through the value chain from procurement through production into distribution. The costs of creating value is significantly influenced by efficiency with which this process is carried out. What is more, the quality of input into the production process is monitored by material management function. If done effectively, it lowers the production costs. As a result, the quality of the firm's output improves. In this way more value can be added and premium pricing becomes achievable. The research and development function in the value chain is to develop new products and process technologies. Technological developments can lead to reduced production costs and creation of more useful as well as attractive products. The more attractive the product, the more premium price a firm can demand. Therefore, research and development affect primary activities and marketing activities and through them ultimately the value creation. The effective human resource function assures that the firm possesses an optimal mix of people to perform its primary production and marketing activities. It also makes sure that the staffing requirements of the support activities are fulfilled and that the employees are properly trained for their tasks and compensated accordingly. The information systems function gives the management access to the information it needs in order to maximize the efficiency of its value chain and to exploit information-based competitive advantages in the market place. The firm infrastructure that consists of such factors as organizational structure, general management, planning, finance, and legal and government affairs embraces all other activities of the firm and constitutes the context for them. To create value and reduce the costs of value creation an efficient firm infrastructure is essential (Hill, 2001).

To be more accurate about each support activity, procurement in the value chain means activities, costs and assets associated to purchasing of raw materials, supplies, and other consumable items as well as assets.

Technology development in the value chain represents activities, costs and assets associated to product research and development, process research and development, process design and improvement, equipment design, computer software development, telecommunication systems computer-assisted design and engineering, database capabilities, and development of computerized support systems. This part of the value chain is mainly focuses on know-how, procedures, and technological inputs needed in every value chain activity.



Human resources management activities, costs and assets associated with the recruitment, hiring, promotion, placement, appraisal, rewards, training, development and compensation of all types of personnel, labor relations activities and development of knowledge-based skills and core competencies.

Firm infrastructure concerns general management, planning, finance, accounting, legal, government affairs, culture of the firm and quality management. Because top management can exert considerable influence in shaping these aspects of a firm, top management should also be viewed as a part of infrastructure. Through strong leadership top management can considerably shape the infrastructure of a firm and through that the performance of all its value creation activities (Biernat, 2005).

<b>Primary Activities consist of:</b>
<p style="text-align: center;"><b>Inbound Logistics</b></p> <p>Receiving, storing, materials handling, warehousing, inventory control, vehicle scheduling and returns to suppliers.</p> <p style="text-align: center;"><b>Operations</b></p> <p>Transforming inputs into final product form (e.g. machining, packaging, assembly, equipment maintenance, testing, printing and facility operations).</p> <p style="text-align: center;"><b>Outbound Logistics</b></p> <p>Distributing the finished product (e.g. finished goods warehousing, material handling, delivery vehicle operation, order processing and scheduling).</p> <p style="text-align: center;"><b>Marketing and Sales</b></p> <p>Induce and facilitate buyer to purchase the product (e.g. advertising, sales force, quoting, channel election, channel relations and pricing).</p> <p style="text-align: center;"><b>Service</b></p> <p>Maintain or enhance value of product after sale (e.g. installation, repair, training, parts supply, and product adjustment).</p>
<b>Support Activities consist of:</b>
<p style="text-align: center;"><b>Procurement</b></p> <p>Purchasing of raw materials, supplies, and other consumable items as well as assets.</p> <p style="text-align: center;"><b>Technology Development</b></p> <p>Know-how, procedures, and technological inputs needed in every value chain activity.</p>



**Human Resources Management**

Selection, promotion, placement, appraisal, rewards, management development and labor/employee relations.

**Firm Infrastructure**

General management, planning, finance, accounting, legal, government affairs, and quality management.

EXHIBIT 2. VALUE CHAIN ACTIVITIES (PEARCE *ET AL.*, 2005, P. 160)

To summarize, a company's value chain and the way it performs each activity reflects the evolution of its own particular business and internal operations, its strategy, the approach it uses to execute its strategy and the underlying economics of the activities themselves. These factors differ from a company to a company. Therefore, the value chain of rival enterprises may differ substantially. It complicates the task of assessing the rival's relative costs propositions. For instance, music retailers like Blockbuster and Musicland, which purchase CDs from recording studios and wholesale distributors and sell them in their own retail store locations, have value chains and costs structures different from those of rival online music stores like Apple's iTunes and Musicmatch, which sell downloadable music files directly to music shoppers. Competing companies may differ in their degree of vertical integration. The operations component of the value chain for a manufacturer that makes all of its own parts and assemble them into a finished product differs from the operations component of a rival producer that buys the needed parts from outside suppliers and performs assembly operations only. Likewise, there is legitimate reason to expect value chain and costs differences between a company that is pursuing a low-cost or low-price strategy and a rival that is positioned on the high end of the market. The costs of certain activities along the low-cost company's value chain should indeed be relatively low, whereas the high-end firm may understandably be spending relatively more to perform those activities that create the added quality and extra features of its products (Hughes, 2008).

A company's value chain is embedded in a large system of activities that include the value chains of its suppliers and the value chains of whatever distribution channels allies it uses in getting its product or service to end users. Suppliers' value chain are relevant because suppliers perform activities and incur costs in creating and delivering the purchased inputs used in a company's own value-creating activities. The costs, performance features and quality of these



inputs influence a company's own costs and product differentiation capabilities. Anything a company can do to help its suppliers' drive down the costs of their value chain activities or improve the quality and performance of the items being supplied can enhance its own competitiveness. It is a powerful reason for working collaboratively with suppliers in managing supply chain activities (Hill, 2005).

The value chains of forward channel partners and/or the customers to whom a company sells are relevant because the costs and margins of a company's distributors and retail dealers are part of the price the ultimate consumer pays and the activities that distribution allies perform affect customer satisfaction. Moreover, the costs and price differences among rival companies can have their origins in activities performed by suppliers or by distribution channel allies involved in getting the product to end users. Suppliers or wholesale/retail dealers may have excessively high cost structures or profit margins that jeopardize a company's cost-competitiveness even though its costs for internally performed activities are competitive. For these reasons, companies normally work closely with their forward channels allies, who in this case are their direct customers, to perform value chain activities in mutually beneficial ways. Consequently, accurately assessing a company's competitiveness from the perspective of the consumers who ultimately use its products or services requires understanding an industry's entire value chain system for delivering a product or service to customers, not just the company's own value chain. The primary value chain activities in the pulp and paper industry (timber farming, logging, pulp mills, and papermaking) differ from the primary value chain activities in the home appliance industry (parts and components manufacturing, assembly, wholesale distribution, retail sales). The value chain for the soft-drink industry (processing of basic ingredients and syrup manufacture, bottling and can filling, wholesale distribution, advertising, and retail merchandising) differs from that for the computer software industry (programming, disk loading, marketing, distribution). Producers of bathroom and kitchen faucets depend heavily on the activities of wholesale distributors and building supply retailers in winning sales to homebuilders and do-it-yourselfers, but producers of papermaking machines internalize their distribution activities by selling directly to the operators of paper plants.





### 1.3. APPLICATIONS OF THE VALUE CHAIN CONCEPT

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By studying a product's or service's value chain, an organization can identify ways to create additional value and assess whether it has the means to do so. Value chain analysis is helpful in identifying opportunities for new business and in understanding how business models emerge. Many scholars possess a wider view of the value chain than the original conceptualization. A key reason this expanded view has evolved is that most products and services are produced in a complex supply chain that involves many companies rather than a single firm. Variations of a value chain have been created to depict the production of the goods and services through "value networks" or "value systems" rather than a single firm value chain. Because of this, a value chain tends to be identified more with a product or service than a particular company.

Entrepreneurs look at the value chain of a product or a service to pinpoint where the value chain can be made more effective or to spot where additional "value" can be added in some meaningful way. This type of analysis may focus on a single primary activity of the value chain for instance the marketing and sales element of the value chain, the interface between the stage of the value chain and another such as the interface between the operations, which are the activities required to manufacture a product, and outbound logistics, which are activities required to warehouse and ship it, or one of the support activities such as the human resource management. If a product's value chain can be strengthened in any one of these areas, it may represent an opportunity for the formation of a new firm to perform that activity. A separate firm or a business unit can be formed to strengthen the value chain for a product. However, oftentimes a viable business model needs to be created to support the new business idea.

Start-ups can choose to enhance or improve their value chain only if they can put together a value chain or a value network that brings their own products or service to market. It applies even if their market is enhancing only a portion of the value chain of an existing product. Typically, this involves developing core competencies in one or more areas and developing key partnerships to do the rest.

The value chain analysis finds an application in analyzing a company's cost structure, as a company's primary and support activities indicate the major components of its cost structure



(Porter, 1985). Therefore, segmenting a company's operations into different types of primary and support activities is the first step in understanding its costs structure. Each activity in the value chain gives rise to costs and ties up assets.

Assigning the company's operating costs and assets to each individual activity in the value chain provides cost estimates and capital requirements – a process called activity-based costs accounting. There are links between activities such that the manner in which one activity is done can affect the costs of performing other activities. For example, how a product is designed has a tremendous impact on the number of different parts and components, their respective manufacturing costs and the cost of assembling the various parts and into a finished product.

The combined costs of all the activities in a company's value chain define the company's internal cost structure. Furthermore, the costs of each activity contributes to whether the company's overall cost position relative to rivals is favorable or unfavorable. The tasks of value chain analysis and benchmarking are to develop the data for comparing a company's costs activity-by-activity against the costs of key rivals and to learn which internal activities are a source of cost advantage and disadvantage. A company's relative cost position is a function of how the overall costs of the activities it performs in conducting business compare to the overall costs of the activities performed by rivals (Hugh, Dough, 2008).

It is significant to remember that each primary and support activity is a source of strength or weakness for a company. It is the management that determines whether each activity “enhances or detracts from customer value and incorporate this knowledge into the process of formulation the firm's strategy” (Wild, *et al.*, 2008, p. 316).

During analysis of the primary activities the managers strive to determine the areas in which the company can increase the value provided to customers. For instance, the production process might be analyzed in order to find new, more efficient manufacturing methods that lead to reduced production costs and higher quality. Logistics management might also contribute to increasing customer's satisfaction for example through shortening the period of product delivery to the end-customer or securing superior customer service (Wild, *et al.*, 2008).

The support activities support the company in performing their primary activities. For instance, the actions undertaken by employees influence the company's success. Therefore,



the primary activities such as manufacturing, logistics, marketing and sales as well as customer service benefit from the company's well-trained and qualified employees. The product quality can be improved thanks to investments in worker training and management development. Accordingly, ensuring quality helps to increase efficiency of manufacturing, marketing and sales and customer service activities. Location of low costs, high quality raw materials, product intermediation, assurance of on-time delivery to the production facilities can be guaranteed by effective procurement. "A well-designed infrastructure improves internal communication as well as strengthens organizational culture and supports each primary activity" (Wild, *et al.*, 2008, p. 317).

A company that supremely manages its value chain activities relatively to competitors, stands a big chance in succeeding at achieving sustainable competitive advantage. Outmanaging rivals in performing value chain activities can be accomplished in either or both of two ways: by astutely developing core competencies and maybe a distinctive competence that rivals do not have or cannot match and that are instrumental in helping it deliver attractive value to customers, and/or by simply doing the overall better job than rivals of lowering its combines costs of performing all the various value chain activities, such that ends up with a low-cost advantage over rivals. In brief, performing value chain activities in ways that give a company the competencies and capabilities to either outmatch the competencies and capabilities of rivals or else beat them on costs are two ways to secure competitive advantage. This is of utter importance as the company performance of value chain activities translate into competitive advantage. In general, the term competitive advantage refers to some proprietary characteristics of the business that competitors cannot imitate without substantial cost or risk (Rue, *et al.*, 2007).

There are two main approached to value chain analysis according to Biernat (2005); The first of these approaches begin with management efforts to build more organizational expertise in performing certain competitive important value chain activities, deliberately striving to develop competencies and capabilities that add power to its strategy and competitiveness. If management begins to make selected competencies and capabilities cornerstones of its strategy and continues to invent resources in building greater and greater proficiency in performing them, then over time one or maybe several of the targeted competencies/capabilities may rise to the level of a core competence. The core competence is firm skills that competitors cannot easily



match or imitate (Biernat, 2005). Later, following additional organizational learning and investments in gaining still greater proficiency, a core competence could evolve into a distinctive competence, giving the company superiority over rivals in performing an importance value chain activity. Such superiority, if it gives a company a significant competitive clout in the marketplace, can produce an attractive competitive edge over rivals more important, prove difficult for rivals to match or offset with competencies and capabilities of their own making. As a general rule, it is substantially harder for rivals to achieve best-in-industry proficiency in performing key value chain activities than it is for them to clone the features and attributes of a hot-selling product or service. This is especially true when a company with distinctive competence avoids becoming complacent and works diligently to maintain its industry-leading expertise and capability. For example, GlaxoSmithKline, one of the world's most competitively capable pharmaceutical companies, has built its business position around expert performance of a few competitively crucial activities: extensive research and development to achieve first discovery of new drugs, a carefully constructed approach to patenting, skills in gaining rapid and thorough clinical clearance through regulatory bodies, and unusually strong distribution and sales-force capabilities. FedEx's astute management of its value chain has produced unmatched competencies and capabilities in overnight package delivery.

The second approach to build competitive advantage entails determined managements efforts to be cost-efficient in performing value chain activities (Biernat, 2005). Such efforts have to be ongoing and persistent, and they have to involve each and every value chain activity. The goal must be continuous cost reduction, not a one-time or on-again/off-again effort. Companies whose managers are truly committed to low-cost performance of value chain activities succeed in engaging company personal to discover innovative drive costs out of the business have a real chance of gaining a durable low-cost edge over rivals. It is not easy as it seems to imitate a company's low-cost practices Companies like Walmart, Dell, Nucor Steel, Southwest Airlines, Toyota, and French discount retailer Carrefour have been highly successful in managing their value chain in a low-cost manner.

To sum up thoughts on application of a value chain analysis, it helps a firm identify opportunities to enhance its competitive strategies and to recognize new business opportunities. The analysis of a value chain involves identifying activities that can be improved with substantial



benefits for the organization. The value chain analysis is also useful to identify “resources and competencies that become the basis for a sustained competitive advantage based on whether they provide the company with key strengths or weaknesses to shape strategic action” (Pearce *et al.*, 2005, p. 166). As a result, managers conduct value-chain analysis because they need to select strategies consist with their company’s strengths and market conditions. It is important that the strategic choices are made on the basis of what customers find valuable (Wild, *et al.*, 2008). Therefore, the process of dividing a company’s activities and identifying those that are valuable for the customers called value-chain analysis is a highly appreciated analytical tool.

Nonetheless, the value chain concept is not only used to identify components of costs, but also to identify components of profits, relate activities and core competencies, but maybe most importantly it can be utilized to design business models as it helps to think of a firm as of a value chain composed of series of distinct value creation activities.

#### 1.4. APPLICATION OF THE INTERNET IN THE VALUE CHAIN

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People around the world have begun to use the Web as a real tool of commerce, communication and social interaction. As a result, the information technology is integrated into everything that we do. According to Micheal Porter the basic tool for understanding the influence of information technology on companies is the value chain as it accurately shows the activities through which a product or service is created and delivered to customers (2001). All companies perform a number of discrete but interconnected value-creating activities that intersect with the activities of suppliers, channels, and customers. Therefore, the value chain becomes a suitable framework for identifying all these activities and analyzing how they affect both a company’s costs and the value delivered to buyers (Porter, 2001). What is more, since every activity involves creation, processing, and communication of information, information technology has gained an integrating influence on the value chain. The advantage of the Internet according to Porter streams from its ability to “link one activity with others and make real-time data created in one activity widely available, both within the company and with outside suppliers, channels, and customers” (2001, p. 74). Because the Internet incorporates a common, open set of communication protocols it provides a standardized infrastructure, an intuitive browser interface



for information access and delivery, bidirectional communication, and ease of connectivity (Porter, 2001). What is more, the Internet decreases the cost of that process.

Applications of the Internet in the value chain involve moving physical activities online or making physical activities more cost effective. However, Porter argues that the Internet accelerated evolution of strategy, but it does not render traditional rules of competition obsolete (2001). Many technological improvements affect the value chain.

Fuller automation and functional enhancement of individual activities such as human resource management, sales force operations, and product design has been evident in the value chain analysis of today's enterprises. The Internet application in the value chain is evident through cross-activity integration, such as linking sales activities with order processing. Multiple activities are being linked together through such tools as customer relationship management (CRM), supply chain management (SCM), and enterprise resource planning (ERP) systems. Nonetheless, Porter (2001) believed that the Internet is to impose further changes in the value chain. The Internet has the potential to enable the integration of the value chain and entire value system with the set of value chains in an entire industry, encompassing those of tiers of suppliers, channels, and customers (Porter, 2001). SCM and CRM are constantly developing as end-to-end applications involving customers, channels, and suppliers link orders to, for example, manufacturing, procurement, and service delivery. Porter (2001) thought that product development will be largely influenced by the Internet, too. Complex product models may soon be implemented and Internet procurement may move from standard commodities to engineered items. In near future the information technology will be applied to optimize its working in real time, not only to connect various activities and players in the value system as it initially did. Early application of further application of the information technology in the value chain will involve optimization of sourcing, production, logistical and servicing transactions while the later and more advanced optimization will eventually incorporate the product design. This could be done by optimizing the product design and customizing it based on input not only from manufacturing plants, but also from the customers (Porter, 2001)

The application of Internet affects positively the costs and quality of activities, though it is not the most significant implication of this phenomenon. Scale, the skills of personnel, product, process technology as well as investments in physical assets are prominent factors in the process of gaining competitive advantage in the future (Porter, 2001).



Porter (2001) explained that in some industries the use of the Internet represents a modest shift from well-established practices. An example of such situation is a catalog retailers Lands' End who provides electronic data, interchange services such as General Electric, direct marketers like Geico and Vanguard. In these industries incumbents fancy synergies between their on-line and traditional operations (Porter, 2001). Therefore, they are more competitive than dot-coms in the same business. According to Porter "examining segments of industries with characteristics similar to those supporting on-line businesses in which customers are willing to forgo personal service and immediate delivery in order to gain convenience or lower prices, for instance- can also provide an important reality check in estimating the size of the Inter-net opportunity" (Porter, 2001, p. 74). Mail orders represented only about 13% of mail of purchases in the late 1990s in the prescription drug business. Porter (2001) made a comment that even though on-line drugstores may draw more customers than the mail-order channel, they w are unlikely to supplant their physical counterparts.

"Virtual activities do not eliminate the need for physical activities, but often amplify their importance" (Porter, 2001, p. 74). Porter thought that the complementarity between Internet activities and traditional activities gained on importance because of a few reasons.

In his article Porter (2001) warns against being overly enthusiastic about the Internet's potential. He said that while Internet technology can do many useful things today and will surely improve in the future, will never be able to do everything.

Traditional activities, often modified in some way, can compensate for these limits, just as the shortcomings of traditional methods.

The Internet application and a traditional method benefit each other. For example, many companies have found that Web sites that supply product information and support direct ordering make traditional sales forces more, never less, productive and valuable. The sales force can compensate for the limits of the site by providing personalized advice and after-sales service, for instance. On the other hand, the site can make the sales force more productive by automating the exchange of routine information and serving as an efficient new conduit for leads.

To sum up Porter's thoughts about the Internet and the value chain, the Internet should be view as a complement to, rather than a cannibal of existing business practices. It should be a part of the whole value chain and the business model not a separate entity on its own. Companies must integrate the Internet into their value chain to prevent competitors from copying



their strategy. By integrating the Internet into overall strategy, new technology will become an equally powerful force for gaining competitive advantage.





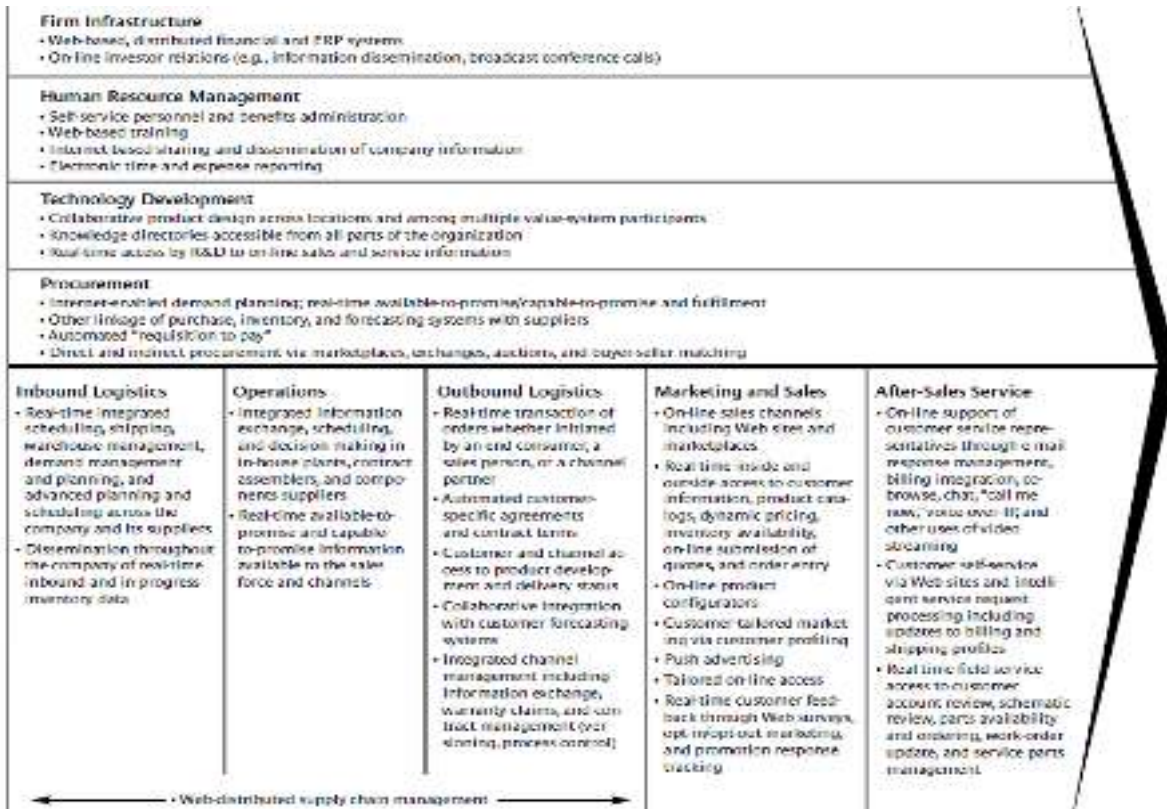


EXHIBIT 3. APPLICATION OF THE INTERNET IN THE VALUE CHAIN (PORTER, 2001, P. 75)

## 2. APPROACHES TO INNOVATION

### 2.1. DEFINITIONS OF INNOVATION

Theodor Levitt who was an American economist and professor at Harvard Business School said, "Just as energy is the basis of life itself, and ideas the source of innovation, so is innovation the vital spark of all human change, improvement and progress" (Sarkar, 2007, p.1). His words describe what innovation is in a very epic way. Investigation of the term "innovation" reveals that the verb "innovate" is derived from Latin "in+novare" which means to make new, to renew or to alter (Sarkar, 2007). Another theory about the origin of the word "innovation" says that it comes from a Latin word "nova" which means new. In effect, the word innovation is



generally understood the introduction of a new thing or method (Harvard Business Essentials, 2003). It has also been defined as invention plus exploitation. Clayton Christensen (2009) explains that innovation in general is an activity embarked upon to achieve growth. At the same time some researchers defined innovation broader as Rue and Byars (2007) for whom innovation is a process of applying a new and creative idea to a product, service or method of operation. Harvard Business Press (2003, p. 221) considers an innovation to be “the embodiment, combination, or synthesis of knowledge in original, relevant, and valued new products, processes, or services.”. According to OECD (2005, p. 46) “an innovation is the implementation of a new or significantly improved product (good or service), or process, a new marketing method, or a new organizational method in business practices, workplace organization or external relations.” Innovation is the process that is central to creating something new, which is central to the entrepreneurial process in the opinion of Barringer and Ireland (2006). They stress that small entrepreneurial firms are responsible for 67 percent of all innovation in the United States and have been responsible for 95 percent of radical innovation since the World War II. Many innovations help individuals and business work more smoothly and efficiently.

To look at innovation from another perspective, it is worthy to cite Sarkar who said that “Innovation is about having and applying an idea, or something applying other peoples’ ideas in new and novel ways” (2007, p. 1). Cited by Sarkar Michael Vance said that “Innovation is the creation of the new or re-arranging of the old in a new way” (Sarkar, 2007, p. 1). Succinctly, Sarkar believes that innovation is “the exploitation of new ideas which find market acceptance, often incorporating new technologies, processes, design and best practices” (Sarkar, 2007, p. 2).

Joseph Schumpeter was a grand economist who played a pioneering role in introducing innovation into economic studies. He defined innovation as new combination of existing resources (Schumpeter, 1949). What is more, he was called “the prophet of innovation” or “the agent of innovation” because he developed an original approach that focused on creative disruption caused by innovation in economy, organization and sociological arena. Schumpeter emphasized the tendency



for innovation to cluster in certain industries and time periods as well as the derived effects on growth (1975). He also stressed the possible contribution of such clustering to the formation of business cycles and the long waves in the world economy. In Schumpeter's opinion an entrepreneur motivated by competition, to improve technology, finance and organization creates innovation (1975). What is more, Schumpeter believed that innovation revolutionized the economic structure from within instantly creating new ones and destroying the old economic structures for good. This process Schumpeter called "creative destruction" (1965). The creative destruction was the key fact about capitalism to Schumpeter's mind. "Capitalism, then, is by nature a form or method of economic change and not only never is but never can be stationary. And this evolutionary character of the capitalist process is not merely due to the fact that economic life goes on in a social and natural environment which changes and by its change alters the data of economic action" (Schumpeter, 1975, p. 82). In Schumpeter's view economic development had to be seen as a process of qualitative change, driven by innovation, taking place in historical time.

Peter Drucker, a management guru, announced that "innovation is a specific tool of entrepreneurs, the means by which they exploit chance as an opportunity if a different business or a different service. It is capable of being presented as a discipline, capable of being leaned, capable of being practiced. Entrepreneurs need to search purposefully for the sources of innovation, the changes and their symptoms that indicate opportunities for successful innovation. And they need to know and apply the principles of innovation" (Drucker, 1986, p. 17).

Similarly, Freeman and Soete declared that innovation is the first commercial application or production of a new process or product, it follows that the crucial contribution of the entrepreneur is to link the novel ideas and the market" (Freeman *et al.*, 1997, p. 201). Another researcher Cumming stresses the originality aspect in defining innovation as he claims that innovation is the first successful application of a product or service (Sarkar, 2007). On the other hand, according to Tidd innovation is a process of transforming opportunities into new ideas and of applying them widely (Tidd *et al.*, 1997).



To deepen understanding of innovation, innovation is believed to be a creator and sustainer of enterprise (Harvard Business Essentials, 2003). As a matter of fact, profitable growth is believed to be a derivative of innovation. “The function of innovation is to introduce novelty (variety) into the economic sphere” (Fagerberg, *et al.*, 2005, p. 20). Providing that innovation would cease, the economy would stop growing. Thus, innovation is indeed a key to economic growth and wealth-creation. Without innovation to increase the shares’ price companies wring out costs savings out of their current business models. Such actions cannot last endlessly. Unless companies innovate, they fail to grow in the long-term (Hamel, 2003).

Regardless of industry, region or business function, innovation has become desirable phenomenon. Companies wish to be seen as innovative. Hence, the word innovation has become the buzz word of the recent years. Firms declare that they focus on innovation. The CEOs claim consider innovation a priority for growth and sustainability. Therefore, it is important to clarify what is understood under the term of innovation. To further investigate the term of innovation it is worth to review its definitions by practitioners in the field of innovation management. Anthony Ulwick (2009) states that innovation is a process of creating a solution in form of a product or a service that assure customers a certain, new value. In his opinion the process of creating innovation starts with choosing the client and the market, includes search for chances and prioritizing them. It ends with creating an innovative product or service. By Jones (2004) innovation is defined as the process by which organizations use their skills and resources to develop new goods and services or to develop new production and operating systems so that they can better respond to the needs of their customers. Dollinger (2003) also provides interesting insights into the issue of innovation. He thinks that pure innovation is the creation of something radically different from existing technologies or products. Because it is different, it has certain characteristics that are economically interesting an invention may have no competitors at its birth, thereby giving a monopoly to the individuals who hold the legal rights to the invention, and there may never be a market at the time of the invention. The combination of the monopolies upside with the no-ready-market



downside makes the economic aspect of invention risky because the outcomes are potentially so variable.

Various sources suggest slightly different definitions of innovation. According to Oslo Manual (OECD, 2005) the bottom requirement for innovation is newness or degree of significant improvement of a product, process, marketing method or organizational method. The same source argues that to be qualified as an innovation an idea must have been implemented. In case of a new product or service it means that it needs to be introduced to the market whereas for new processes and marketing methods it means that they must be utilized in the firm's operations.

Performance of countries and regions as well as enterprises is directly influenced by innovation. The more innovative a company is, the more competitive it is. Innovative environments demonstrate higher productivity and income. Less innovative firms find it harder to prosper in today's economics.

#### INNOVATION VS. INVENTION

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It is important to make a distinction between an invention and innovation. Invention is the first occurrence of an idea for a new product or process whereas innovation is the first attempt to carry it out into practice. Even though invention and innovation might be closely linked to the extent that it might be difficult to distinct one from another. Nonetheless, there is a considerable time lack between the innovation and invention that might take up to several decades (Fagerberg *et all.*, 2005). These delays reflect the different requirements for working out ideas and implementing them. Inventions can be performed anywhere while innovation occurs mainly in firms and public service organizations such as hospitals. In order to turn an invention into innovation, an enterprise needs to combine several various types of knowledge, capabilities, skills, and resources. A firm may require production knowledge, skills and facilities, market knowledge, a well-functioning distribution system, sufficient financial resources etc. Consequently, a role of an innovator i.e. the person or organizational unit responsible for combining the factors necessary for occurrence of innovation, might be quite different from a role of an inventor. History is replete with cases in which the inventor of major technical advances fails to reap



the profits from his breakthroughs whereas to be called an innovator a person needs to demonstrate a capability to commercialize their idea.

Time gaps between invention and innovation in many cases are caused by lack of some or all conditions for commercialization. It is possible that there is not a sufficient demand or it may be impossible to produce and then market because some vital factors are not yet available. Therefore, many inventions require complementary inventions and innovations to succeed at the innovation stage.

Both invention and innovation stream from continuous processes. A car as we know it today has radically improved compared to the first commercial models thanks to incorporation of a large number of different inventions and innovations. Fagerberg and Mowery (2005) believe that initial versions of significant innovations are usually crude, unreliable versions of the devices that with passage of time become widely diffused. They also argue that a majority of innovations are fact results of lengthy processes involving many interrelated innovations. Thus, technology students tend to apply a system perspective rather than to focus exclusively on individual invention or innovations.

Innovation is one of the most important types of organizational change because it results in a continuing stream of new and improved goods and services that create value for customers and profit for a company. Indeed, one important way of assessing organizational effectiveness in the rate or speed at which a company can bring new products to market. It is a function of the level of entrepreneurship and creativity inside an organization.

## 2.2. TYPES OF INNOVATION

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### RADICAL AND INCREMENTAL INNOVATION

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Two types of innovation can be distinguished when radicalism of innovation becomes the criterion for classification. These are radical and incremental innovations. This approach to innovation typology aims to classify innovation according to how radical they are compared to the current technology (Harvard



Business Essentials, 2003). Consequently, continuous improvement of innovations is in this perspective characterized as incremental or marginal. Accordingly, the term radical innovation refers to introduction of a totally new type of machinery or technological revolutions that constitute of a cluster of innovations that altogether may have a far-reaching impact. Schumpeter believed that the radical innovation is of higher importance (Schumpeter, 1949). This view is widely held despite the fact that the cumulative impact of incremental innovation is equally great if not greater. Realization of the economic benefits from radical innovation in most cases requires a series of incremental improvements. As a matter of fact the bulk of economic benefits comes from incremental innovations and improvements.

Radicalism of innovation often becomes a question of convention (Fagerberg, *et al.*, 2005). Theoretically if one company introduces for the first time a particular innovation in one context, then if another company introduces the same innovation in a different context it is still believed to be an innovation, but not as radical. In view of Schumpeter (1949) only the first of these companies should be called an innovator whereas the second one could only be called an imitator. However, that opinion would actually be in conflict with another conviction of Schumpeter (1949) that every company that introduces innovation for the first time in a new context is an innovator. In general, introducing something in a new context often implies significant adaptation and thus constitutes incremental innovation. History has shown that organizational changes or innovations introduce in new contexts also lead to increased productivity and competitiveness. For that reason, such implementation of innovative solutions could have a radical character for the new context.

To investigate further the term of radical innovation, this type is concerned with exploration of new technology, is fundamentally different from incremental innovation that is concerned with exploitation of existing technology (Fagerberg, *et al.*, 2005). According to Harvard Business Essentials (2003) a radical innovation is an “innovation that represents something new to the world and a departure from existing technologies or methods”. This kind of innovation is also



referred to as breakthrough and discontinuous innovation. Radical innovation can appear in form of a product, process, or service with either unprecedented performance features or familiar features that offer potential for significant improvements in performance and cost. It creates such a dramatic change in processes, products, or services that they transform existing markets or industries, or create new ones.

On the contrary, an incremental innovation is an innovation that “either improves upon something that already exists or reconfigures an existing form or technology to serve some other purpose. In this sense incremental innovation is at the margins” (Harvard Business Essentials, 2003, p. 2). It strives to exploit forms or technologies. Intel’s Pentium IV computer chip is an example of incremental innovation as it was developed on the basis of technology applied to create its predecessor Pentium III. Pentium IV was an improved version of Pentium III. Use of global positioning satellite (GPS) to help drivers find their way is another example of incremental innovation as in this case a new application for the existing technology was exploited (Harvard Business Essentials, 2003).

Strategies based on sustaining innovation are effective in shaping or influencing the market in which a company competes (Johnson, *et al.*, 2010). Even though incremental innovations involve small improvements, they add value to the product or service. In effect, they provide more utility and potential benefits to the customer. Incremental innovations help to prolong a product life cycle. Nonetheless, in the long term they fail to secure a firm’s position in the marketplace particularly when major changes such as radical innovations occur in the competitive environment.

In Schumpeter’s opinion competition motivates for disruptive innovation as well as begets imitators who are tempted to copy the innovative solution, attract investments and capitalize on the innovation (1975). Then the innovator’s profit advantage becomes limited and investments shuffle elsewhere. As a result, the sector usually shrinks until the next disruptive innovation which restarts the cycle.





Disruptive innovation puts the incumbents under threat in the long term because the potential disruptor enters with a different, unequalled and unique value proposition (Christensen, 1997). Disruption happens when a formerly leading company with an entrenched position is overturned by a new to the market entrant. The presented below model of disruptive innovation described by Clayton M. Christensen (1997) identifies three elements of disruption.

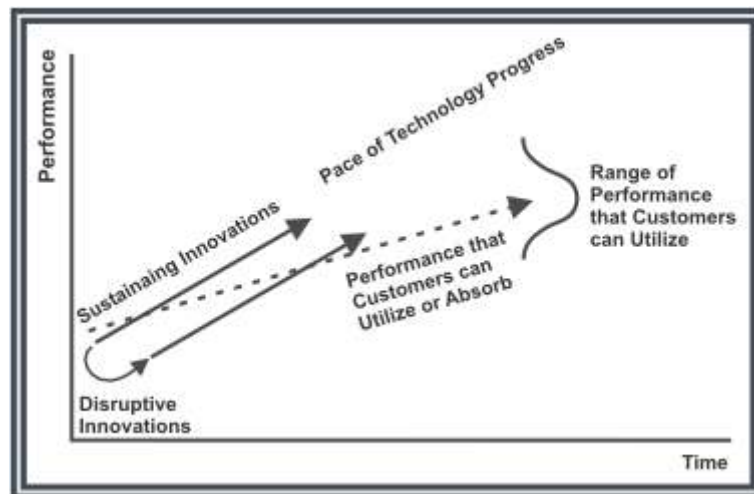


EXHIBIT 4. DISRUPTIVE INNOVATION MODEL (JOHNSON ET ALL., 2008, P. 17 )

First thing recognized by Christensen (1997) in his model of disruptive innovation is that every market possesses a rate of improvement that customers can utilize or absorb (in the model these incremental changes are represented by the dotted line sloping gently upward across the chart). In the model a single line represents the customers' ability to utilize improvement. A distribution of customers around this median shown by a range indicated by the distribution curve on the right. Customers in the highest or most demanding tiers may never be satisfied with the best that's available and those in the lowest or least demanding tiers become oversatisfied with very little. The dotted line indicates the technology that is good enough to serve customers' needs.

The second important element of the model shows a trajectory of improvement as in every market there's a distinctly different trajectory of



improvement that companies provide when they introduce new and improved products. The pace of technological progress outstrips the ability of customers in any given tier of the market to fully utilize it what the more steeply sloping lines in the chart indicate. Accordingly, a company whose products are squarely positioned on mainstream customers' current needs today most probably will overshoot what those same customers are able to utilize in the future. This occurs because companies instantly strive to provide customers with better products that can be sold at higher profit margins to customers in more demanding tiers of the market who have not been satisfied yet.

The third critical element of the model is a distinction between sustaining and disruptive innovation. Sustaining innovations target demanding, high-end customers with supreme performance than what was previously available. Sustaining innovations are often incremental improvements implemented on regular basis. A majority of companies is capable of generating incremental innovations. The technological advancement and degree of difficulty possessed by an innovation does not matter as much because in practice the incumbents almost always conquer new entrants in the battle of sustaining technology. Since strategy focused on incremental innovation entails developing supreme products that can be sold at higher profit margins to the most demanding customers, the established competitors have strong and direct motivations as well as the resources to carry and succeed in battles of sustaining innovations (Christensen, 1997).

It is crucial to notice that disruptive innovations do not attempt to bring better products to established customers in existing markets. They introduce products and services not as good as available products thereby they disrupt and redefine that trajectory. Disruptive technologies compete with simpler, more convenient and less expensive products that appeal to new or less-demanding customers (Christensen, 2008).

When the disrupter gains a market share in a new or low-end markets, the improvement cycle begins. Since the pace of technological progress outstrips



customers' abilities to use it, the technology that had previously been considered not sufficiently good eventually enhances to meet the needs of more demanding customers. In this situation the disruptors start to gain an advantage over the incumbents and push them out of the market. According to Christensen's model (1997) even though the current industry leaders almost always triumph in battles of sustaining innovation, disruptions are typically launched by entrant companies.

It is important to take a notice of a closely related term of disruptive technology. It is a technical innovation that has the potential to upset the status quo and, as it develops and it perfected, displays the established technology and precipitates the decline of leading companies (Harvard Business Essentials, 2003). What is more, "disruptive technologies displace the established technology and precipitate the decline of companies whose business models are based on them" (Harvard Business Essentials, 2003, p. 3). Disruptive technologies tend to create new markets that are initially small, though have a potential to grow.

The information about disruptive innovation suggests that a disruptive innovation can occur in two forms. First, it can take a form of a product or service of disruptive character providing that it serves a segment that is ignored by incumbents. This happens usually for financial reasons such as that margins are too low to interest the incumbents with a certain customer segment, or that the functionality proposition is higher than the certain customer can afford. In this case a disruptor competes with low costs and offers suitable value proposition for the low end market and use that position as a step to expansion upward the market. This renders an incumbent unable to respond because its cost structure is designed and optimized to serve high-end customers. South West Airlines and Ryan Air are great examples of such disruptors.

The second form of disruptive innovation occurs when an incumbent provides a product or service which is overly functional and customers cannot fully utilize its capability. In this situation customers pay a premium price for a good that does not provide them with any extra value. Then a disruptor can offer a product that



is less functional, but in fact serves the customers' needs at a lower price. This also renders the incumbent unable to respond as it can either continue to provide all premium features to the high end or lose its customers altogether. This is what happened to Microsoft as its customers use only 20% of available functionality of its Office product.

Disruptive innovation is “the key to plugging growth gaps and routinely surprising the market” (Johnson, *et al.*, 2010, p. 3). To redefine a market, create a new market or defend from attack from new, potentially disruptive entrants, a company needs to apply disruptive strategies. Radical innovation has the potential to change the basis of competition in favor of an innovator. Thus, a third of the 175 companies from Fortune Global list in 2005 that had not been listed in 1994, had their roots in disruptive innovation (Johnson, *et al.*, 2010). The most recent disruptive innovations have belonged to Skype's Internet phone service, YouTube's online video service, MinuteClinic's diagnostic kiosk model. Procter & Gamble's Swiffer's and Febreze product lines, Salesforce.com's hosted software service, Nintendo's Wii gaming system and Metro's free daily newspaper.

In reality incremental and radical innovation appear simultaneously. Incremental innovations occur notoriously and last longer periods of time whereas radical innovations are rather rare, infrequent and unpredictable. The incremental innovation fuels progress through minor improvements that eventually leads to appearance of radical innovation. When the radical innovation occurs, it suppresses the incremental innovation until there is no more benefit to further enhancement. After that starts the improvement process of the new, radical innovation what means that incremental innovation is resumed, but its subject switched to the new innovation. Thus, it can be noticed that incremental innovation takes place upon appearance of radical innovation in the market.

In general efforts to develop radical innovation are more risky, expensive, hard to measure, rarely produce tangible results immediately if they produce them at all. Long timelines requires to generate radical innovation discourage the incumbent companies from taking the risk of investing in radical innovation. As a result, the



established companies are motivated to focus on developing incremental innovation since it is less expensive, more feasible and produces profits within a shorter period of time. Thus, systematic efforts to generate incremental innovation are a source of enhanced and diverse products.

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## INNOVATION TYPOLOGY ACCORDING TO THE SUBJECT OF INNOVATION

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Joseph Schumpeter (1949) classified innovations according to their subject. Namely, he distinguished five different types of innovation: new products, new methods of production, new sources of supply, the exploitation of new markets, and new ways to organize business.

The Oslo Manual (OECD, 2005) is the foremost international source of guidelines for the collection and use of data on innovation activities in industry. It pinpoints four general types of innovations according to the subject of innovation. They are as follows:

- product innovation,
- process innovation,
- marketing innovation
- and organizational innovation.

This classification of innovation is widely recognized by innovation scholars. Thus, it is recommended to review each type in detail to comprehend the differences and the nature of classification .

## PRODUCT INNOVATION

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OECD explains that a product innovation is considered to be an introduction of a good or service (2005). These good or services need to be new or significantly improved when it comes to characteristics or intended uses to be considered product innovations (OECD, 2005). The product innovation category includes significant improvements in technical specifications, components and materials, incorporated software, user friendliness or other functional characteristics.



Product innovations takes advantage of new knowledge or technologies. It can also focus on new uses as well as combinations of existing knowledge or technologies. A new use for a product with noticeable changes to its technical specifications constitutes a product innovation.

It is important to notice that design changes do not constitute product innovation. Even though design is considered an important part of the development and implementation of product innovations, the design changes that do not involve a significant change in a product's functional characteristics or intended do not qualify for product innovations. However, they can have a character of marketing innovations (OECD, 2005).

According to Christensen (2009) a product innovation is typically introduced to drive top-line growth through increases in volume or price. For services product innovations covers significant improvements regarding their delivery, addition of new functions or characteristics or implementation of completely new services.

## PROCESS INNOVATION

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Process innovation is an implementation of a new or significantly improved production or delivery method. "This includes significant changes in techniques, equipment and/or software" (OECD, 2005, p. 49)

Process innovations often aims to decrease unit costs of production or delivery in order to increase quality, or to produce or deliver new or significantly improved products (Christensen *et al.*, 2009). Process innovations consists of new or significantly improved methods for the creation and provision of services. They usually stream from changes in the equipment and software used in services-oriented firms or in the procedures or techniques that are employed to deliver services. "Improved techniques, equipment and software in ancillary support activities, such as purchasing, accounting, computing and maintenance are examples of process innovation" (OECD, 2005, p. 49)



Frequently process innovation improvements are made by people working for large companies. If these companies are not the best place to fully exploit these improvements the people who develop the changes may decide to become entrepreneurs. They literally spin themselves and their new product off into a new venture.

## PRODUCT VS. PROCESS INNOVATION

Product innovations and process innovations are closely related to the concept of technological product innovation and technological process innovation. A company that created product innovation needs to manufacture it what may constitute a need for process innovation. Often product innovations are mistaken for process innovations and the other way round. Jacob Schmookler (1966) tried to make a distinction between product and process innovation that rested on the assumption that their economic and social impact may differ. In spite of the fact that product innovation is assumed to have a direct, clear positive effect on growth of income and employment, the process innovation because of its cost-cutting nature may have a more ambiguous effect (Schmookler, 1966). Such differences often become obscure at the level of overall company as product of one company or industry spreads to other and is in the end used to produce goods or services in another.

Fagerberg (2005) states that Charled Equis suggested dividing the category of process innovation into technology process innovation that is related to new types of machinery and organizational process innovation that is related to new ways to organize work. Organizational innovations are not restricted to new ways to organize the process of production within a given firm. Organizational innovation in Schumpeter's opinion includes arrangements across firms as the reorganization of entire industries. Many of the most significant organizational innovations have occurred in distribution with relevant consequences for a whole range of industries.

## MARKETING INNOVATION

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A marketing innovation is defined as an “implementation of a new marketing method involving significant changes in product design or packaging, product placement, product promotion or pricing” (OECD, 2005, p. 49)

Marketing innovations are created with an intent to address customer needs more fully and open up new markets, or newly positioning a firm’s product on the market. The main aim of marketing innovation is increasing the firm’s sales.

To be a marketing innovation every applied marketing idea needs to be a marketing method not previously used by the firm that constitutes a part of a new marketing concept or strategy that is entirely new to the company.

“Marketing innovations include significant changes in product design that are part of a new marketing concept. Product design changes here refer to changes in product form and appearance that do not alter the product’s functional or user characteristics. They also include changes in the packaging of products such as foods, beverages and detergents, where packaging is the main determinant of the product’s appearance” (OECD, 2005, p. 50). A marketing innovation in product design is the implementation of a relevant change in the design of a furniture line to provide it with a new look and broaden its appeal. Innovations in product design can also include the introduction of significant changes in the form, appearance or taste of food or beverage products, such as the introduction of new flavors for a food product in order to target a new customer segment. An example of a marketing innovation in packaging is the use of a fundamentally new bottle design for a body lotion, which is intended to give the product a distinctive look and appeal to a new market segment.

New marketing methods in product placement mainly involve the introduction of new sales channels. Sales channels here refer to the methods used to sell goods and services to customers, and not logistics methods including changes in transport, storing and handling of products which deal mainly with efficiency. Examples of marketing innovations in product placement are the introduction for the first time of a franchising system, of direct selling or exclusive retailing, and of





product licensing. Innovations in product placement can also involve the use of new concepts for the presentation of products. An example is the introduction of salesrooms for furniture that are redesigned according to themes, allowing customers to view products in fully decorated rooms.

New marketing methods in product promotion involve the use of new concepts for promoting a firm's goods and services. For example, the first use of a significantly different media or technique – such as product placement in movies or television programs, or the use of celebrity endorsements – is a marketing innovation. Another example is branding, such as the development and introduction of a fundamentally new brand symbol (as distinguished from a regular update of the brand's appearance) which is intended to position the firm's product on a new market or give the product a new image. The introduction of a personalized information system, e.g. obtained from loyalty cards, to tailor the presentation of products to the specific needs of individual customers can also be considered a marketing innovation.

Innovations in pricing involve the use of new pricing strategies to market the firm's goods or services. Examples are the first use of a new method for varying the price of a good or service according to demand (e.g. when demand is low, the price is low) or the introduction of a new method which allows customers to choose desired product specifications on the firm's Web site and then see the price for the specified product. New pricing methods whose sole purpose is to differentiate prices by customer segments are not considered innovations.

Seasonal, regular and other routine changes in marketing instruments are generally not marketing innovations. For such changes to be marketing innovations, they must involve marketing methods not previously used by the firm. For example, a significant change in a product's design or packaging that is based on a marketing concept that has already been used by the firm for other products is not a marketing innovation, nor is the use of existing marketing methods to target a new geographical market or a new market segment (e.g. socio-demographic group of clients).

## ORGANIZATIONAL INNOVATION

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An organizational innovation is the implementation of a new organizational method in the firm's business practices, workplace organization or external relations (OECD, 2005, p. 51)

Organizational innovations are supposed to increase a firm's performance through reducing administrative costs or transaction costs, improving workplace satisfaction, gaining access to non-tradable assets or reducing costs of supplies (OECD, 2005, p. 51)

This type of innovation needs to be connected to an implementation of an organizational method that has not been used before in the firm and is the result of strategic decisions taken by management.

Examples of organization innovations are new methods for organizing routines and procedures for the conduct of work. They may involve implementation of new practices to improve learning and knowledge sharing within the firm. The first introduction of management systems for general production or supply operations, such as supply chain management systems, business re-engineering, lean production, and quality-management systems are further examples of organizational innovations. This sort of innovations may involve new ways of distributing responsibilities and decision making among employees for the division of work within and between firm activities. The first implementation of an organizational model that assigns the firm's employees more autonomy would be an example of organization innovation.

New organizational methods in a firm's external relations involve the implementation of new ways of organizing relations with other firms or public institutions, such as the establishment of new types of collaborations with research organizations or customers, new methods of integration with suppliers, and the outsourcing or subcontracting for the first time of business activities in production, procuring, distribution, recruiting and ancillary services.

Changes in business practices, workplace organization or external relations that are based on organizational methods already in use in the firm are



not organizational innovations. Nor is the formulation of managerial strategies in itself an innovation. However, organizational changes that are implemented in response to a new managerial strategy are an innovation if they represent the first implementation of a new organizational method in business practices, workplace organisation or external relations. For example, the introduction of a written strategy document to improve the efficient use of the firm's knowledge is not, by itself, an innovation. Innovation occurs when the strategy is implemented through the use of new software and practices for documenting information in order to encourage knowledge sharing among different divisions.

It is important to realize that neither mergers nor acquisition are not considered organizational innovations. In spite of the fact that mergers and acquisitions might lead to organizational innovations they are not themselves considered innovative.

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#### STRATEGIC INNOVATION

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Strategic innovation is another recognized type of innovation described by Fagerberg (2005) related to the character of introduced innovation. It is the creation of growth strategies, new product categories, services or business models that change the game and generate significant new value for customers and the corporation.

Innovation becomes "strategic" when it is an intentional repeatable process that creates a significant difference in the value delivered to consumers, customers, partners and the corporation. A Strategic Innovation initiative generates a portfolio of breakthrough business growth opportunities using a disciplined yet creative process.

Strategic Innovation takes the road less traveled – it challenges an organization to look beyond its established business boundaries and mental models and to participate in an open-minded, creative exploration of the realm of possibilities.



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## LINEAR-CLOSED INNOVATION

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The linear model of innovation is based on an assumption that innovation is applied science. It is called linear due to the fact that it has a well-defined set of stages that innovations are supposed to go through. In the linear innovation model scientific research comes first, then it is followed by development and eventually production and marketing occurs. As the research takes place first, it becomes the critical element in the linear innovation model. The majority of innovations do not come from scientific breakthroughs. Firms are motivated to innovate because they spot a commercial need for it. They most commonly start by reviewing and combining elements of existing knowledge. Only providing that this approach does not bring about benefits, they firms decide to invest in research. In many cases the experience of users not the scientists have proven to be the most effective source of innovation. What is more, according to Fragerber – nazwisko jest niepoprawne (2005) the linear model ignores the feedback and learning that occur in between stages of the innovation process. Very often shortcoming and failures that occur at various stages may lead to a reconciliation of earlier steps and totally new innovations.

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## OPEN INNOVATION

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Henry Chesbrough (2006, p.1) advocates for open innovation which he defines as “the use of purposive inflows and outflows of knowledge to accelerate internal innovation, and expand the markets for external use of innovation, respectively”. Open innovation is a process, a set of internal relationships, and a cognitive paradigm. Originally Henry Chesbrough (2003, p. xxiv) defined open innovation as “a paradigm that assumes that firms can and should use external ideas as well as internal ideas, and internal and external paths to market, as the firms look to advance their technology.” This paradigm in the authors understanding assumes that firms can and should use external ideas as well as internal ideas, and internal and external paths to market, as they look to advance their technology. Chesbrough (2003) stresses that open innovation combines internal and external ideas into architectures and systems whose requirements are defined by a business model.



The problem behind open innovation is that companies usually reward employed researchers for internally developed projects. Therefore, R&D is likely to become resistant to the idea of open innovation as it promotes externally developed solutions. Externally produced innovations are often taken for granted and do not provide the researchers with the reward that they deserve for finding an application for an externally developed solution.

### 2.3. INNOVATION PROCESS

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Schumpeter (1949) argued in favor of three aspects of innovation process. First in his opinion comes fundamental uncertainty inherent in innovation projects. The second was the need to move quickly before somebody else did in order to reap the potential economic reward. The third important to Schumpeter aspect of innovation process was the prevalence of resistance to new ways or inertia at all levels of society, which threatened to destroy every novel initiative and forced entrepreneurs to fight hard in order to succeed in their projects. The inertia mentioned by Schumpeter was to some extent endogenous, since it reflected the embedded character of existing knowledge and habit, which was meant to be energy-saving tended to bias decision-making against new ways of doing things.

In Schumpeter's early work innovation is pictured as the outcome of continuous struggle in historical time between individual entrepreneurs, advocating novel solutions to particular problems, and social inertia which was particularly endogenous (Schumpeter, 1949). During the first decades of twentieth first century innovation process started to increasingly involve teamwork and take place within larger organizations. Therefore, Schumpeter (1949) acknowledged this and emphasized the need for systematic study of cooperative entrepreneurship in big firms. Nonetheless, he did not analyze the phenomenon in much detail.

Many managers see innovation as a process (Harvard Business Essentials, 2003) similarly to the process depicted it in the diagram below.



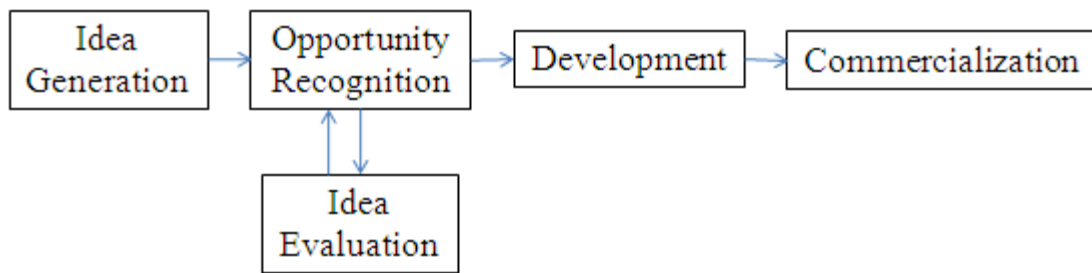


EXHIBIT 5. INNOVATION PROCESS (HARVARD BUSINESS ESSENTIALS, 2003, P. XII)

This process starts with two creative acts: idea generation and opportunity recognition. Idea generation happens when a person develops an insight about something new. It can take a form of technical insight with no apparent technical application or be directly inspired by an existing problem or opportunity (Harvard Business Essentials, 2003).

Opportunity recognition takes place when a potential value for the market is spotted in the idea. Then it is incubated up to a point when a decision maker evaluated its potential. An idea that is assessed positively and obtained organizational support are moved to a stage of idea development and eventually this idea is commercialized. Commercialization is the final test for the idea's application, feasibility and profitability. At the stage of commercialization it is the customers who either approve or disapprove of the idea (Harvard Business Essentials, 2003). This process is based on creativity that leads to an initial idea as well as helps to develop it.

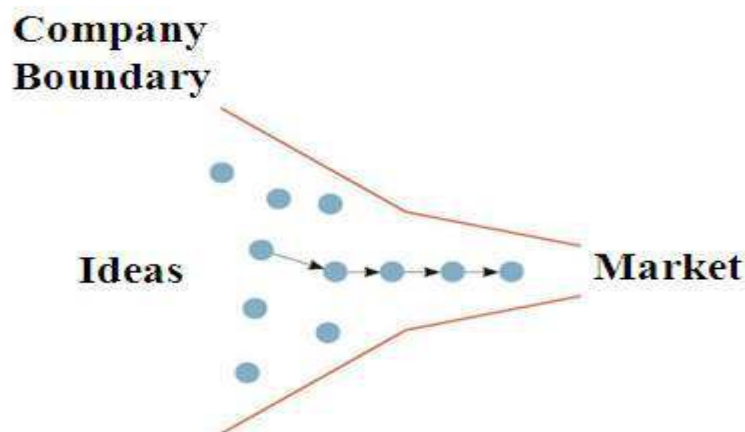
To comprehend the innovation process it is relevant to review two basic innovation models. Namely, the traditionally used closed innovation model and the open innovation model.

Chesbrough (2003) recognizes that the closed innovation model assumes gaining a competitive advantage by funding research laboratories. The aim of such laboratories is developing from scratch technologies that lead to creation of new



products. High costs of such policy trigger high profit margins for the newly launched products to cover the costs and invest in following research.

The presented above vertical integration of research function is capital-intensive. As a result, this model of innovation development means that the firms that cannot afford spending considerable amounts of capital on research and development are at a disadvantage to firms that can. The vertically integrated concept of research and development pipelines is shown below.



#### EXHIBIT 6. CLOSED INNOVATION (CHESTBROUGH, 2003)

The closed innovation model produces few completed research projects that eventually reach the market. What is more, innovations developed in the closed model are often useless to the company's core business. Therefore, many idea are not immediately utilized. They await a market opportunity that may or may not arise. In some cases companies fail to capitalize on the disruptive innovations that they developed.

Chesbrough (2003) noticed a beginning of changes in this model in the 90's when firms such as Cisco Systems were gaining a competitive advantage over firms such as Lucent Technologies that were spending a vast amounts of resources on research and development focused around the closed model.

Chesbrough (2003) claims that one reason why companies fail to capitalize on the developed innovations is that they neither adjust their existing



business models nor create new business models that would suit the needs of the innovation. To illustrate that issue Chesbrough (2003) talked about the Xerox Palo Alto Research Center so-called PARC. Even though PARC's researchers generated many promising ideas that were discarded by managers. Hence, staff that worked on the potentially successful innovations departed for start-up companies such as 3Com or Adobe. In effect, the market capitalization of Xerox's spin-offs exceeded that of Xerox itself and the shareholders of Xerox did not derive as many benefits from quite a few PARC's innovations as others did. The PARC's example shows that the closed innovation model has lost on its value. Its viability is doubtful in the 21st century. According to Chesbrough (2003) the closed innovation model had to erode due to increased mobility of skilled workers, expansion of venture capital, external opportunities for underutilized technologies and increased availability of capable outsourcing partners.

The open innovation model described by Chesbrough (2003) allows research results to traverse the company's boundaries. It facilitates other companies to license usage of developed technologies and allows our company to license technologies created by other firms that may become useful to our firm. This model creates a win-win situation and accelerates technological progress. The concept of open innovation is depicted in the picture below.

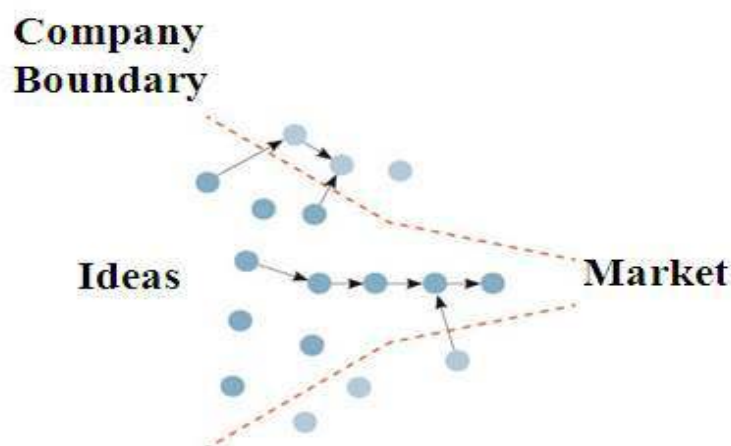


EXHIBIT 7. OPEN INNOVATION (CHESBROUGH, 2003)





The dashed lines represent a company's porous boundaries. The dots outside of the company's boundaries represent ideas and technologies that have been licensed to other firms as they could not be utilized by the existing business model of our company and therefore would have been unutilized. The dots entering the company's space represent outside technologies that were not originated in the firm's own research laboratories, though could be beneficial to the firm's core business and were therefore licensed to the firm.

What is more, Chesbrough (2003) argues that internal ventures should be treated as laboratories that test real market real products to real customers. This sort of a test is more useful than extensive, hypothetical market research. Following benefits of forming internal ventures have been implied by Chesbrough (2003): they allow capitalization on technologies that would otherwise be unused in the firm's own business, the venture process brings new technology to the market much quicker and it is a source of priceless feedback from applying technology to different uses in different markets. Forming alliances and acquiring start-ups is a sign of taking the open innovation a step further according to Chesbrough (2003). Furthermore, he believes that when there is an innovation in the business model itself, a venture group facilitates rapid prototyping of new business models that would be effective in bringing the innovative solution to the market.

Other experts in the field of innovation have different approaches to innovation. Peter Drucker (1986) promoted the concept of practicing systematic innovation. To him systematic innovation „consisted in the purposeful and organized search for changes, and in the systematic analysis of the opportunities such changes might offer for economic or social innovation”. Drucker thought it was particularly significant for entrepreneurs not to wait until „the Muses kisses them” and gives them a right idea, but to work on the idea scrupulously.

Systematical innovation methods create innovative solutions that last and can be replicated as well as repeated (Chan *et al.*, 2006). Organizations need to mindfully manage innovation process to increase the chance of competitive advantage steaming from innovation (Jones, 2004). In the long run only innovation has the



potential to sustain company growth and survival. Without innovation the competition becomes more tense and closer. That limits competition to some very basic aspects such as lowering prices and increasing quality. However, in Jones' opinion developing a company is about experiment and discovering new market spaces.

According to Gary Hamel (2006) innovation streams from happen-stance, desire, curiosity, ambition and need, not from dirigisme planning processes. On contrary to traditional strategy planning process that are procedural, reductionist, extrapolative, elitist, easy, business concept innovation is a creative, expansive, inventive, inclusive and demanding strategy process. Hamel thinks that innovation starts beyond continuous improvement. Innovation is in his opinion is going nonlinear.

The innovation process is uncertain because by definition what needs to be learned in it can only become known through the process itself (Lazonik, 2005). By investing in learning, an innovative strategy confronts the uncertain character of the innovation process. The innovation process becomes cumulative when learning cannot be done at once. It rather requires continuous collaboration of different people with different complementary abilities. Therefore, "investments in collective learning demand an integration of the work of these people into an organization" (Lazonik, 2005, p. 30).

According to Dollinger (2003) after the invention is commercialized the process innovation that constitutes the second type of technological change become dominant. In spite of the fact that invention possesses radical and revolutionary character that can potentially create new industries and, process innovation is incremental and evolutionary. It aims to increase efficiency of existing industries. It rather refers to small changes in design, product formulation and manufacturing materials as well as service delivery that are introduced to prolong a product's life cycle, keep it up-to-date and lower costs. Frequent process innovation appears particularly often in large companies. Providing that these companies fail to facilitate full exploration of exploit potential improvements, the change-drivers may decide to



become entrepreneurs and ultimately competitors to the change-resistant firms. What happens then it that the “company’s entrepreneurs spin themselves and their new product off into a new venture” (Dollinger, 2003, p. 62).

In the end it is crucial to realize that an innovative firm is supposed to comprehend how strategizing, financing and organizing can efficiently support the innovation process. Efforts of theoretical economists have been focused on optimizing firm’s processes rather than innovating. Optimizing demands technological capabilities and market prices for inputs as well as outputs. It aims to maximize profits given technological and market constraints. Nonetheless, competing solely on the basis of high quality and low costs leads to lower profitability in a long-term. To stay competitive and profitable a company needs to differentiate itself from competitors in the industry a company needs to transform the technological and market conditions that are perceived as constraints by optimizing. Thus, innovation firms engage “in a mode of resource allocation that requires a theoretical perspective on the processes of industrial and organization change” (Lazonik, 2005, p. 31).

#### 2.4. MANAGING INNOVATION

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According to John C. Huber (2001) managing innovation is not only about managing people. He believe that innovation management means also managing ideas. Huber (2001) thinks that investors and investors are the ones who also manage innovation as they need to manage their own way of getting ideas and than manage how those ideas become successful products. What is more, Huber pinpoints that even a first-level manager in a product development laboratory manages innovation even though he may not be aware of it. According to Huber innovation cannot be managed in the classical way of command-and-control (2001). At the same time, he thinks that there is no secret, fit-all recipe for success in innovation. Neither standard rules nor principles assure desired results when it comes to innovation. The management techniques that find suitable application in manufacturing or accounting are unless in managing innovation (Huber, 2001). Managing innovation involves risks that are hardly possible to anticipate. Interestingly, Huber thinks that people are interchangeable in innovation (2001).



Hence, he compares managing innovation to coaching a professional sports team where the manager just like the team's coach creates a game plan or a game strategy that gives players competitive advantage over the rivals. Nonetheless, the game imposes alterations in the strategy as competition's strategy becomes evident. This happens because innovation requires instant changes with changes of the competitive landscape. As a result, in Huber's view managing innovation is successful when an inventive solution solves a relevant market problem within a business unit's strategy. To protect itself from competition a company needs to offer a solution that is inventive, otherwise competition will replicate and the competitive advantage would be lost (Huber, 2001). With regards to the market problem that the solution should address, it needs to be urgent and significant or else the customers will refuse to pay a price high enough to cover the costs of a novel solution development. Likewise, the developed solution should suit the business unit's strategy, because in other case it may lack in prerequisite technology, marketing channels, or sales skills (Huber, 2001). Withal, Huber presents a unique approach managing innovation. He reckons that it consists of three basic elements: managing inventive idea, strategic statement and market need. These components need to fit together like legs on a stool, because then altogether these elements allow for successful creation of innovation (Huber, 2001).

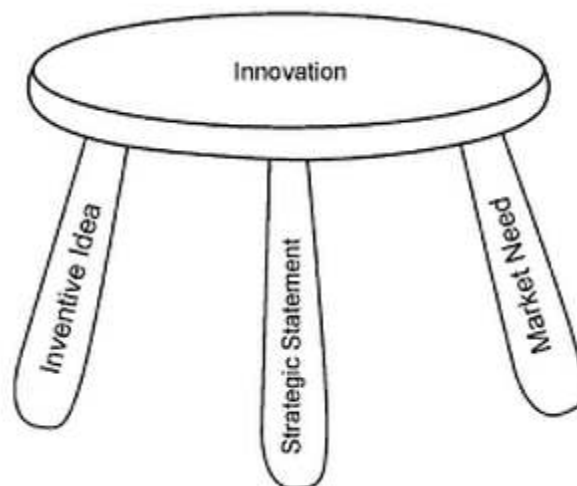


EXHIBIT 8. COMPONENTS OF MANAGING INNOVATION (HUBER, 2001, P. 5)

To sum up Huber's views on managing innovation, managing innovation is difficult and complicated because components of managing innovation described above are hard to identify and develop. Not only important market problems are hard to find, competitive strategies hard to invent, new projects development projects hard to seize, turning development projects into new product difficult to achieve, but also improving future innovations and practices for managing innovation hard to accomplish (Huber, 2001). In the end, it successful innovation management seems to be a matter of comprehensive knowledge, managerial skills, lots of good luck for working with the right people and many situational variables.

In many industries it has become increasingly risky not to innovate. Consumers and industrial markets have come to expect periodic changes and improvements in the product offer. As a result, some firms felt pressurized to make innovation their grand strategy. Therefore, firms are attempting to figure out the best practices for innovation management. In general, companies search for recipes for effective and profitable innovation. Methods of managing innovation should serve to overcome resistance to change and lead to visible benefits, competitive advantage and profits.

Managing the process of innovation and change to enhance organizational effectiveness is a central challenge facing managers today. An increasing rate of technological change and an increase in global competition are two forces that are putting enormous pressure on organizations to find new and better ways of organizing their activities to increase their ability to innovate and create value (Jones, 2004).

As it turns out, accumulation of innovation experience enables a company to deal with increasing costs and growth constraints. An asset of an innovative company is that it can reshape its productive resources to utilize the opportunities created by the new market conditions. Each move into a new product market is an opportunity for a company to use productive services gathered in the process of organizational learning. They can become source of firm's growth through in-house complementary investments in new product development and the acquisition of other firm that have already developed complementary productive services.



Joseph Schumpeter (1949) in his work focused on a role of an innovative entrepreneur who managed to create new combinations of productive resources that could. To Schumpeter entrepreneurship was the fundamental phenomenon of economic development as the innovating firms could challenge optimizing firms and thereby drive the development of economy. He viewed innovative firms as a result of entrepreneurial work of an extraordinary individual. He notices that large innovative corporation engaged in a process of creative destruction. In effect, existing models created in the past were exchanged by new productive models of production transformation.

It is argued that for potentially rewarding innovation one may not know what are the most relevant sources of information, chance of success or the best options to pursue. It has also been stressed that the innovative firms need to consider the potential problems that steam from dependency created by taking a particular innovating path. Providing that a firm takes a certain innovation path very early in the process, it risks overlooking other alternatives and staying on the path in spite of its inefficiency (Schumpeter, 1949). Staying on the current path is often reinforced by various convictions and assumption on its righteousness. In the end it may turn out that there existed a better, superior path that was given more patience and attention by competitive companies. The longer a company persists to its wrongful path, the more costly and difficult it becomes for it to switch paths. Hence, it is recommendable in the early stage of the innovation process before sufficient knowledge of alternatives has been generated, the best strategy may simply be to avoid becoming stuck on a particular path and remain open to different, competing ideas and solutions according to Schumpeter (1949). Therefore, pluralistic leadership helps to allow for a variety of competing perspectives. In contrast to the homogenous, unitary leadership style advised by the management literature, pluralistic leadership turns out to be the most advantageous (Fagerberg *et al.*, 2005).

There are a number of techniques that managers can use to help promote innovation. These include project management, using a stage-gate development funnel, using cross-functional teams and a product team structure establishing strong



team leadership, making use of skunk works and new ventures divisions, and creating a culture of innovation (Jones, 2004).

Innovation understood as development of new products or new production and operating systems, including new forms of organizational structure, needs to be managed as they are vital to knowledge-creating activities organizations.

The fundamental characteristics of innovation such as that every innovation consists of a new combination of existing ideas, capabilities, skills and resources etc. indicate that management and openness to new ideas and solutions is considered essential for success of innovation projects especially in the early phases. The greater the variety of innovation factors within a given system, the greater the scope for them to be combined in different ways , producing new innovations which will be more complex and more sophisticated.

External resources facilitate numerous innovation activities in companies. More and more often it is said that “a firm does no innovate in isolation, but depends on external interaction with its environment” (Fagerberg, *et all.*, 2005, p. 20).

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## LEADERSHIP AND INNOVATION

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Leadership plays a significant role in developing innovation. The human resources of an organization are capable of creating innovation, but their talents are wasted if there is no thoughtful, strategic leadership. For this reason, it is crucial that leaders actively participate in the innovation process from its early stages when they can influence the design and the direction of innovative projects. It means that senior management needs to be visible, approachable. They must recognize and nurture promising ideas ( Harvard Business Essentials, 2003).

Fagerberg (2005) recognized four factors such as organizational culture, structure, people as well as proprietary rights that need to be managed within an organization regarding innovation. In his opinion these aspects of an organization influence its innovations.



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## ORGANIZATIONAL CULTURE AND INNOVATION

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Organizational culture understood as “the set of important assumptions (often unstated) that members of an organization share in common.” (Pearce, Robinson, 2005, p. 345). The shared assumptions are significant as they influence opinions and actions undertaken by company’s employees. It is said that every organization has its own culture that is similar to individual’s personality (Pearce, Robinson, 2005). It is believed to be an intangible, however omnipresent theme that provides meaning, direction, and the basis for action. Members of an organization might be aware of its organizational culture without sharing the organization’s beliefs and values out in the open. Nonetheless, the members become devoted to the beliefs and values of their organization when they internalize them and begin to consider them their own. Values and beliefs appreciated by the employee and embodied by the organizational culture increase job satisfaction. Working for an organization that rewards behaviors mirroring values of an individual becomes gratifying. In such a situation employees derive satisfaction from the results of their behaviors as they are congruent with corresponding personal beliefs and values. In effect, organizational “assumptions become shared assumptions through internalization among an organization’s individual members” (Pearce, Robinson, 2005, p. 346). The shared assumptions are essential for an organization as they are thought to shape the content and account for the strength of an organizational culture.

The organizational culture has a profound impact on how a firm performs according to Biernat (2005). It also plays an important role in shaping and promoting innovation (Fragerber *et al.*, 2005) . Values and norms can reinforce the entrepreneurial spirit and allow an organization to respond quickly and creatively to a changing environment. Hence, culture of an organization also needs to be managed as an integral part of effective innovation management.

It is stressed by Lazonik (2005) that innovative enterprises depend on social conditions. Therefore, the development as well as utilization of skill bases that occur in particular organizational environment might not be applicable in another industry environment. Dynamic capabilities differ, age and change within same





industries and nations. Different innovation outcomes are generated by the skill base enterprises that employ people to transform technologies and access markets. The markets vary significantly in their industrial activity too. Hence, an organization needs to adjust its culture to the challenges faced by its employees.

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## ORGANIZATIONAL STRUCTURE AND INNOVATION

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An organizational structure is defined as a “way in which a company divides its activities among separate units and coordinates activities between these units” (Wild, *et al.*, 2008, p. 325). It needs to clearly define areas of responsibilities and chains of command. The organizational structure is not permanent and undergoes modifications to adjust to changes within a company and in its external environment. Organizational structures are typically based on strategies, changes in strategies influence a company’s structure. Matching a company’s structure to its strategy is essential for effective strategy execution and effectiveness.

It is relevant for an organization to define a degree to which decision making in an organization will be centralized or decentralized. Centralized decision making facilitates close control over operations whereas decentralized decision making gives authority to employees who might be capable of taking better decisions on the basis of their knowledge of the business environment.

Since organizational structure influence the way people behave, creating a favorable for innovation setting is important to foster an intraprenurial culture (Fagerberg, *et all.*, 2003). Several factors can stunt innovation and reduce the ability of an organization to introduce new products as it grows.

Increasing the organization size may slow innovation. As organization grow decision making slows down. Decisions have to be made through established channels in a sizeable hierarchy, and a thriving bureaucracy may stifle the entrepreneurial spirit. As an organization becomes more bureaucratic, people may become conservative and unwilling to take risks, and those most willing and able to innovate may become discouraged and leave the organization (Jones, 2004).



As organizations age, they tend to become less flexible and less innovative. Relatively old, inflexible organizations may fail to notice new opportunities for new products. What is more, it is difficult for people to remain entrepreneurial throughout their careers. Thus, the organization and its personnel age may lead to greater conservativeness.

Organizational growth triggers complexity and an increase in vertical and horizontal differentiation may hurt innovation. As increase in hierarchical levels make it hard for employee entrepreneurs to exercise meaningful authority over projects. They may be under the constant scrutiny of upper level managers who insist on following procedures. Similarly, when the skills and knowledge needed for innovation are spread across many subunits and functions, it is difficult for a product manager or product champion to coordinate the innovation process and secure the resources needed to bring a project to fruition.

In order to promote innovation organizations need to adopt a structure that can overcome those problems. Organic structures based on norms and values that emphasize the lateral communication and cross-functional cooperation tend to be better at promoting innovation. Matrix and product team structure possess these organic characteristics and provide the autonomy for people to make decisions on their own (Jones, 2004). Additionally, many organizations use informal organization to overcome obstacles presented by the formal structure, Such organizations give their employees wide latitude to act outside formal task definition and to work on projects where they think they can make a contribution. Hewlett-Packard and 3M informally grant their employees the right to use organizational resources to work on projects of their own choice. Sony allows its scientists to move from one project to another as well as select a team to work on where they can make the best contribution. Apple and Microsoft confer on their top R&D scientists the title research fellow and give them the autonomy and resources to decide how to put their skills to best use. When a research fellow's research leads to a promising new product development, a project team is established.



Solely strategizing, financing and organizing do not necessarily mean innovating. A firm begins to strategize when it chooses a product market in which it intends to compete as well as when it chooses technologies that they hope to be competitive. Making investments to transform technologies and access markets that can combine resources in an intent to transform them into saleable products is when companies finance. Nonetheless, innovation takes learning how to transform technologies and access markets in a manner that generates high quality products at a low cost. In this case learning is considered a social activity that render innovation process uncertain, cumulative, and collective (Lazonik, 2005, p. 30).

The ability of recognize competitive strengths and weaknesses of firm's skills base is crucial for executives in control as changes in the skills base are essential for innovative response to competitive challenges.

Investments in the skills base may bring about higher quality and lower cost products. Nevertheless, this requires committing finance to sustain that investment all along the way. "Only with financial commitment and support of decision makers a company may engage in cumulative and collective learning that yields innovation" (Lazonik, 2005, p. 34).

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## PEOPLE AND INNOVATION

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People aspect is crucial for innovation management as by people managers mean "not just employees of the organization, but also the strategy used to recruit, compensate, and retain those individuals and the type of people that they are in terms of their skills, values, and orientation" (Hill, 2001, p. 442). The people component can be used to reinforce the prevailing culture of an organization.

The culture of innovation in high-tech organizations is fostered by the characteristics of employee themselves (Fagerberg *et al.*, 2005). People play a key role in developing innovations. In many research setting, people cooperate so closely on product development that they become increasingly similar to one another. They buy into the same set of organizational norms and values and thus are able to communicate well with each other. In turn, organizational structures select new



members who buy into the same set of values, so that over time a recognizable culture that promotes communication and the flow of new ideas emerges. However, an organization needs to guard against too much similarity in its scientists, lest they lose sight of new or emerging trends in the industry. IBM scientists, for example, fixated on improving mainframe computers and ignored signs that customers wanted better personal computers, not more sophisticated mainframes. To maintain a capability to innovate successfully, a high-tech organization must strive to maintain diversity in its scientists and to allow them to follow divergent paths. The uncertainty associated with innovation makes it important for people to be adaptable and open to new ideas. One way to encourage flexibility and open-mindedness is to recruit people who are committed to innovation but who travel along different pathways to achieve it.

To apply an innovation strategy strategic decision makers need to mobilize the required financial resources, create incentives for employees inside the firm, its functional and hierarchical divisions to cooperate. “Abilities to amount financial resources and motivate the human resources of an organization are considered social conditions of innovative entries” (Lazonik, 2005, p. 33).

Human factor determines whether or not as well as in what ways an enterprise accumulates innovative capability and thereby adds social dimension to work on dynamic capabilities. It is the strategic control determines how strategic decision makers build on asset positions. What is more, it is the financial commitment that determines whether the company will possess appropriate resources to stay on the innovative path up to the point when accumulation of innovative capabilities manage to generate financial returns. It is important that the organizational integration is responsible for shape of the incentives’ structure and shape organizational processes. These “processes transform individual actions and individual capabilities into collective learning” (Lazonik, 2005, p. 34).

In knowledge-intensive industries the skills base allows enterprises to pursue its innovative strategy. Strategic decision makes choose how to structure the skills base to bring about collective and cumulative learning. In an intent to do so executives can influence how the employees move around and up the functional and



hierarchical division of labor over the course of their time with the company. However, the skills base possessed by an organization constantly faces constraints of particular learning requirements posed by particular industrial activities that make up the firm's competitive environment as well as the personal for whom the company must compete.

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## PROPERTY RIGHTS AND INNOVATION

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Intellectual property right in particular intend to promote innovation in expression and invention. The copyrights and patents are the most commonly used ways of protection for intellectual right Through focusing on property rights, people and structure, an organization creates a culture in which norms and values foster innovation .

Strong property rights can also be created if an organization ties individual and group performance to large monetary premiums (Fragerber *et al.*, 2005). Innovative employees should receive bonuses and stock options that are promotional to the increase in profitability that can be attributed to their efforts. Making employees owners in the organization will discourage them from leaving and will provide them with a strong incentive to perform well. Many successful high-tech organizations, such as Merck and Apple, do this, an one in five of Microsoft's employees is a millionaire as a result of the organization's policy of giving stock options to employees. The last thing that Bill Gates wants is for his best employees to leave and fund their own organizations that then would compete with Microsoft.



## 2.5. MEASURING INNOVATION IN EMPIRICAL RESEARCH

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Managers are taught at business schools that what they cannot measure, they will not be able to manage. Therefore, to manage innovation businesses should develop some sort of tool, metrics or assessment survey that would allow for evaluation of their innovation activity. What is more, measuring innovation would provide a deeper insight into increasing effectiveness of innovative initiatives as well as motivate organizations to embrace innovation broadly and innovate on daily basis. Common sense prompts to think that setting innovation goals, communicating innovation strategy and rewarding people involved in innovation process for achieving milestones shall accelerate the pace of implementing innovative ideas, capitalizing on them and eventually achieving sustainable growth as a result of consistent innovation policy.

Ironically, there are few systemic approaches to measuring innovation. The issue of measuring innovation is more complicated than it may initially seem as innovation by definition is intangible, not easy to measure and predict at the beginning and intuitive. Therefore, Kuczmarki (2000) suggests that innovation shall be measured from retrospective using the Return on Innovation Investment ratio shorted to R2I. Measuring R2I renders the intangible tangible, hence providing managers, employees and the investment community with valuable information that can be utilized in numerous ways. R2I represents return on investment from new product innovation investments, excluding all other not related to innovative initiative investments. R2I takes into consideration a firm's total profits from newly launched products divided by its total expenditures for new products. This is a long-term ratio that shows the firm's total return from new products over a three- to five-year period. This ratio has two distinctive usages; First of all, it has a descriptive usage to demonstrate the overall effective contribution of new products. Second of all, it has a predictive usage to forecast or set goals for the organization. However, Kuczmarki (2000) recommends not to ignore the other measures and focus on R2I alone though. R2I is driven by all the other metrics, since all have an impact on the bottom line. Remember also, that for R2I measurement to work, the process must be applied consistently to all new products and services.



Michael Dell *et al.* (2006) suggest measuring innovation with the use of return on invested capital (ROIC). This ratio is measures of effectiveness of companies to create shareholder value to cost of capital invested. ROIC similarly to R2I helps to identify what businesses are performing well and those that fail to deliver expected results (Dell *et al.*, 2006).

OECD clearly pinpoints that currently research on innovation fragmented. Therefore, there is need for a general framework of analysis and greater coordination of research efforts to comprehend how innovation happens from inputs to economic and social impacts. They also emphasized that indicator and related econometric research should move forward from innovation inputs and activities to include the outputs and impacts of innovation (OECD, 2007). In OECD' opinion new methods of analysis are necessary to understand innovation processes, which will require improved data access, data linkages and the adoption of interdisciplinary approaches to data. To create a science of science policy a considerable improvement in the policy relevance of innovation research will have to occur (OECD, 2007).

OECD (2010) explains that to measure innovation more effectively by statistical systems we could experiment with satellite accounts, exploit the potential of existing microdata, add questions to existing surveys, add topic-specific modules to main survey vehicles or develop short turnaround surveys to meet special needs. Fulfilling this task would require co-ordination to prevent geographically fragmented research efforts over the long term and ensuring that the results of successful experimentation in a limited number of countries are taken up by the international community. In the longer term, the challenge for the statistical community is to redesign surveys to address the relevant unit of innovation analysis. Another challenge according to OECD (2010) is to restructure data collection to maximize data-linking opportunities for research and the analysis of impacts. This also means finding ways of providing researchers with access to microdata while respecting confidentiality requirements.

OECD (2010) stresses urgency to develop innovation metrics in five key action areas that can be linked to aggregate measures of economic performance.

The first key action area indicated by OECD (2010) is improvement of

the measurement of broader innovation and its link to macroeconomic performance. Therefore, the surveys that aim to examine science, technology and innovation should be redesigned to consider a broader view of innovation and link surveys' findings to science, technology and innovation policies to economic growth. OECD (2010) thinks that to pursue that goal we need to measure and value intangible assets, review the measurement framework for innovation to identify and priority areas for survey design and re-design and then align survey and administrative data with economic aggregates.

Second key action area that requires improvement to enhance innovation measurement, is investing in a high-quality and comprehensive data infrastructure to measure the determinants and impacts of innovation (OECD, 2010). OECD argues that reasonable policy advice should “rely on a high-quality and comprehensive data infrastructure, including at the sub-national level” (2010, p. 14). Key actions in this area include improvement of business registers, exploiting the statistical potential of administrative records, improvement of the data infrastructure at the sub-national level and establishing a data infrastructure which combines data linkages with good researcher access to the data, while protecting business and individual confidentiality (OECD, 2010).

Third area of key activity aiming to systematize measuring innovation is recognizing the role of innovation in the public sector and promote its measurement as there is a need to account for the use of public funds, measure the efficiency of producing and delivering public policies and services, and improve learning outcomes and the quality of the provision of public services via innovation (OECD, 2010). Although, there have not been an agreement on international concepts and comparable metrics for studying innovation in the public sector (OECD, 2010). A framework for the measurement of public-sector innovation is necessary to provide “a basis for a more innovative approach to public activities and services and allow for comparisons and benchmarking” (OECD, 2010, p. 14).

Fourth are of key activity in this area is promotion of the design of new statistical methods and interdisciplinary approaches to data collection (OECD, 2010). OECD advocates that novel methods of interdisciplinary



analysis are necessary to understand innovative behavior, its determinants and its impacts at the level of the individual, the firm and the organization. To do so following we need to develop interdisciplinary approaches to data collection and new units of data collection, improve the measurement of innovative activity in complex business structures, organizations and networks, promote the measurement of the skills required in innovative workplaces and broadly promote the joint measurement of emerging and enabling technologies (OECD, 2010).

The last are of key activity to measure innovation more effectively in the future according to OECD is promotion of the measurement of innovation for social goals and of social impacts of innovation (2010). OECD argues that the existing measurement framework fails to measure the social impacts of innovation (2010). The two key actions OECD advices to undertake in this domain is to develop measures of innovation that address social needs as well as to devise measurement tools that bridge the economic and social impacts of innovation activities (2010).

**Key actions on a measurement agenda for innovation according to OECD:**

**1<sup>st</sup> Improve the measurement of broader innovation and its link to macroeconomic performance.**

**Key to-do actions in this area:**

- Measure and value intangible assets;
- Revisit the measurement framework for innovation to identify and prioritise areas for survey design and re-design; and
- Align survey and administrative data with economic aggregates.

**2<sup>nd</sup> Invest in a high-quality and comprehensive data infrastructure to measure the determinants and impacts of innovation**

**Key to-do actions in this area:**

- Improve business registers;
- Exploit the statistical potential of administrative records;
- Improve the data infrastructure at the sub-national level; and

- Establish a data infrastructure which combines data linkages with good researcher access to the data, while protecting business and individual confidentiality.

**3<sup>rd</sup> Recognize the role of innovation in the public sector and promote its measurement.**

**Key to-do actions in this area:**

- Develop a measurement framework for innovation in the public sector for the delivery of public services, health and education; and
- Devise indicators that capture the nature, direction and intensity of public support for innovation, at national and sub-national levels.

**4<sup>th</sup> Promote the design of new statistical methods and interdisciplinary approaches to data collection**

**Key to-do actions in this area:**

- Develop interdisciplinary approaches to data collection and new units of data collection;
- Improve the measurement of innovative activity in complex business structures, organizations and networks;
- Promote the measurement of the skills required in innovative workplaces; and
- Promote the joint measurement of emerging and enabling technologies.

**5<sup>th</sup> Promote the measurement of innovation for social goals and of social impacts of innovation**

**Key to-do actions in this area:**

- Develop measures of innovation that address social needs; and
- Devise measurement tools that bridge the economic and social impacts of innovation activities.

EXHIBIT 9. KEY ACTION AREA ON A MEASUREMENT AGENDA FOR INNOVATION (OECD, 2010 )

To sum up OECD's findings, it encourages to invest in a high-quality and comprehensive statistical infrastructure to analyze innovation at the firm-level as well as promote metrics of innovation in the public sector and for public policy evaluation, find new and interdisciplinary approaches to capture knowledge creation and flows, promote the measurement of innovation for social goals and of social impacts of innovation. These five key areas of action, according to OECD (2010) would become the "basis for a forward-looking, longer-term, international measurement agenda for innovation" (OECD, 2010, p. 11). OECD (2010) believes development and implementation of such agenda I would last long. Therefore, it requires mutual efforts of the statistical community and engagement of policy makers to define user needs and of researchers to use the data, analyze impacts and feed into the development of appropriate metrics and data infrastructures.

### 3. INNOVATIVE BUSINESS MODELING

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#### 3.1 ORIGINS AND DEFINITIONS OF BUSINESS MODEL CONCEPT

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Development of Internet and knowledge on e-commerce provided new tools, applications and opportunities for businesses to organize and manage their activities in novel, creative, value-adding, adjusted to market needs and cost-effective ways. Thanks to innovative business models some companies managed to build and maintain relationships with the external world and to strategically position themselves in the increasing dynamic environment.

Innovation and business models are interrelated. Innovations are believed to bring value to a company and while innovations of all kinds are extremely valuable to a company, true transformative growth occurs predominantly when business model innovations are involved (Christensen, 2009). Chesbrough has an opinion similar to that of Christensen on this subject. Namely, Chesbrough (2006) believes that an innovation has value if it is commercialized by means of a business model. The dot-com boom proves that innovations on their own are worthless unless they are supported by a business model capable of capturing potential value of innovations. Hence, in the opinion of Mark W. Johnson the business model innovation is the process by which a company delivers radically new value to existing or new customers by devising dramatically new business models that deliver profits in innovative new ways (2009). Chesbrough (2006) argues that a firm can capture value from an innovation by applying the created innovation to its existing model, licensing the innovation to other firms or by launching a new venture with a new business model that will take an advantage of the innovation. In the last case, the business model serves to connect the entrepreneurial inputs to the economic outputs.

At this point it is significant to comprehend the nature of business models. In general, a model is a plan used to make or describe something (Johnson, 2010). A business model is a company's plan for how it competes, uses its resources, structures, its relationships, interfaces with customers and create value to sustain itself on the basis of profits it generates (Barringer *et al.*, 2006). Hence, a business model basically describes how a company operates. To put it simply, a business model is a firm's plan or diagram for how it competes, uses its resources, structures its relationships, interfaces with customers, and creates value to sustain itself on the basis of the profits it earns. A firm's business model is its



plan or diagram for how it intends to compete, use its resources, structure relationships, interface with customers, and create value to sustain itself on the basis of profits it generates. Supply chain management refers to the flow of all information, money and materials that moves through a product's supply chain. The more efficiently a company can manage its supply chain, the more efficiently its entire business model will perform. Business model takes it beyond its own boundaries. Many companies partner with others to make their model work.

The development of a firm's business model follows the feasibility analysis stage of launching a new venture but comes before the completion of a business plan. Providing that a firm has conducted a successful feasibility analysis and knows that it has a product of service with potential, the business model stage addresses how to surround it with a core strategy, a partnership model, a customer interface, distinctive resources, and an approach to creating value that represents a viable business.

At the business development stage, it is premature for a business venture to raise money, hire a lot of employees, establish partnerships, or implement a marketing plan. A firm needs to have its business model in place before it can make additional substantive decisions. Failure to develop a well-designed business model generally stems from a naive understanding of business or a rush to get a new product or service idea to market. A great product or service that is not supported by a carefully crafted business model will likely become an unfulfilled promise of success.

Having a clearly articulated business model is important for several reasons. Even though some business models are better than others, it is dangerous to link the performance of a firm solely to the configuration of a business model. Often performance is a function of both the choice of a business model and how effectively a firm uses its chosen model. The problem that befell many of the early e-commerce companies was that they thought that by selecting an Internet-based business model, they could relax and wait for profits in peace. However, entrepreneurship is not that simple. Such approach neglects to pay attention to how they performed within that business model. A company must craft a strategy, use resources efficiently to be successful.

Understanding of a business model serves as an ongoing extension of feasibility analysis as it continues to ask a question of whether or not our business model make sense (Barringer, Ireland, 2006). What is more, comprehension of the business model, focuses



attention on how all the elements of a business fit together and constitute a working whole. The business model also describes why the network of participation needed to make a business idea viable is willing to work together and articulates a company's core logic to all stakeholders, including the firm's employees.

In general it can be said that business model is believed to convert innovation to economic value for businesses. Many venture capitalists see themselves as investing in a business model. Consequently it often is the venture capital investor that pushes for a change in the business model when it becomes apparent that the original model is not working. In the world of venture capitalists' it is said that the business model spells-out how a company makes money by specifying where it is positioned in the value. It draws on a multitude on business subjects including entrepreneurship, strategy, economics, finance, operations, and marketing. Simply put, a business model describes how a business positions itself within the value chain of its industry and how it intends to sustain itself, that is to generate revenue. In the most basic sense, a business model is the method of doing business by which a company can sustain itself meaning the way it generates revenue.

A well-though business model is supposed to answer the questions about the sense of the model, a need for participative partners, motivation of the partners to cooperate, partners' interest, customers and value of our products to them, motivation of partners and customers at a sufficient scale to cover the overhead of my business and make profit, distinctiveness of a business, level of simplicity to copy the business model utilized by the company. If the business model does not provide a satisfactory answer to these dilemmas, then the business model should be revised or abandoned. In the end, the business model is viable insofar as the buyer, the seller, and the partners involved see it as an appropriate method of selling a product or service.

A company's business model is management's story line for how the company will use its resources to produce a profit. The story line sets four key components of the enterprise's business approach, indicates how revenues will be generated and makes a case for why the strategy can deliver value to customers in a profitable manner. A company's business model thus explains how its business approach and strategy will generate ample revenues to cover costs and capture profits (Dough , 2008).

Closely related to the concept of business model is the concept of strategy (Barringer *et all.*, 2006). The concept of business model is more narrowly focused than



concept of business strategy. A company's strategy relates broadly to its competitive initiatives and action plan for running the business, but it may not lead to profitability. However, a company's business zeros in on how and why the business will generate revenues sufficiently to cover costs and produce attractive profits and returns on investment. Absent the ability to deliver good profits, the strategy is not viable, the business model is flawed, and the business model is in jeopardy of failing. Thus, a company's business model explains the rationale for why its business approach and strategy will be a moneymaker. Absent the ability to deliver good profitability, the strategy is not viable and the survival of the business is in doubt.

To sum up, the most basic understanding of a business models is the profit formula used by a company to generate its income. Nonetheless, Christensen (2009) advocates it is appropriate to increase the scope of the term business model beyond profit model to embrace how a company delivers value to customers, and therefore how a company organizes resources and processes to support its profit model and customer value proposition. Christensen's understanding of a business model is the one that will be used when writing about business models throughout the rest of this research,

### 3.1.BUSINESS MODEL COMPONENTS AND TYPOLOGIES

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According to Christensen, a professor from Harvard Business School who is a guru in innovation management, a business model consists of four interlocking elements (customer value proposition, profit formula, key resources, key processes) that, taken together, create and deliver value (Christensen *et al.*, 2009). He believes that the first element, customer value proposition is by far the most important. Clayton Christensen (2009) proposes a four-box business model framework presented below to help in describing business models. His approach is very simplified, but effective particularly in consulting.



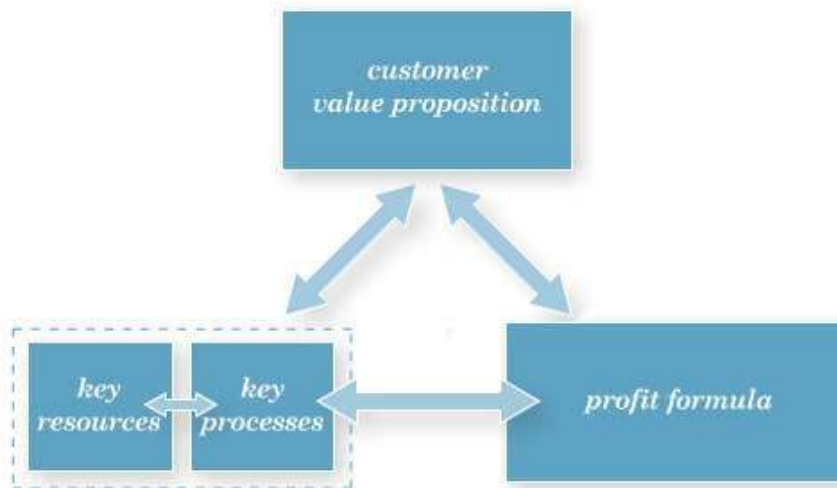


EXHIBIT 10. BUSINESS MODEL (JOHNSON, 2010, P. 24)

In the above model customer value proposition means a solution or offering in form of product or service that helps customers do more effectively, conveniently and affordably a job understood as a deep consumer need or problem that the consumer would like to have solved and is eager to pay a certain price for it (Johnson, 2010).

Profit formula in the business model depicted above is another element of Christensen's model. It is based on the offering and its associated price as defined in the customer value proposition (Christensen, 2009). Profit formula is in fact the blueprint that then defines how the company creates value for itself.

Key resources are the unique people, technology, products, facilities, equipment, and brand required to deliver the value proposition to the targeted customer (Christensen, 2009).

Key processes are both operational and management processes that make delivery of the value proposition repeatable and scalable. These include the recurrent, critical tasks that must be delivered in a consistent way (Johnson, 2010).

In spite of the fact that there is no precise agreement on the components of a business model, many agree that a successful business model has a common set of attributes. One team of academic thinks of a business model as a coordinated plan to design strategy along three vectors: customer interaction, asset configuration, and knowledge leverage. Gary Hamel (2000) believes that a business model consists of four components: core strategy,



strategic resources, customer interface, and value network. Barrington *et all.* (2006) adopted a similar view and describe a business model consisting of four components: core strategy which shows a firm competes, strategic resources which present how a company acquires and uses its resources, partnership network which describes how a firm structures and nurtures its partnerships and customer interface which indicates how a firm interfaces its customers. Each of the components has several subcomponents. The components of business models according to Barrington *et all.* (2006) are shown and explained below.

<b>Core Strategy</b>	Demonstrates how a firm competes relative to its competitors.
<b>Product/Market Scope</b>	Defines the products and markets on which it will concentrate.
<b>Basis for Differentiation</b>	Shows how firm's products or services are not different from those of its competitors.
<b>Strategic Resources</b>	Consist of firm's core competencies and its strategic assets.
<b>Core competencies</b>	A resource or capability that serves as a source of a firm's competitive advantage over its rivals
<b>Strategic Assets</b>	IT is anything rare and valuable that a firm owns. They include plant and equipment, location, brands, patents, customer data, a highly qualified staff and distinctive partnerships.
<b>Partnership Network</b>	A partnership network of a company includes suppliers and other partners.
<b>Customer Interface</b>	Customer interface shows how a firm interacts with its customers.
<b>Target Market</b>	A firm's target market is the limited group of individuals or businesses that it goes after or tries to appeal.
<b>Fulfillment and Support</b>	Fulfillment and support describes the way a firm's product or services goes to market or how it reaches its customers.
<b>Pricing Structure</b>	Pricing models vary depending on a firm's target market and its pricing philosophy.

EXHIBIT 11. BUSINESS MODEL ELEMENTS (BARRINGER *ET ALL.*, 2006)



### 3.2. BUSINESS MODEL INNOVATION BASED ON THE INFORMATION AND COMMUNICATION TECHNOLOGIES

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As noted by Michael Porter (2001, p. 63) “the Internet is an extremely important new technology, and it is no surprise that it has received so much attention from entrepreneurs, executives, investors, and business observers.” As Porter (2001) noticed many people had assumed that the Internet would change practically everything and render the previous competition rules obsolete. That incorrect assumption had led newly established companies particularly dot-coms and incumbents to decisions that eroded the attractiveness industries and undermined their competitive advantages (Porter, 2001). In hindsight, it has become evident that the Internet changes industry structures in ways that “dampen overall profitability, and it has a leveling effect on business practices, reducing the ability of any company to establish an operational advantage that can be sustained” (Porter, 2001, p. 64).

On the other hand, according to Porter (2001) Internet technology brings about greater opportunities for companies to establish distinctive strategic positioning than did the former generations of information technology. In Porter’s opinion, the Internet intensifies the importance of strategy more than ever before as gaining a competitive advantage requires building on the proven principles of effective strategy. Porter believed that the dot-com companies can also be winners providing that they learn to take advantage of the trade-offs between Internet and traditional approaches and can fashion truly distinctive strategies (Porter, 2001). In Porter’s opinion (2001) the key to gaining competitive advantage is about incorporating Internet effectively into a firm’s strategy and operations so that they complement, rather than cannibalize established competitive approaches and create sustaining, not easy to copy advantages. Porter (2001) emphasized that integrating Internet initiatives into company’s business models enhances a company’s ability to develop unique products, proprietary content, distinctive processes, and efficient personal service. Furthermore, those things create true value, and can be considered as competitive advantage. Therefore, Internet-connected solutions have become an important, oftentimes integrating element companies’ business models. The business models that embrace the Internet tend to have innovative character and even be innovations themselves. In other words, the business models involving usage of Internet can be business model innovations. However, Porter (2001) believed that the strategic question how to use Internet and traditional methods to compete, it’s how you can and achieve strategic advantage.



According to Johnson (2010) business model innovation involves more than involving Internet, operations streamlining, new product development, increased investments in research and other incremental changes implemented to reduce the costs and increase profits. These efforts are good practices for sustaining an operational business. Nonetheless, business model innovation needs to modify the core of the business, transforming its nature (Johnson, 2010). External interactions with a company's value chain and end customers are also a part of an overarching business model. Therefore, according to Christensen (2009) business model innovation occurs when a company fundamentally shifts its operations and its role in the market, delivering novel value through new means.

In view of another researcher business model innovation is an initiative that revolutionizes how products are sold in an industry (Barringer *et al.*, 2006). The term business model innovation refers to initiatives that revolutionize how products are sold in an industry (Barringer *et al.*, 2006). For example, the term "business model innovation" refers to initiatives such as that undertaken by Micheal Dell that revolutionized how products are sold in an industry. Business model innovation should be developed around company's core competencies. A core competency is something that a firm does particularly well. It is a resource or capability that serves as a resource of a firm's competitive advantage over its rivals.

Having reviewed a few approached to business models and business model frameworks in general it can be stated that modeling a business model is about shaping different parts of a company's value chain. It is cutting the value chain of every model into pieces that integrate with each other. Therefore, it could be states that a business model innovation requires shaping each separate part to make it fit the models and integrate with it in an innovative way.

Shining examples of business model innovation that transform their industries include Wal-Mart, Southwest Airlines and Apple iTunes. However, to understand reasons behind success of those business it is essential to investigate the term of business model innovation and basis for its efficiency.

For example, the success of eBay streams from its business model and its new market strategy. eBay created an online platform that enables buyers and sellers to meet in the Internet. The sellers sell in an online auction goods that could never be sold in a traditional auction house. A the time when eBay decided to introduce to the market its



strategy other companies treated Internet only as an additional form of commerce. eBay used Internet to create a radical business model innovation whereas other enterprises treated it as a hope for incremental innovation that is typical for established businesses (Christensen *et al.*, 2008).

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## TYPES OF NEW INTERNET-BASED BUSINESS MODELS

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The development and popularization of Internet-connected technologies facilitated creation of new business models. While a list of e-business models expands there is no established taxonomy. The majority of new business models seem to be altered versions of existing business models. Brahm Canzer in his book “E-business: strategic thinking and practice” managed to classify the business models and identify eight distinctive models (2006).

### BROKERAGE MODEL

The first model described by Canzer is the brokerage model. It “encompasses online marketplace where buyers and sellers are brought together in an organized environment to facilitate the exchange of goods and services (Canzer, 2006, p. 23). Firms based on this model tend to specialize in a particular product classification and may not be organized by a major supplier or vendor of these products. Even though a great amount of brokerage activity is conducted among businesses, the popular and profitable, for example eBay, provides both business and consumers with access to a communication structure for buying and selling everything.

### ADVERTISING MODEL

Second model of the taxonomy of the fundamental models of e-business is the advertising model. E-business model is based on learning revenues in exchange for the display of advertisements on a firm’s website (Canzer, 2006). It reminds of models applied by television, radio, newspapers and magazines. Representatives of this model are Yahoo! and MSN. Their revenues are captive on volume of traffic. This e-business model has easily been accepted by the audience as it was free for them, though sponsored by advertising. In this case omnipresent advertising is viewed as the price for quality online content. The Internet advertising model has an advantage over traditional media, because it engages customers more easily through unique design and interaction with the targeted audience.



## SUBSCRIPTION, PAY-FOR-VIEW AND MEMBERSHIP E-BUSINESS MODELS

Thirst model described by Canzer (2006) is a model based on payments for the online content. A firm charges a subscription fee, a fee to view single items or membership fee for giving access to its site. Therefore, this model was classified as subscription, pay-per-view and membership business model. Although this model seems like three models in one it is in fact basically the same model with different structure of revenues. It happens that sources of revenues for this models are combined with advertising revenues (Canzer, 2006). This particular model is popular with publication and research organizations like Forrester Research. Inc. In this model, companies oftentimes provide sample of the site's content free of charge. Afterwards, companies operating in this model try to induce clients to pay for full range of products and services available. Hence, the common practice is giving free trial subscription for a limited time period as well as price reduction for new customers (Canzer, 2006).

## DISTRIBUTION E-CHANNEL MEMBER E-BUSINESS MODEL

Another distinct model characterized by Canzer is the distribution channel member e-business model. It embraces activities of retailers, wholesalers and manufacturers who run their business mainly through the Internet. It is a perfect solution for businesses that are present at any levels in the distribution system of product delivery to end users (Canzer, 2006). "Taking product offerings into a global and virtual environment is easier than ever, as e-commerce software that facilitates this is available for relatively small fees from hosting firms that provide everything required to get started" (Canzer, 2006, p. 24). Canzer also pinpoints that this model is easy to scale up if the a firm's activity generates positive results. This is exactly that happened in case of an online retailer Amazon. New Internet players may follow Amazon's examples and place only their top-selling products in an online facility and with passage of time build up a broader online catalog in tandem with the brick-and mortar retail or wholesale operations (Canzer, 2006).

## AFFILIATION E-BUSINESS MODEL

An interesting concept is presented by Canzer in the affiliation e-business model. This model reckons payments to website operators for customers who find their way to a company's site and either buy merchandise, services or perform other action for example registering and providing information (Canzer, 2006). Amazon was the main actor in popularizing this model. Similarly to other operators of affiliate programs, Amazon managed



to automate the process of registering and creating an online link to the site of final destination (Canzer, 2006). Therefore, every site operator who wishes to earn a share of revenues from books and other products sold through Amazon.com website to customers that the website operator sent there has to click a few times at the Amazon.com registration site. Then, Amazon.com link will appear at the affiliate's website. This way the affiliate can earn 15 percent of so-called finder's commission for customers who were brought to its online store this way. The program has been very successful and well-received by website operators (Canzer, 2006).

#### COMMUNITY E-BUSINESS MODEL

The next type of an e-business model is called the community business model because it is built around the idea that a group of Internet users "can be regularly brought together at a commonly used website for commercial purposes" (Canzer, 2006, p. 25). These online communities can be diverse as well as may share a common interest. The communities of people with the same hobby allows the members to exchange views, experiences, know-how, or look for reestablishing contact with classmates. Because of great human need to live in a community, the community e-business model has bloomed and has potential for further growth. The online communities derive revenues from advertising and shopping services that may be unique to their focus as they facilitate easier targeting of specific and niche product customers (Canzer, 2006). In order to be successful with this business model companies need to build awareness among potentially interested users and spreading the word. Thus, site operators are inclined to offer incentives and rewards to members that help enlist new users (Canzer, 2006).

#### INFOMEDIARY BUSINESS MODEL

Canzer (2006) also described an e-business model based on collection and sale of online information. For this reason, it was named the intermediary business model. Research firm such as Forrester Research and ComScore utilized this model. Their basic activity is displaying articles written by their reporters and other individuals. Companies with this business model are in position to analyze users' interests and behaviors and sell their findings to interested parties such as advertisers (Canzer, 2006).

#### PORTAL E-BUSINESS MODEL

The last e-business model depicted by Canzer (2006) is the portal model. It is a sort of an intermediary that earns revenues by drawing users to its site and serving as a gateway



or portal to information located somewhere else on the Internet. These models vary in range. The ones with a wide range of topics covered are referred to as horizontal portals. The models that have a narrow focus on a particular topic are referred to as vertical portals. Both subtypes earn revenues by selling advertising, providing search services to users to seek merchandise and products and charging the finder's fee for customers sent to a particular merchant (Canzer, 2006). These portals are entry points to the Internet. They are gateways to websites of various sellers. Interestingly, these portals may focus on providing information, entertainment, a search engine service for the Internet etc. (Canzer, 2006). For examples Microsoft 's portal allows users to select and customize their view of news , local weather and other content.

Type of the model	Description
Brokerage e- business model	An e-business model that encompasses online market place in which buyers and sellers are brought together in an environment to facilitate exchange of goods.
Advertising e-business model	An e-business model is based on learning revenues in exchange for the display of advertisements on a firm's website.
Subscription, Pay-per-view, and Membership business model	An e-business model in which access to a site is controlled by a subscription fee, a charge to view single items or membership fee.
Distribution e-channel business model	An e-business model that includes activity of retailers, wholesalers', manufacturers conducting business through the Internet.
Affiliate e-business model	An e-business model includes payments to website operators for customers who find their way to company's site and either buy merchandise or service or perform some other action such as registering and providing certain information.
Community e-business model	An e-business model built around the idea that a group of online users can be regularly brought together at a commonly used website for commercial purposes.
Intermediary e-business model	An e-business model based on the collection and sales of online information.
Portal e-business model	A form of intermediary that earns revenues by drawing users to its site and serving as a gateway or portal to information located elsewhere on the Internet.

EXHIBIT 12. TAXONOMY OF THE FUNDAMENTAL MODELS OF E-BUSINESS (CANZER, 2006)



### 3.3. BUSINESS MODELS AND COMPETITIVE ADVANTAGE

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Competitive advantage occurs when an entrepreneur manages to implement a value-creating strategy that has not been implemented by any other current or potential competitor (Dollinger, 2003).

In view of the above definition of competitive advantage, value creation means above-average growth or gain. However, sustained competitive advantage involve inability of current as well as potential competitors to duplicate the benefits of this strategy. It is also important to notice that although the sustainable competitive advantage by definition cannot be easily copied, it is not doomed to last forever as the changes in environment and industry structure can hurdle the source of the competitive advantage. With passage of time “what once used to be important strategic factors in a certain setting may become barriers to adopt or simply lose its relevance” (Dollinger, 2003, p. 27).

According to Johnson (2008) business model innovation powers disruption. The disruptive power of an innovation stems not from the business mode that encases the product or service not from the offering’s features and functionalities. The successful business model innovations feature new revenue or profit models. Thanks to the business model innovation companies have the capability to generate profits at low price points or to serve a relatively small market profitably. They often take advantage of a different value chain and distribution channels created through collaboration with new partners and suppliers. These differences in business models becomes company’s competitive advantage and have the power to disrupt a competitive landscape and change the rules of competition of a certain market. Initially the market incumbents ignore the disrupting innovators as the disruptors usually begin to compete with a low-margin product that does not appeal to the incumbent’s mainstream customers and is delivered an untypical manner (Johnson, 2008).

Examples of disruptive innovation model are Intel, Black and Decker, Microsoft, Bloomberg, Oracle, Cisco, Toyota, Southwest airlines, QuickBooks Intuit, Salesforce.com.

Cited by Christensen (2008) research by Economist Intelligence Unit in 2005 showed that 50% of global managers believe that business model innovation is going to be of greater importance for company success than creating new products or services. IMB’s CEOs’ survey in 2008 confirmed this result. A majority of the respondents acknowledged the necessity to adjust business models to the current situation. More than 75% admitted that their





companies are in need of changes on a large scale. CEOs are on search for innovative business models that would allow them to effectively face the changes in their environment .

As Christensen (2008) explains Apple's success with iPod comes from „enveloping a new technology in an appropriate, powerful business model” (Christensen, *et al.*, 2008). Google is a great example of business mode innovation its innovation lays in its revenue structure. Google considers itself an advertising business. Thanks to considerable revenue from advertising Google could give customers a free browsers, free e-mail accounts and other products that are all innovative in one way or another.

Southwest airlines to revolutionize their business model chose to direct their offer to the individuals who make a decision to travel by car or bus rather than by plain. Southwest also managed to take over the customers of other air transportation enterprises that were focusing on low costs (Christensen, *et al.*, 2008).



## 4. BUSINESS MODEL INNOVATION IN THE SELECTED COMPANIES

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### 4.1. RESEARCH METHODOLOGY

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The aim of the empirical research is to discuss business model innovations in the selected global and Polish companies as well as to identify and evaluate business models in those enterprises. To answer our basic questions about business models, we needed to select a sample of companies that have built their brokerage e-business models around application of Internet-connected technology, then analyze application of Internet-connected-technology in their value chain to eventually proceed to analyzing their business models according to the 4-box business model suggested Clayton Christensen.

The criteria for selection will be first and foremost application of the e-business brokerage business model and the distribution channel member e-business model in global firms and in Poland. Second criterion for selection will be precedence and leadership in a given company's domain of business. Third criterion for selection will be innovativeness and newness for a company's respective market.

The questions that this research is striving to answer are as follows:

#### **Research questions:**

1. What types of business models and innovations are applied by the companies under research?
2. What are strengths and weaknesses of the business models studied? What is their innovative value?

The sources utilized for the research include primary and secondary research. Primary research includes interview with a Customer Service Consultant from an online brokerage Allegro and with Ms. Agata Czarnowska PR and Communication Specialist from and on online retail store Merlin. The secondary research includes desktop research on business models applied by selected companies, their strategy, missions, visions, value chains, core. All of the selected companies possess viable innovative business models meaning that they manage to capture value from applied innovation and stay profitable.

## 4.2.CHARACTERISTICS OF THE RESEARCH SAMPLE

For this research I have chosen two global business model innovators and two Polish business model innovators of similar nature. The investigated companies created new markets and new ways of competing on those markets.

The first two chosen companies are eBay and Allegro. They represent the e-brokerage business model. Therefore, as typical e-brokers they provides both business and consumers with access to a communication structure for buying and selling everything. They organize exchange of goods through their online trading platform.

The other two companies selected for this research are Amazon and Merlin. They represent the distribution channel member e-business model. Hence, they embrace activities of retailers, wholesalers and manufacturers who run their business mainly through the Internet. They take product offerings into a global and virtual environment.

## 4.3. EBAY – A PROMINENT EXAMPLE OF BROKERAGE BUSINESS MODEL

eBay is a new-market disruptor. eBay's business model and its strategy allowed it to build its competitive advantage on auctioning items that were not attractive for the established, incumbent auction houses. As eBay grew, it attracted more up-scale, mainstream customers and ultimately disrupted the markets and the position of conventional auctioneers. Low costs as well as omnipotence of Internet facilitate further growth, experimenting with the business model and pursuit of disruptive strategy.

This thesis will discuss the case of eBay, because it is one of the most notable success stories of the dot-com bubble and a prominent example of brokerage e-business model that has been copied by many other companies around the world. As a representative of the brokerage model, it conducts auctions for sellers such individuals and merchants. It charges the seller a listing fee and commission scaled with the value of the transaction. Auctions vary widely in terms of the offering and bidding rules.

eBay as an online market place was a disruptive innovation. It created new growth by facilitating something that previously called for more time, efforts, and was less efficient. eBay as a new market-disruption brought consumption to none-consumers.

The company has had a transformative effect on markets for many products in many countries. eBay is the unquestionable industry market leader in person-to-person auctions (Steiner, 2005). The term “eBay” has become a generic name for online auctions. eBay’s influence on society is evident even through the everyday language as it has become common to hear that someone is “ebaying” or is an “eBayer” or that someone is going “to eBay”. eBay’s effect on foreign entrepreneurs has also been evident in Poland as in the recent years many start-ups have tried to copy and apply eBay’s business model. Some have modified it before applications in a more or less significant ways, others basically tried to emulate eBay in every single detail. As a result, some clones of eBay’s business model have been successful, other have not managed to sustain profitability and survive. In the following section of the thesis I will attempt to explore the secrets and uniqueness of eBay’s business model as well as analyze a selected couple of Polish companies that have embraced a similar model.

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## EBAY’S PROFILE

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eBay was founded in September of 1995 that is in the early days of Internet diffusion with the emergence of world wide web (Steiner, 2005). It is a Web-based forum, value-providing platform that provides an efficient market for buyers and sellers of products that did not used to have an efficient distribution system because of either information or price inefficiencies.

According to the company’s mission statement "eBay's mission is to provide a global trading platform where practically anyone can trade practically anything" (eBay, 2010).

The company’s vision is to “transform countries and cities and villages and empower people to make a living in ways they could not before” and to create “new trade on a global basis that the world has never seen” (eBay, 2010).

eBay seem to have succeeded in turning its mission and vision statement into reality as it has become the leading global brand for online auctions. According to Steiner (2005) eBay owns a share in the online auction business that is equal to circa 80 percent. What is more, the company was profitable soon upon its establishment. The company is a gigantic marketplace used by more than 100 million people to buy and sell all manner of things to each other. It is now a multi-billion dollar business. From the original set-time auction format to a much wider range of options such as "Buy It Now" standard shopping, shopping by UPC, ISBN, or other



kind of SKU (via Half.com) as well as online classified advertisements (via Kijiji or eBay Classifieds), online event ticket trading (via StubHub) and online money transfers (via PayPal) and other services (Cohen, 2003) . Through eBay millions of items are listed, bought and sold daily. eBay launched Business & Industrial category in 2005. The site allows for auctioning of practically anything as long as it is not illegal and does not violate the eBay Prohibited and Restricted Items policy. Even services and intangibles can be sold on eBay (Cohen, 2003) .

The company plays a role of an intermediary software program linking buyers and sellers, charging listing fees, payment fees, and final value fees to its sellers. Having established a strong base in the United States, eBay aggressively pushed the idea of global expansion and developed or acquired local on-line auction sites in more 30 countries (Cohen, 2003) .

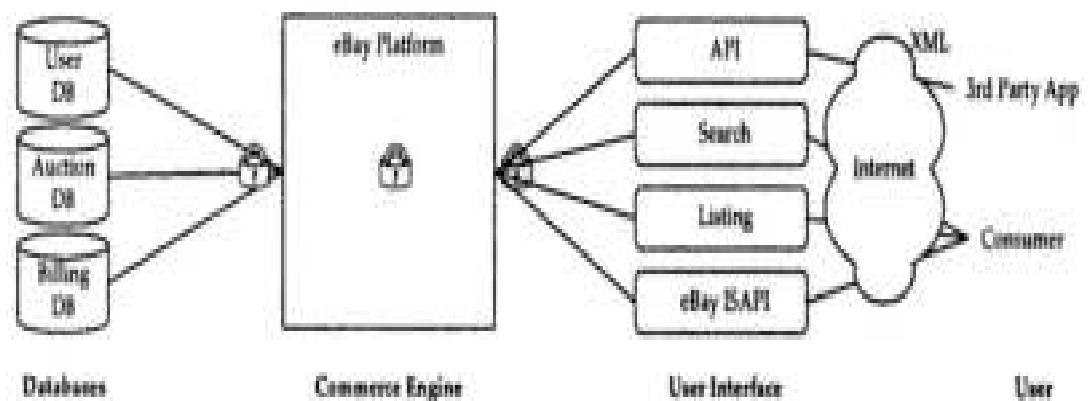


EXHIBIT 13. EBAY'S SYSTEM ARCHITECTURE (STEINER, 2005, P. 87)

The strength of eBay is also evident in the group of partners that chose to cooperate with it. Powerful corporations such as IBM decided to sell their newest products and offer services on eBay using competitive auctions and fixed-priced storefronts. Separate eBay sites such as eBay US and eBay UK allow the users to trade with the use of local currency. Software developers can create applications that integrate with eBay through the eBay API by joining the eBay Developers Program (Cohen, 2003). In June 2005, there were more than 15,000 members in the eBay Developers Program, comprising a broad range of companies creating software applications to support eBay buyers and sellers as well as eBay Affiliates.

## EBAY'S BUSINESSES

The profound success of eBay is definitely caused by its ability to “orchestrate” its businesses. “Orchestration in the business world refers to the activities through which a company combines the skills of its partners to its own skills in order to create a superior product or service offering” (Vesa, 2005, p. 95). The most basic form of business orchestration helps to combine resources. Another level of business orchestration is about creating a new concept and to find partners to with capabilities to successfully apply the new concept. According to Vesa (2005) the third and most complex category of business orchestration is based on using the Internet to create virtual communities. eBay is oftentimes cited as the perfect and the most natural example for the advancement of business orchestration. Vesa (2005) claims that business orchestration of its individual businesses built the company’s success. The main purpose of business orchestration is to integrate external knowledge and skills into the value creation processes. Therefore, business orchestration and the concept of value chain are very closely related. The virtual value chain orchestration is “a way of creating and capturing value by structuring, coordinating and integrating the activities of previously separate markets, and by relaying these activities to in-house operations with the aim of developing a network of activities that create fundamentally new markets” (Hinterhuber, 2002, p. 615). In opinion of Hinterhuber, the orchestration of the virtual value chain is an emergent phenomenon of strategizing and organizing.

eBay own quite a few business which it orchestrates. Each is different and demands a different set of skills to manage. Therefore, it is worth to learn a little bit about every business of eBay. They are as follows:

## PAYPAL

Alike eBay, PayPal is a network facilitator business. To be more exact, it is a payment intermediary service that facilitates worldwide e-commerce. PayPal was founded in 1998 and acquired by eBay Inc. in October 2002, PayPal enables any individual or business with an email address to securely, easily and quickly send and receive payments online. PayPal became an electronic alternative to traditional paper methods such as checks and money orders. PayPal's service builds on the existing financial infrastructure of bank accounts and credit cards and uses the world's most advanced proprietary fraud prevention systems to create a safe payment solution. A PayPal accounts are funded with an electronic debit from a bank account or by credit cards. The recipient of a PayPal transfer can either request a check



from PayPal, establish their own PayPal deposit account or request a transfer to their bank account.

As a global leader in online payment solutions, PayPal has tens of millions of registered accounts and is accepted by millions of merchants worldwide (PayPal, 2010). It helped eBay grow and ensured customers that online shopping can be safe.

PayPal disrupted the well-established network facilitators in this domain such as Visa, MasterCard, American Express.

## SKYPE

Skype is a software application that facilitates voice calls over the Internet. Calls to other users within the Skype service are free, while calls to both traditional landline telephones and mobile phones can be made for a fee using a debit-based user account system. Skype has also become popular for its additional features which include instant messaging, file transfer, and video conferencing. Skype has relationships with a growing network of hardware and software providers (Skype, 2010).

Unlike other VoIP services, the Skype company does not run servers, but makes use of background processing on computers running Skype software. Skype software. Skype is available in 27 languages and is used in almost every country around the world.

Skype was acquired by eBay Inc. in October 2005 for circa 2.6 billion. eBay has to write off half of that value in 2008. The acquisition was supposed strengthen eBay's global marketplace and payments platform, while opening several new lines of business and creating significant new monetization opportunities for the company (Skype, 2010)

## HALF.COM

It provides a fixed-price, person-to-person online platform that allows customers to buy and sell new and previously owned books, movies, music and games at discounted prices. These listing are all brought together onto one platform within the eBay.com marketplace.

## SHOPPING.COM

Shopping.com is a price comparison service operating websites in USA, United Kingdom, France, Germany and Australia. Shopping.com started out as as DealTime.com. It



was founded in Israel in 1998. The original business model was to create a downloadable client that would monitor changes in prices of products the user seeks to buy over time, notifying the user when the product price reached a predetermined level (Shopping.com, 2010).

It is one of the fastest growing shopping destinations on the Internet. With millions of products, thousands of merchants and millions of reviews from the e-opinions community. Shopping.com aims to empower consumers to make informed choices and, as a result, drives value for merchants. It was acquired by eBay Inc. in August 2005 (Shopping.com, 2010). eBay and Shopping.com functionalities are being merged what is apparent for example in how eBay's PayPal payment system in SDC's offering advertises merchants.

## RENT.COM

Rent.com was the first pay-for-performance online rental site. Its business model outperformed competitors who went with subscriptions, listing fees, or costs-per-lead revenue models. Rent.com's service is available to renters as well as property owners and managers in most American cities. Rent.com provides extensive information about apartments, including availability, rental rates, virtual tours, roommate searches, and links to moving resources. Rent.com charges the property manager \$375 when a verified lease is produced through the site (Rent.com, 2010).

It is not the most visited online apartment listing service in the United States. Rent.com was acquired by eBay Inc. in February 2005 (Rent.com, 2010).

## ONLINE CLASSIFIEDS

eBay Classifieds (formerly Kijiji meaning "village" in Swahili) was launched in the U.S. in 2007 (Online Classifieds, 2010). Since then it has grown into a very large community. A local eBay Classifieds site is available in 272 areas across the U.S. eBay Classifieds is part of the eBay Classifieds Group, the number one online classifieds group, with eight unique brands that span the globe

It was designed to help people meet, share ideas and trade on a local level (Online Classifieds, 2010). eBay's classifieds sites include Kijiji, Gumtree.com, LoQUo.com, Intoko, Netherlands-based Marktplaats.nl, and German automotive classifieds site mobile.de. In addition, eBay owns a minority investment in craigslist (Online Classifieds, 2010).





## EBAY'S VALUE CHAIN

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Every company, even an e-business is a value chain of activities for transforming input into output that customers value. This transformation process involves primary activities and support activities that add value to the product. Application of the Internet in eBay's value chain makes its business model viable. Before popularization of the Internet, the business model of eBay was not applicable. The value chain of eBay is a value chain of an intermediary who facilitates transactions, but the company itself is not a bargaining side in the deals conducted on its platform. Therefore, elements of eBay's value chain such as inbound logistics or procurement are scarce and hardly existent.

### **Primary Activities:**

#### **Inbound Logistics**

eBay is a company build on Internet-related technology. It is primarily a service company that facilitates exchange of goods online. Therefore, its inbound and outbound logistics are significantly reduced compared with those of tradition manufacturing businesses, because a large part of eBay's value that comes from this element of the value chain is actually created by buyers and sellers.

The input of eBay's trade is provided by sellers. Practically everyone is a potential supplier to online retailers like eBay. Therefore, it does not have a chain of traditional manufacturers, but rather provides services that bring buyers and sellers together. eBay also has several thousands of online store suppliers who use eBay's site to reach out to new customers. On sellers' side when it comes to inbound logistics, the sellers list items and provide descriptions, photographs. They also specify the conditions of the auction and the end time of the auction. The buyers provide information about sellers and create demand.

E-businesses like eBay need to incorporate a large amount of technology into their companies to make them work efficiently. Technological system development is needed to support eBay's services. In case of eBay, data management systems are a part of inbound logistics. They are necessary to deal with vast amounts of data used in creation and support of the eBay's marketplaces. Database management systems that accumulates eBay's data are provided by Sun Technologies. Servers are also a part of eBay's inbound logistics. They are needed to store data used in creation and support of eBay's marketplaces. What is more, they store data and back-up main servers in the instance of system crashes.



eBay developed some of its technology and outsources some technological developments to other firms. The innovativeness of eBay's business model forced eBay to design its technological system itself or have them made to order by other companies as never before any other company had not applied such solutions as for example auction-board. The auction-board coding that facilitates online auctions is possible thanks to advanced software tools and services that support the core online platform.

In contrast to traditional auction houses, eBay needed to build a communication channel that took form of virtual venue for trade. eBay's online platform hosts data from sellers and buyers and allows them for conducting transactions. Traditional auction houses assist in conducting transactions in real time between businesses and individuals they interact with whereas eBay does not have direct contact with its customers. eBay plays a role of an intermediary without actually meeting face to face with buyers and sellers. It only transfers data between buyers and sellers and oversees their transactions.

## **Operations**

Buyers also take part in the value creation process at this stage as they create traffic and demand. Potential buyers bid on the items on sale until a fixed time. It is noteworthy that traditional auctions continue until no more bids are placed whereas online auctions have different rules. For e-brokerage like eBay bidding is the most active as the auction approaches the closing time. This phenomenon is sometimes driven by automated sniping programs that some buyers use to place a bid under certain conditions just before the auction closes. The interaction between buyers and sellers becomes involving and interesting to observe.

Operations of eBay are focused on managing its marketplaces that bring their suppliers and buyers together through a single platform.

eBay enables transaction between buyers and sellers. Therefore, eBay operates its marketplace platforms with two types of structures for its customers. These include auction-style listings and fixed-price listings.

With regards to the auction-style listening, auctions are the traditional offering of eBay and are administered through IT coding and electronic software.



With regards to the other type of listing structure, fixed-price listing is based on a fixed price format. It allows buyers and sellers to complete the transaction process in a timely manner rather than waiting for the auction period to expire. Thus, for certain commodities it might be more convenient and practical way of selling and buying.

Operations make it possible for eBay to bring deliver value and the final product to the customers. Products offered by suppliers in the eBay marketplace are listed in an online catalog that buyers can view and purchase items from it. This marketplace platform where the operations take place has been developed to include features that add value to the selling and buying process.

These features include Turbo Lister, eBay Blackthorne, ProStores, Selling Manager and Selling Manager Pro which were designed to help automate the selling process.

More features such as Picture Services enable sellers to include pictures in their listings. Shipping Calculator is a feature calculates shipping costs.

Shipment Tracking was created to enable sellers to track their shipped packages.

eBay Toolbar allow eBay users to stay connected with eBay wherever they are on the Internet whereas eBay Desktop allows eBay users to stay connected with eBay from their desktop computer.

Shipping Labels are a feature that allows sellers to print certain postage and UPS labels.

eBay Countdown makes it possible for eBay users to bid and buy from anywhere on the Internet.

eBay Neighborhoods is an interesting feature as it assists users in connecting around items in which they have a mutual interest.

eBay To Go allows users to embed item listings in their own Internet websites.

eBay Marketplace Research is a trait that analyzes sales in categories across the site. The information derived this way are helpful to the sellers in making merchandise choices.



The Reviews and Guides is a feature assisting shoppers in making more aware, informed choices. Therefore, it is valued particularly by those to whom eBay is new.

eBay Sales Reports and eBay Sales Reports Plus provide sales and fee information to sellers.

Best of eBay allows eBay users to vote for their favorite items.

Bill Me Later allows sellers to lend money to buyers. It is a form of transaction-based credit.

PayPal payment is a crucial feature as it facilitates and secures the online exchange of capital. Before PayPal was introduced, buyers and sellers felt insecure when transferring money. The appearance of PayPal increased confidence in safety of online money transfer and draw more buyers and sellers to online auctions.

The Skype feature was embedded in eBay's portal after eBay purchased it in 2005. It enables VoIP communications between eBay's buyers and sellers.

More features related to operations are conducted through other marketplaces businesses owned by eBay such as Half.com, Rent.com, and Shopping.com.

### **Outbound Logistics**

Unlike any manufacturing businesses, eBay is not accountable for transportation of goods to the end-customers. Because eBay acts as an online auction site, it does not need to be worried about goods being sent along the supply chain to wholesalers, retailers or the final consumer. In this element of the value chain, value is created by sellers who take care of shipment, packaging and tracking of sold goods. The outbound logistics is outsourced to the sellers that utilize eBay's platform.

At the outbound logistics phase suppliers and buyers enter into an order contract which commits each other into the purchase. eBay facilitates this action through administering the communication between each party. This solution saves eBay's efforts, time and money as well as became its competitive advantage over businesses with traditional auction models.



## Marketing and Sales

The brand of eBay was worth 12,970 million dollars in 2009 what made it 54<sup>th</sup> brand on the list of global most valuable brands according to the Brandz Top (MilwordBrown Optimore, 2009).

eBay's challenge in the domain of marketing and increasing sales was to establish trust among buyers and sellers. Considering the fact that eBay attracts anonymous traders who are likely not to interact with each other more than once, the feedback forum played a significant role in building trust and reputation of the company that followed. To popularize the site, eBay strived to build a community. Its members have felt safe in interaction with each other. They can use a number of tools to make their transactions secure. The majority of purchases on eBay are protected by an insurance policy administered by Lloyd's of London. It is a part of the standard eBay service that gives buyers protection at no cost. Withal, high value transactions are protected by Tradenable- a third party escrow service company (Cohen, 2003) .

Market and sales conducted by eBay focuses on obtaining new buyers and sellers to enlarge the eBay's community and make it even more attractive for new users of eBay, both sellers and buyers.

eBay mainly offers its customers a way to market and sell their own products through the use of their marketplace. Thus, eBay promotes its marketplace rather than single products relying on an assumption that is a great amount of buyers and sellers is present on its platform, its product offering will be competitive and attractive. eBay's marketing campaigns, that are nation-wide for example in the United States, as well as pricing promotions, discount coupons help to increase traffic and continue the growth in the amount of products listed and purchased. The customers market and sell their product through the use of product differentiation, such as online auctions, and the use of promotions.

What is more, customers also play a role in promoting the brand of eBay in an indirect way. For example, when sellers embed their offerings from eBay's website on their own websites, they promote their goods and eBay brand at the same time. As a result, this form of indirect marketing aids sales of products within the marketplace.

For eBay sales comes down to finalization of bringing together suppliers and buyers and the processing of payments. Handling payments from buyers involves the use of



eBay owned PayPal, to transfer money directly from buyer to seller, while making payment for usage back to eBay. PayPal enables individuals and businesses to securely, easily and quickly send and receive payments online in approximately 190 markets worldwide. The other aspect of payments which eBay owns is the use of Bill Me Later, enabling online U.S. merchants to offer, and U.S. consumers to obtain, credit for the transaction at point of sale. These economic tools have given eBay a financial network to support global, real-time payments.

## **Service**

Customer service ensures customer retention for companies like eBay. The feedback forums, features added onto the platform are the services provided by eBay to its customers to gain trust and loyalty.

Technology, innovation and reputation have all contributed to building personalized, accurate and timely support services to the community of users. Buyers and sellers can contact eBay through a variety of means, including email, online text chat and also by telephone. Resources are focused on improving accessibility, increasing capacity, expanding category-specific support, extending online self-help features and improving systems and processes in order to provide efficient and effective support.

The eBay community flourishes and its members interact with each other exchanging information under a set of shared rules, value and expectations.

The after-sale services especially complaint handling are provided by sellers of items on eBay. Only the complaints about fraud are handled by eBay's employees. These complaints

can be reported electronically through the company's website.

Training and installation that are areas of this element of value chain for many companies, are naturally excluded from eBay's value chain, because of the nature of this e-business.

## **Support Activities**

### **Procurement**



Procurement is not a key element of eBay's value chain, as eBay does not take possession of the items being sold. This reduces inventory management costs. Unlike the majority of businesses, eBay does not have to order its inventory, store it and transport it, because physically its inventory never travels from the sellers to eBay as a company.

eBay's only activities related to procurement involve creating systems for suppliers to effectively use the marketplace platform. The suppliers secure the inputs needed for the company's final products. eBay provides tools for suppliers in form of computer servers, database systems and IT software that combined with suppliers' input create a strong online marketplace.

### **Technology Development**

Technology development strongly contributes to eBay's competitive advantage. eBay uses online platform to innovate, to reduce costs, to protect and sustain its competitive advantage over potential new entrants attempting to enter the market and already existing competitors. Research and development totaled \$736M for the 2008 year and this applies to new product design, product upgrades and services additions to the website (eBay, 2010).

eBay acquired many businesses to grow faster. Nonetheless, eBay's innovation also creates growth. Innovation and technology has been used in order to create marketplace platforms which seek to bring buyers and sellers together through fully automated and easy-to-use online websites that are available 24 hours a day, seven days a week, from any place in the world at any time. The company hires software and computer engineers who develop new coding and software systems. Most recent eBay's innovation is the "Best Match" searching tool, using algorithm in order to sort top searches and also the "eBay to Go tool" which allows the embedding of item listings into other internet websites. Having the capacity to innovate is also used in modifying the payment process to enhance speed, reliability and customer satisfaction. eBay was the very first internet e-business that was awarded the National Medal of Technology and Innovation.

### **Human Resource Management**

eBay believes that people are its future. Therefore, the company takes care of its employees for example when eBay was forced to lay off employees due to the economic circumstances, it paid out handsome severance packages to those who were forced to leave.



Magazine Fortune listed eBay as the 83<sup>rd</sup> best company to work for in 2009 and in 2008 it was ranked 68<sup>th</sup>. Human capital allows eBay to operate effectively and keep the competitive advantage.

### **Firm Infrastructure**

eBay possesses an advanced online infrastructure. eBay's financial reports, media on quarterly statements and company updates are available through the company website. The company's infrastructure supports its goals and vision.





## ANALYSIS OF EBAY'S BUSINESS MODEL

eBay has applied a brokerage model. As other online brokers, eBay is a market-maker. Its primary job is to bring buyers and sellers together and facilitate transactions. Brokers like eBay are an integral element of business-to-business (B2B), business-to-consumer (B2C), or consumer-to-consumer (C2C) business models. eBay's revenues come from fees or commissions the brokers charge for the transactions it enabled.

The uniqueness of eBay's business model come from the fact that it was the first online auction model designed initially for collectibles, but no sells even high-end automobiles. Its demand grew faster than the supply. Therefore, eBay added new categories, market segments, pricing schemes. This is how eBay became the largest Internet market-maker for anything one can imagine addressing individual customers as well as micro businesses and multinational corporations (Steiner, 2005). From the beginning trust played a significant role in eBay's business model. Thus, early on eBay decided to supplement the reputation mechanism by rules created to govern who could be a member, what members could trade, and how they were to conduct themselves in interaction with the eBay's web site.

A problem of the eBay model is a group of its unscrupulous individuals who can exploit the C2C business model as the eBay model does leave itself open to a number of fraudulent activities. It happens that counterfeit goods were marketed to unsuspecting eBayers, stolen goods were redistributed. eBay has undertaken actions to protect its buyers from being fooled, yet the fraud and theft are problems with individuals, not eBay itself.

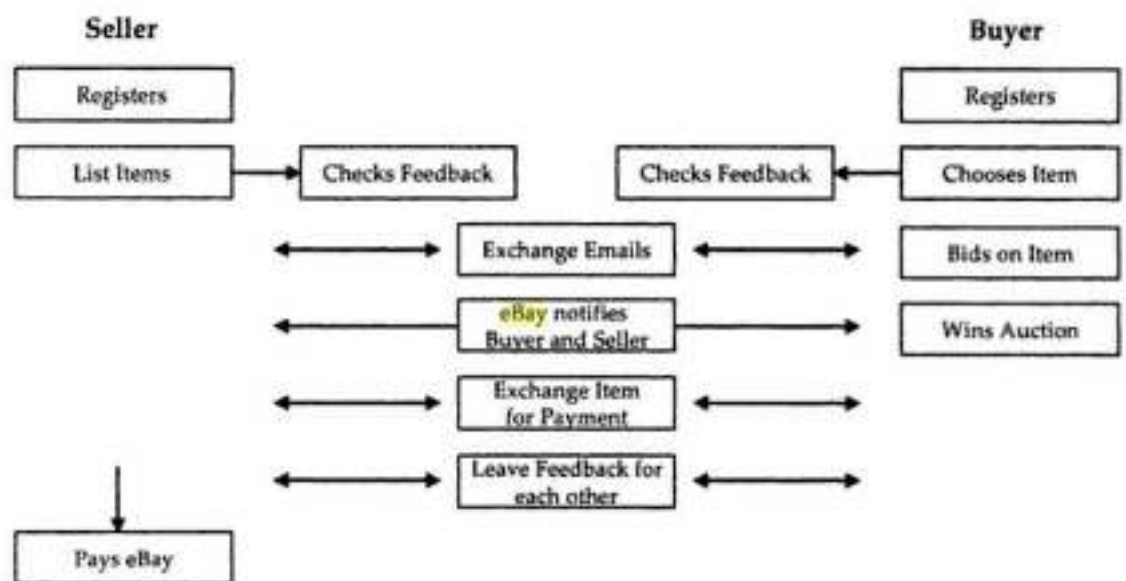


EXHIBIT 14. EBAY'S BUSINESS MODEL (STEINER, 2005, P. 89)



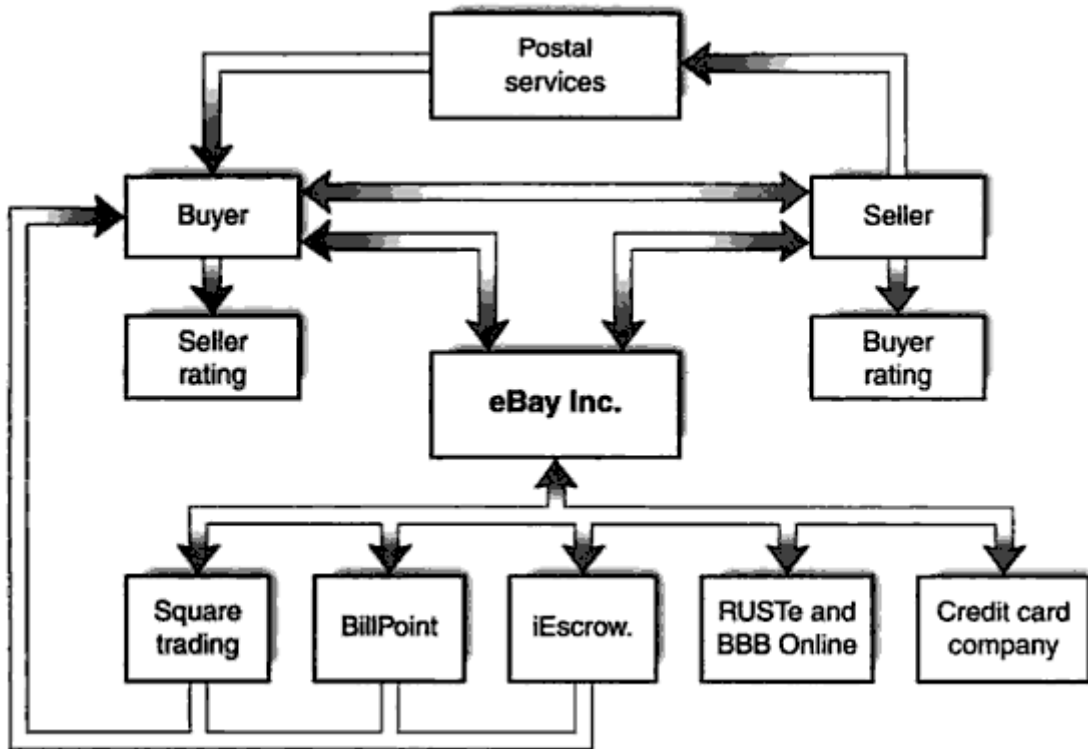


EXHIBIT 15. EBAY'S BUSINESS MODEL (AMID ET AL., 2002, P. 22)

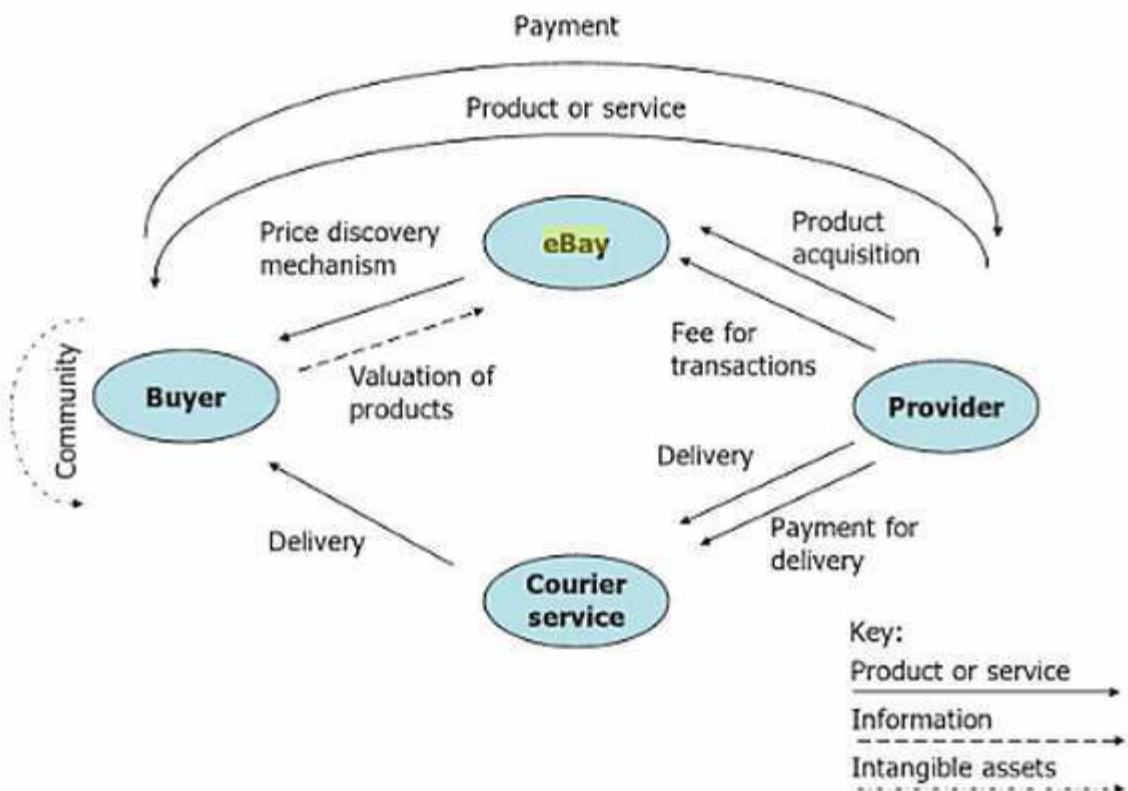


EXHIBIT 16. VALUE PROPOSITION FOR EBAY (MEIER ET ALL., 2009, P. 27)



## VALUE PROPOSITION

The value proposition offered by eBay is more than providing value for trade. The value of eBay appears to come from the fact that it has become an online marketplace with attendant payment services and forum for online auction. Withal, eBay is a provider of place for socializing, discussion, entertainment, spending leisure time, sharing feedback, building trust among buyers and sellers as well as feel a part of a greater, global community with similar values. eBay's value proposition seems to go far beyond value seen in place for a customer-to-customer online auction. eBay reminds a giant online retailer that connects people. Lowy at al. suggest that the core value proposition of eBay is liquidity understood as ease of converting assets into cash. eBay and other similar business models "achieve liquidity by matching buyers and sellers and facilitating price discovery, whereby buyers and sellers cooperate and compete to arrive at a mutual acceptable deal" (Lowy *et al.*, 2000, p. 40).

The value of eBay also lies in the achievement of critical mass of buyers and sellers who wish to exchange goods, during the same period of time, use the same mechanism to communicate and conduct price discovery. Users add their own value to eBay when they list items and provide content. Both buyers and sellers benefit indirectly from an increased number of buyers and sellers, because it is a sign of current and future liquidity and enhances site's attractiveness to potential customers and new entrants. Choosing to conduct trade through eBay, users build its competitive advantage.

Another source of eBay's value proposition is the efficiency and rationality that attunes pricing to fluctuations in supply and demand. Before popularization of eBay negotiating every transaction was far more complex and expensive.

As an auction platform eBay is a neutral third party facilitating negotiations and transactions between customers (buyers) and content providers (sellers). Therefore, its value contribution comes from creation, management as well as regulation of price-setting and allocating resources.



With passage of time eBay launched a FeedbackForum for buyers and sellers rating to facilitate development of trust and reputation among the members. Feedback from co-users appeared in form of positive, neutral, negative next to the name of given registered users. Withal, if a user earned four negative opinions, he or she was removed from the community. This initiative helped to establish and maintain trust. FeedbackForum grew into a broader initiative called SafeHarbor. SafeHarbor was launched in February 1998. It embraced peer review of users, user verification, integrated escrow services as well as secure payment means. As the company grew, it also established rules and norms to govern its marketplace. As a result, eBay community value were born.

**Community Values**  
eBay is a community where we encourage **open and honest communication** between all of our members. We believe in the following five basic values.

**We believe people are basically good.**  
**We believe everyone has something to contribute.**  
**We believe that an honest, open environment can bring out the best in people.**  
**We recognize and respect everyone as a unique individual.**  
**We encourage you to treat others the way that you want to be treated.**

eBay is committed to these values. And we believe that our community members should also honor these values -- whether buying, selling, or chatting. We hope these community values will help you better understand the eBay community.

EXHIBIT 17. EBAY COMMUNITY VALUES (STEINER, 2005, P. 101)

## PROFIT FORMULA

eBay has a few revenue streams. Although browsing, bidding for items at eBay is free of charge, sellers are charged an insertion fee for listening items, extra charges for different listening options and a final sales price fee.



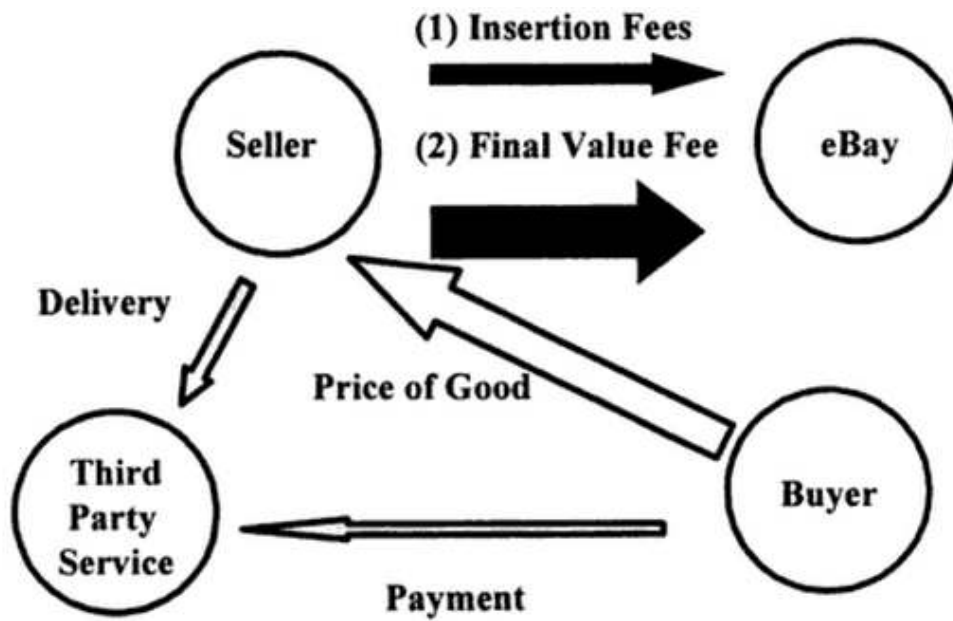


EXHIBIT 18.EBAY’S REVENUE MODEL (STEINER, 2005, P. 92)

The price for listing an item depends on the opening price and varies between \$0.3 and \$3.3 (Steiner, 2005). What is more, eBay offers several listening options that increase the likelihood of selling an item or achieving higher final price.

Opening Value or Reserve Price	Insertion Fee
\$00.01-\$09.99	\$0.30
\$10.00-\$24.99	\$0.55
\$25.00-\$49.99	\$1.10
\$50.00 - \$199.99	\$2.20
\$200 & higher	\$3.30

EXHIBIT 19.EBAY’S INSERTION FEES (STEINER, 2005, P. 93)

To increase the probability of selling or reaching a higher price eBay offers a few listening options. Exhibit 16 provides an over view of eBay’s listening options.



Listing Option	Description	Insertion Fee
Home Page Featured	Item is listed in a Special Featured section and is also rotated on the eBay home page.	\$99.95
Featured Plus!	Featured Plus! Item appears in the category's Featured Item in bidder's search results.	\$19.95
Highlight	Highlight Item listing is emphasized with a colored background.	\$5.00
Bold	Bold Item title is listed in bold.	\$1.00
Buy-It-Now	Buy-It-Now Allows the seller to close an auction instantly for a specified price.	\$0.05

EXHIBIT 20. EBAY LISTENING OPTIONS (STEINER, 2005, P. 93)

Aside from the revenues from its core business, eBay generates revenues from advertising on its site. "Advertising and partnering generates advertising revenue that account for 20% of total revenue" (Steiner, 2005, p. 92).

The final sales price fee is captive on the final price attained. "eBay charges 5 percent on final price up to \$25, 2,5 percent for goods in range of \$25 to \$1,000 and 1,25 percent for everything above that" (Steiner, 2005, p. 93). Along with new pricing categories eBay introduces new pricing mechanisms. At the beginning as eBay members were selling new unique and rare items, bidding mechanism worked without a fault. With more commodities goods, fixed pricing system became more suitable. Therefore, eBay introduced fixed pricing system with the acquisition of half.com. Helf.com was a pioneer in selling used items in good shape and with identification numbers.

Sales practically equaled profit since the cost of goods constituted of computing infrastructure and customer service. Thanks to this, eBay earns gross profit margins at the level of circa 80%.



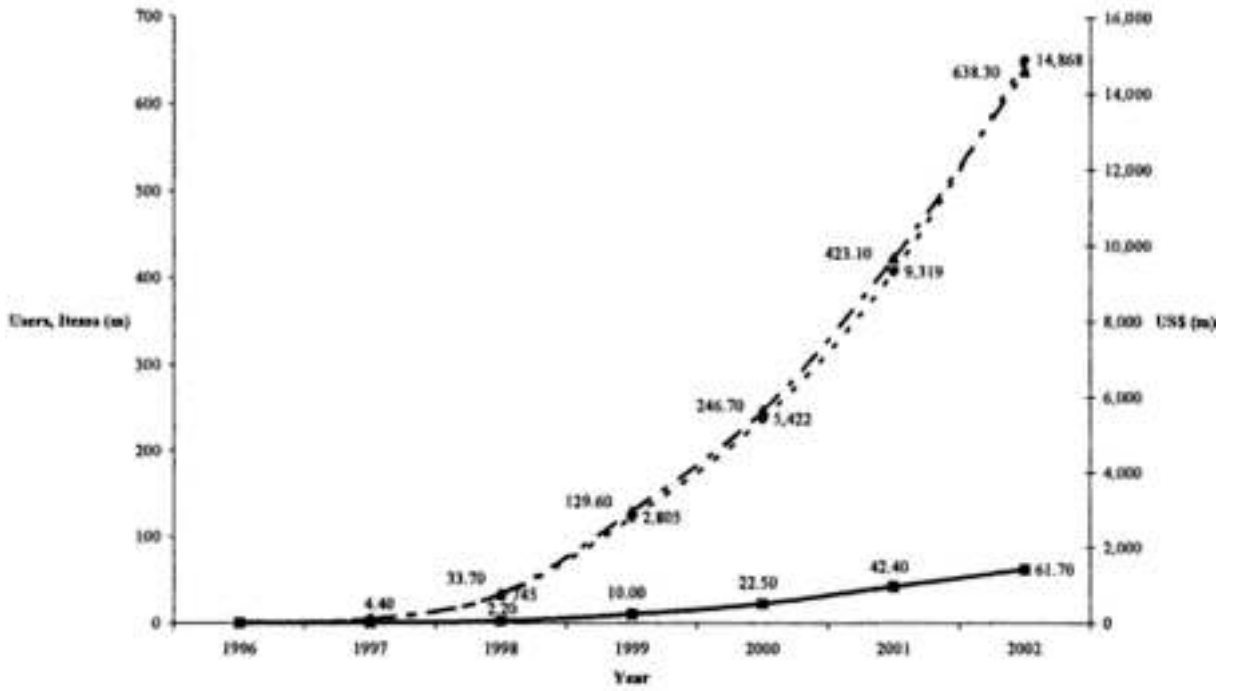


EXHIBIT 21. EBAY GROWTH (STEINER, 2005, P. 94)

The sharp increase in sales that began in 1997 spurred revenue growth.

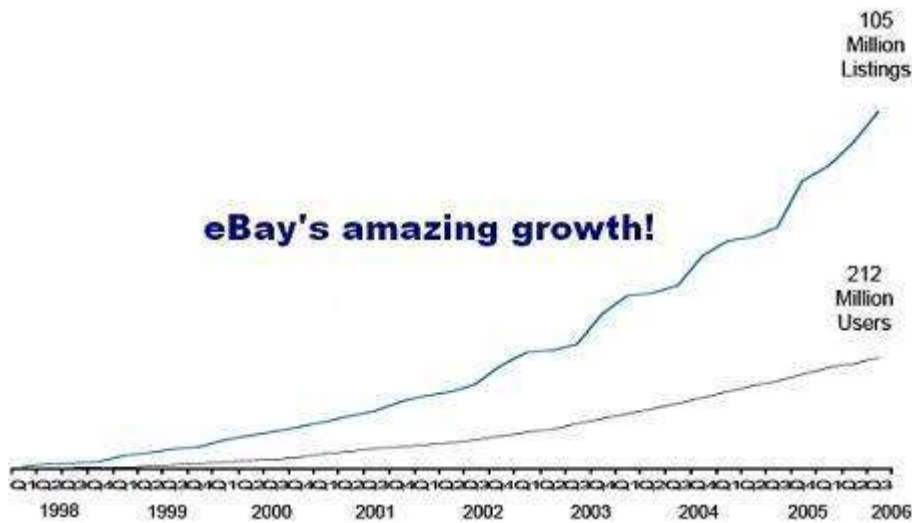


EXHIBIT 22. EBAY'S EXPOTENTIAL GROWTH (SHOUP *ET AL.*, 2006, P. 3)



## KEY RESOURCES AND KEY OPERATIONS

eBay decided to focus on its core businesses and allows other businesses to handle relevant complementary services for example shipping and handling of goods. The company concentrates on collecting and managing the sharing of information in a virtual market. Shipping, payment processing, traffic from the Internet portals, inventory, warehousing, sales force are eBay's essential activities for the marketplace that are handled by external entities.

Technology platform is naturally one of the key resources. At the beginning, the unreliability of the online platform that could not handle the pace of eBay's community growth was the major obstacle for eBay's growth. With passage of time, the platform has been developed and gained on reliability, value as well as attracted lots of attention. It became a benchmark for other firms striving to build their businesses on the basis of the brokerage model.

The customers of eBay once provided with an entire infrastructure basically took over many tasks of traditional retailers' such as advertising, increasing word of mouth, fraud identification and prevention, recommendation system, customers service and support, money transfers.



EXHIBIT 23. EXTERNAL AND INTERNAL CAPABILITIES OF EBAY (STEINER, 2005, P. 96)

Another source of eBay's competitive advantage and key resource is its database content from the marketplace to the ownership of the community interface (Steiner, 2005).



To keep competitive edge, eBay decided to rely on an open standard-base platform with limited proprietary extension. An important proprietary model is the API which enables connections to the marketplace from third parties.

The executive team is one of eBay's key resources as well. It has been built in order to provide management among a variety of business areas which are specific to eBay. Namely, eBay's executive team includes senior managers of human resources, platform technology, general counsel, corporate communications, marketplaces, finance, and PayPal. These managers report to the CEO John Donahoe and then to the board of directors who are involved with the company.

eBay's intangible resources include of users' and employees' ideas.

The community of eBayers could be classified as an intangible asset. The so-called social capital is eBay's key resource. eBay's competitive advantage streams from its strong position achieved making the company sticky with community, customer branding and positioning the company as a user interface in the value system (Steiner, 2005). Furthermore, eBay have achieved network effect because "the utility of a customer is indirectly affected by the overall number of participants and sellers" (Steiner, 2005, p. 86). eBay's recipe for success seems to be mirrored in logics saying that more buyers and sellers attract more buyers and sellers. As a result, the company has been able to address a large market and serve specific market segments. Its competitors could not offer the same breadth and depth of product range. Other major web sites, like Amazon.com and Yahoo!, have entered the auction marketplace with far less success than eBay. eBay has been able to maintain its dominant position, because of its strong efforts to conceptualize its users as a community not as individual customers. Withal, eBay expanded the range of its target customers. It is becoming a place where small and big businesses choose to auction their wares.

The company exploits the benefits of Customer Relationship Management (CRM). Buyers and sellers register with the company and data is collected by eBay on individuals. This is the Business-to- Consumer (B2C) side of their business. However, the strong customer relationships are founded on a Consumer-to-Consumer (C2C) business model, where strong interrelationships occurs, for example where buyers and sellers leave feedback for each other, and whereby awards are given to the most genuine of eBayers.



#### 4.4. ALLEGRO – A POLISH CLONE OF EBAY

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Allegro was established at the end of 1999 by Surf Stop Shop. The very first press note about the company appeared on 13th December 1999. In March 2000 Allegro was acquired by a British company QXL.com PLC which specializes in building auction portals. In March 2008 a media concern Naspers decided to buy the British concern and therefore a South-African company Naspers has become Allegro's major shareholder. Allegro is now present in the Czech Republic, Hungary, Russia, Ukraine, Belarus, Bulgaria, Romania, Slovakia, Kazakhstan and Serbia.

Allegro basically copied the e-business model of eBay and adjusted it to the Polish market needs. The initial headquarters was located in two apartments in Poznan. At the moment the company has build a new large building from where it operates. At the beginning the company employed 20 people, now this number has grown to 400 individuals. The initial concept of Allegro was similar to that of eBay as the portal was supposed to create an exchange platform for hobbyists. Nonetheless, now Allegro serves as an exchange value for technically anything except illegal goods. A few people would sign up for Allegro daily, the Allegro community is as large as 6 million registered users and the offer was as wide as 500 items. Today there a few thousand individuals register for the platform daily and above a few thousands items on auction each day. Interestingly, Allegro has a separate portal called motoAllegro for serving as an exchange value for automobiles, boats, motor-cycles, yahts. MotoAllegro applies auction rules similar to those of Allegro (Allegrolive, 2010).

#### **Primary activities**

##### **Inbound logistics**

Just like eBay, Allegro does not need to stock its own inventory, because it plays a role of an intermediary in the trading process. Therefore, Allegro does not bear any costs related to keeping warehouses or maintaining relations with suppliers.

##### **Operations**

Having developed a portal that serves as a venue for items exchange for 6 millions of people, Allegro needs to supervise the ongoing operations and ensure their safety. Allegro

verifies sellers' information and punishes those who do not stick to the rules of the online community.

### **Outbound logistics**

The customers took over the task of delivering products to end customers. The sellers send items sold through the online platform of Allegro to the buyers with a use of various postal services.

### **Marketing and Sales**

The company did not advertise in press or TV. It focused of word of the mouth marketing and creating a loyal community. Year by year the company managed to attract more buyers and sellers that run their own online businesses through the Allegro platform. In 2005 the company launched a marketing campaign in media to promote its activity and enlarge the community of buyers and sellers.

To develop the online community, Allegro rewards sellers for their performance. The company also developed a partnership network through an affiliate program. To join the affiliate program, one needs to fulfill an online form.

Allegro cooperates with other Internet portals such as Onet.pl, Wp.pl, Interia.pl, Gazeta.pl, IDG Poland. Thanks to that cooperation Allegro is advertised on these portals and advertises partner portals as well.

Allegro sells its services and access to its trading infrastructure. Outside sellers sell their own belongings, but Allegro supports their efforts to sell, makes their offering searchable in Internet browsers and advertises it on its own website. Only registered users are allowed to sell goods through Allegro.

### **Support activities**

#### **Procurement**

Similarly to eBay, Allegro does not stock any inventory itself. Since the company plays a role of an intermediary, it facilitates transaction between buyers and sellers through its platform. The company is a venue for commerce, but not a seller itself. The procurement

role of the company has been outsourced to individual sellers. Therefore, the company does not incur procurement costs.

### **Human Resource Management**

Allegro is a service company. Thus, the success of the company depends directly on creativity and professionalism of the people it employs. The company stresses that its employees derive satisfaction from working with the Allegro' community. On regular basis since September 2000 Allegro organizes "Allegro parties" for its employees and loyal customers to interact with one another and exchange ideas.

Work at Allegro is considered to be prestigious. Allegro seeks qualified employees in all regions of Poland. Naturally, since the headquarters is located in Poznan, the majority of staff is employed there. Due to high demand for technological solutions, Allegro employs a great amount of software creators

### **Technology Development**

Allegro strives to constantly improve its offer and introduce new services. otoMoto, otoDom, platnosci.pl as well as other foreign portals were introduced with the development of the company.

The initial customer interface and its graphics were very simple, not to say primitive, but with time Allegro developed its IT infrastructure and made it convenient and easy for buyers and sellers to interact with each other through the platform.

The technical requirements for customers wishing to use the service are same as for any other type of service provided online. Namely, everybody with a computer with a browser and an Internet connection may use Allegro.

The searching tool on Allegro allows its users to browse inventory with use of filters that help in finding the most interesting to particular customers deals.

Allegro strives to simplify its portal, so that it would be convenient to use for Internet users with various advancement of computer skills.

For more advanced technology users, Allegro prepared an option of using Allegro through iPhones. It allows iPhones' owners to follow Allegro instantly. Since this service is



relatively new, application errors have been reported. However, Allegro keeps working on its improvement and fixes all the problems as soon as possible.

### **Service**

Allegro communicates with its customers and gathers feedback from its community. Café Allegro serves as a venue for exchanging opinions between users and consulting the experts from Allegro on issues related to Allegro's services.

Allegro also governs the community and ensures its safety. The sellers who do not abide the rules, are excluded from the community.

Besides Allegro's core activity, the company is a sponsor and a patron of various cultural events. For example, Allegro supports the Great Orchestra of Christmas Help.

ABI stands for Academy of Internet Business. It is Allegro's initiative aimed at increasing people's knowledge on doing business online and helping them start their own businesses. Entrepreneurs as well as regular people join ABI to become active in the e-business community.

People new to Allegro are provided with guidelines for service usage and assistance of online consultants.

The recommendation system is a type of a feedback forum established by eBay. Buyers and sellers may leave each other feedback after having done business together.

### **Firm infrastructure**

Allegro has an online infrastructure that function thanks to application of advanced technology. Instant technology developments shape the infrastructure. Before emergence and popularization of the Internet technology the business model of Allegro was not viable.

### **ALLEGRO'S BUSINESS MODEL**

Allegro adopted the brokerage model just like eBay did. Interestingly, in spite of similar business models eBay so far eBay has not endangered Allegro's leading position on the Polish market when it entered it some time ago. Allegro advantage over eBay in Poland may strive from earlier, quicker adoption of eBay's business concept of creating a loyal, trusted community of buyers and sellers in this geographic region. It may be said that on the



Polish market Allegro has fought eBay with eBay's own weapon: the strategy of creating online community of buyers and sellers.

### **Value proposition**

The value of Allegro comes not only from offering a venue for trade, but also from providing comprehensive service for buyers and sellers to interact with each other.

Allegro is highly appreciated for the speed with which sellers are able to sell their assets and receive money for them.

The larger the Allegro's community, the easier it becomes to sell items and find sought-after commodity. Therefore, Allegro's value proposition lies also in the size of its community. The more sellers and buyers use the platform, the higher is its value proposition. Thus, the community commits to building Allegro's competitive advantage.

Price setting mechanism utilized by Allegro makes it easier for both buyers and sellers to maximize their satisfaction from purchases.

The feedback system that allows Allegro users to leave each other feedback builds the trust and therefore value of Allegro.

Round-the-clock service and convenience add value to Allegro's services. Customers value accessibility of the portal at all times of day and night.

### **Profit formula**

Allegro earns money thanks to charging for every auction that has been listed as well as earns a share of the final good's price. Withal, sellers pay an insertion fee for listening items and special fees for extra listening options that attract more attention to a particular item.

### **Key resources and key operations**

For Allegro its community, IT infrastructure as well as people who develop the portal are the key resource. Altogether these resources allow for Allegro to grow and protect its competitive position.

Allegro's key operations include governance of the online platform, supervising transactions and promotional activity. To be an effective intermediary, Allegro needs to



support sellers who provide website contents in efficient conduct of selling activities and ensure access to potential buyers.

#### 4.5. COMPARISON OF EBAY AND ALLEGRO

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Both companies under research eBay and Allegro have adopted the online brokerage business models. They have been business model innovators in their respective markets. Both companies started small, but aspired to grow big and became leaders on their respective markets.

Both businesses: eBya and Allegro have lots in common. In particular the business concepts of both businesses seem to be identical, as the companies strive to provide a trusted marketplace for individuals to exchange goods. What is more, both online platforms for trade started out as venues for hobbyists and unique items' collectors. Neither company sells anything tangible. They are providers of competitive services that relates buyers and sellers and facilitates trade. The online form of the service and its availability enhances the price setting mechanism and allows for elastic adjustment of price to supply and demand.

After all, both companies earn profit on charging sellers what is called the insertion fee for the opportunity to put commodity on sale with the use of their platforms. They also charge so-called final fees that are constitute a fraction of the final fees of any sold good, optional feature fees for extra advertising and some other fees for additional services.

eBay appears to be a more advanced form of Allegro. Its technological infrastructure is far more advanced. This may stem from the fact that it was established 4 years earlier, reached far more customers and gathered far more capital for development. Nonetheless, Allegro instantly catches up with eBay's new solutions or actually emulates and adopts them for its own need as well as market demands.

Allegro keeps an eye on eBay's new initiatives. It diligently copies new initiatives launched by eBay. eBay owns a payment service PayPal, Allegro owns PayU, PayGSM and Płatnosci.pl. eBay started to sell cars, so did Allegro. eBay has started to do some business with classified advertisements on job offers, rental offers and travel services, Allegro has then launched its own online classifieds site. eBay has expanded its services worldwide starting with Canada, Australia, Asia and Europe whereas Allegro expended on its local market entering neighborhood countries like Russia, Belarus, the Czech Republic, Kazakhstan,



Slovakia, Ukraine, Hungary. eBay has a Half.com, Shopping.com, MicroPlace, ProStores, StubHub, but Allegro has its equivalents in form of BuyVip, Oferia, CoKupis.pl, Ceneo and iStore.pl. To sum up, Allegro utilized eBay's growth strategy on a smaller, more local scale. Due to accumulated know-how and knowledge on the local market Allegro succeeded quite impressively with its expansion strategy. eBay took advantage of its experience and first-entrant to the market advantage to grow and constantly enhance its value proposition.

Affiliate program has been implemented by both eBay and Allegro. They added some innovative value to the adopted affiliate programs. The way in which they introduced their affiliate programs indicates that their affiliate programs have been a sort of marketing innovation.

Both companies try to be eco-friendly. Allegro encourages sellers to be eco-friendly and advertise themselves as such. Sellers may choose to promote their offering as eco-friendly, but to be able to do so they must donate at least 5 PLN for "All for Planet" Foundation. eBay stresses the importance of increasing the number of eco-friendly products sold through its platform. It possess a so-called "eBay Green Team" that promotes green products, pinpoints ways of choosing eco-friendly products, unites eco-friendly buyers and sellers and facilitates communication between them. The Green section on eBay enjoys quite a lot of attention. That section even shows individuals ways of going green for Halloween.

eBay as well as Allegro seem to understand customers' anxiety about trading online. Thus, they ensure security of online money transfers and cooperate with online financial services providers.

Both Allegro and eBay have paid lots of attention to developing customers' trust and loyalty. They established feedback systems to allow buyers and sellers to exchange experiences and opinions on quality of trade with other users. Both did an outstanding job at building more than a marketplace, they have built an online community, a social network of people who believe in the values of that community. Some members of that community make their living this way, others consider the way of shopping enabled by these platforms congruent with their life styles. These two companies were business model innovators on their respective markets and this has given them competitive advantage over subsequent emulators.

On the other hand, eBay entered the Polish market in 2005, so 6 years after Allegro. Entering emerging markets like Poland was a result of search for new sources of





growth as the growth on the established markets slowed down. In spite of its global experience and leadership on the international market in online auctions, eBay has not gained a leadership in online auctions in Poland. The early entrant and creator of online auction model in Poland Allegro has not succumbed to its role model eBay. Early application of similar to eBay's strategy of nurturing a loyal community of buyers and sellers paid off on the Polish market and keeps eBay as well as other competitors at bay. It might be said that Allegro survived eBay's entrance onto its major market thanks to following eBay's defense philosophy. Allegro has fought eBay with eBay's own weapon what shows the power of this business model innovation.

Allegro and eBay are online service providers. For these service companies the quality of their work is dependent on the people they employ. Therefore, they need to attract and retain creative managers and skillful engineers in order to stay competitive. In both companies strong leadership influenced the direction of future growth.

#### STRENGTHS OF THE BROKERAGE BUSINESS MODEL

One strength of the business model adopted by eBay and Allegro is that the main risk of the transactions is held by the buyers, not the providers of platform for trade. As a matter of fact, in this business model a buyer pays a seller for purchased item before the item is shipped, delivered and unpacked.

This business model generates no storing and delivery costs for the e-business brokers. As a result, the companies with this business model do not have to invest in warehouses, inbound and outbound logistics. This allows e-brokers to focus on developing core competencies and technology. The model assumes that the sellers would take over the costs of shipping, delivery and take care of all the issues related to these activities. In the value chain of this business model, the sellers add value to the final service delivered by the e-broker. This makes this business model particularly enticing and attractive to entrepreneurs.

eBay and Allegro actually share target customers, as on the supply side, almost everyone is a potential supplier to online retailers like eBay and Allegro. Through the trading platform sellers reach out to new customers. The sellers are the web content providers: they specify the conditions of the auction and the end time of the auction. The buyers provide information about sellers and create demand. The platform owner stimulates sales growth, but earns profits on just listening items even if eventually they are not sold.



Another strength of the business model seem to lie in its transferability. The model seem to catch up with any new market where Internet technology has become popular. Therefore, with minor changes the model can be applied almost everywhere around the world what has been proven by eBay's and Allegro's expansion to other markets.

Once the community of e-broker reaches a critical mass, the profitability and attractiveness of the trading value are primarily secured. As the community grows, it attracts new customers and generates more profits for the stakeholders of the trading platform. Thus, the revenue model seem to be like a snow-ball pushed down the hill: once it is running down that hill, it is hard to stop and self-energized.

The model possess flexibility to adjust to any given market's needs. It can be utilized to sell collectable items as well as cars. The only limits to diversity of the product portfolio seem to be dependent on sellers' imagination and legal constraints.

Affiliate programs play a role of marketer in this business model. Individuals and businesses can join the affiliate program and both side will derive benefits from cooperation. The affiliate programs generate traffic and draw interest. This marketing method is inexpensive, but effective. Hence, it suits the low-cost business model of e-brokers.

This business model is attractive for individuals who wish to sell their goods. Thus, the model does not need lots of advertising. It develops best thanks to the word-of-mouth and growth of the community.

Great strength of this business model comes from efficiency and rationality that attunes pricing to fluctuations in supply and demand. Negotiating every transaction is far more complex and expensive if it is not performed through an online platform like the platform of eBay or Allegro.

Feedback forum is an easy mechanism incorporated into the brokerage business model that adds value and creditability to the brokerage business model. Enabled by the platform creators information exchange among buyers and sellers creates synergy effects in this community. This system is a strength of the business model and makes it even more attractive to potential customers.

This business model impresses with its trans-boundary reach. Based on the Internet services are active round-the-clock. As a results, online trading platforms created



within this business model have become truly multi-national, global trading venues. This leads to critical mass of customers that is hard to imagine and attain in different market conditions. The economy of scale in such conditions is self-evident.

#### WEAKNESSES OF THE BROKERAGE BUSINESS MODEL

The online trading platform needs to be constantly developed, up-dated, supervised, protected against fraud and kept up with the market standards. Thus, to stay afloat businesses with such business model need to invest heavily in technology development and follow rivals' moves. The companies with this business model need not only to keep up with the technological progress, but they need to be the technology innovators. This calls for instant investment in research and development as well as employing the very best software developers. These operations generate costs while the return on the investment is never guaranteed and viable only in the long run.

The daily supervision and security protection are activities that cannot be eliminated or performed wholly by machines. Thus, a weakness of this business model is that it needs human supervision and development.

The business model is viable only thanks to the use of Internet technology and dependent on it. As a results, it cannot be implemented in places without access to the Internet. Providing that due to some circumstances, the world wide web would crash forever, the companies with this business model would go out of business.

A problem of the brokerage business model is a group of unscrupulous individuals who can exploit the security weaknesses and lack of users' knowledge. Counterfeit goods have been marketed to unsuspecting online buyers. Stolen goods have been redistributed this way. Both Allegro and eBay have undertaken actions to protect their buyers from being fooled. Such incidents decrease trust and creditability of online shopping. Nonetheless, fraud and theft are problems with individuals, not companies like eBay or Allegro themselves.

This business model is highly vulnerable to systems breakdowns that if occur disturb the entire trading activities. eBay has encountered shutdowns and outages. Fortunately with the technological progress this weakness becomes less of an issue.

A weakness of this model is that companies that apply it are not capable of controlling all the costs. Delivery charges, credit card charges and other inherent costs are not under control of this business model. Increase of fuel prices would mean that the extra cost



would have to be passed on to the costumers in terms of delivery and postal fees. As a result, the overall cost of an auctioned item could rise and become too expensive for customers to purchase goods with this business model. Providing that a credit card company imposes a charge for online transaction, the overall cost of trading within this business model would increase with similar consequences.

#### APPLIED INNOVATIONS AND THEIR INNOVATIVE VALUE

eBay is a new-market disruptor. eBay's business model and its strategy allowed it to build its competitive advantage on auctioning items that were not attractive for the established, incumbent auction houses. As eBay grew, it attracted more up-scale, mainstream customers and ultimately disrupted the markets and the position of conventional auctioneers. Low costs as well as omnipotence of Internet facilitate further growth, experimenting with the business model and pursuit of disruptive strategy

eBay has been a disruptive business model innovator on a global scale. It has created a new market and a new value proposition. Its business concept revolutionized the auction industry and changed the rules of competing in that domain. Therefore, eBay is certainly a radical innovator who has changed the rules of competition in the auction industry thanks to application of numerous product, service, technology and marketing innovations in the meantime.

Allegro seem to have adopted the business model of eBay for the Polish market. Thus, the type of innovation implemented by Allegro at the first glance seem to possess incremental, repetitive nature. Allegro is not a radical innovator. However, in Clayton Christensen's understanding of disruptive innovation, Allegro's business model still has a nature of disruptive innovation as it adopted eBay's disruptive business model for a brand new geographically market and in the end it disrupted that market. What is more, Allegro developed some minor service, technology and marketing new solutions that could be considered innovations.

The majority of eBay's efforts to develop innovation have been focused on developing the platform and increasing number of applications available to eBay's users. It started with innovating around consumer-to-consumer commerce and the auction format online. Then over the last five or six years, eBay has had to innovate around technology to keep abreast of evolving market, scale of operations and fast growth. So it has been focused



on scalability, performance and search. In that sense, many of its investments and efforts around innovation have been focused on building up the platform. The goal of eBay is continue to innovate around new business and feature ideas.

eBay wishes to create a structured innovation program that would allow for constant review of new ideas. To ensure constant innovation eBay has created teams for each of the major business areas. Namely, it a buyer team, seller team and eBay express team. Each team works separately on its own innovations, as it feels that constant innovation process within the company is an imperative. This is eBay's policy for following the customer demand, determining trends and new growth directions.

In the recent years eBay also made some acquisition ass more innovative value to its services. Acquisitions of PayPal - the online payment solution and Skype - the largest provider of Voice over IP solution in the world are examples of eBay's search for innovation outside the company.

The companies under research seem to have adopted marketing innovation. Affiliate programs are evidences of innovation in marketing domain. Allegro has also been appreciated for its innovation in use of Internet and interactive media. It even won an award in the contest "Trendy 2008" for its innovative media plan with use of sponsorship, ambient media and special initiatives.

The PayBack program is an example of Allegro's service innovation. It allows customers to collect points for purchased products and exchange them for prices and goods offered by the partners of the program. To be able to perform this service Allegro invited to cooperation BP, TP s.a., Orange, Real, Jesk, Orbis etc.

Building the community of buyers and sellers has committed to creation of innovation in customer experience in case of both eBay and Allegro. The approach to customers and the entire policy of customer relationship management has been innovative of eBay and Allegro. The companies have paid lots of attention to providing customers with supreme experience that would be different from that offered by other providers of trading platforms.

eBay believes that disruptive ideas are essential for staying competitive. Therefore, eBay strives to find them inside and outside. It wants employees as well as customers to so submit ideas to a database and enjoy innovativeness of the company's



environment. As an addition to the structured innovation model inside the company, eBay applied open innovation model. It approached its own customers' for help asking for their expertise to develop fresh products and services. As a result, 11 new categories of goods have been invented, developed and still implemented. This innovation has allowed to enlarge the diversity, scope and worth of good traded on eBay. In the end, eBay's stock is estimated at worth of circa \$60 billion.

eBay posses a well-communicated policy on innovation. That company preaches that innovation is a mindset, it is in the DNA. What is more, eBay is not afraid of cannibalization in order to generate more innovations.

Allegro does not seem to be so serious about frequent delivery of innovation. The company has no written policy on how innovation is championed. Allegro appears to be more of an accidental, serendipitous innovator and scrupulous imitator. However, so far this strategy has been helping Allegro achieve its goals and preserve leadership on the Polish market.



#### 4.6. AMAZON- A PROMINENT EXAMPLE OF DISTRIBUTION CHANNEL MEMBER E-BUSINESS MODEL

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Amazon.com (Amazon) is an online retailer. The CEO and Founder of Amazon says that his company strives to be the e-commerce destination where consumers can find and discover anything they want to buy online (Byers, 2006). Amazon started off by pursuing a low-end disruption strategy. Low costs, long-tail of products, constantly upgraded technology made Amazon a leader in its industry. As the company grew, it extended to new markets, diversified its portfolio of products. The traditional book sellers have been permanently disrupted by Amazon, as they could not compete with such omnipresent low-end disruption. Trials to go online with its offering made by traditional bookstores, for example by Barnes and Nobles, did not bring about much positive results and did not treat Amazon's position, as they were not disruptive in nature and came too late to fight with the incumbent of online book retailer Amazon.

Amazon takes product offerings into a global and virtual environment through e-commerce software and its online platforms.

#### AMAZON'S VALUE CHAIN

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##### **Inbound Logistics**

Inbound logistics of Amazon are strongly supported by secondary activities such as selective procedures and technology development.

Over the years it has also built a sophisticated logistics system that has enabled it to reduce its costs. However, at the beginning Amazon was incurring relatively high costs to guarantee availability of goods. With passage of time, it has managed to solve that problem thanks to applying technological and organizational innovations.

Amazon entered strategic alliances with several companies. This allowed it to increase the range of products available on its site.

Amazon decided not to collect all its items offered on the website in one place. In its warehouses it only stocked items that were frequently purchased. If an item was not frequently ordered, Amazon would order it from the distributor who shipped it to the company only after the item has been paid for. This process could then take a little longer, but



in the end thoughtful organization of this process optimized the costs and delivery time. This stock policy saved Amazon money and stocking space.

Customer Fulfillment Network that obtains products directly from the distributors allows Amazon not to stock all the goods in its warehouse .

What is more with regards to the inbound services conducted by Amazon, merchants can send inventory shipments to Amazon's fulfillment centers where Amazon takes care of the rest of operations. In the fulfillment centers everything from labeling to sticking packaging slips is conducted. Amazon unpacks and repacks the delivered items. Then, it ships them to its end-customers. In this area Amazon acts as a shipment-intermediary who ensures that the process of shipping from the distributor to end-customer is conducted flawlessly and efficiently.

## **Operations**

Amazon has to maintain its own warehouses in order to be able to enjoy the benefits of time and cost efficiency and keep the customers satisfied. Operating warehouses is a key to Amazon's success. Each warehouse costs \$50 million. To accumulate such an amount of capital Amazon issued \$2 billion as bonds. When in 2001 Amazon outsources its inventory, the company had to manage less operations. Initially the stakeholders were afraid that outsourcing inventory may harm the quality of Amazon's services, but eventually inventory was outsourced and no major deficiency in service quality has been reported.

Day-to-day operations of Amazon consist mainly of managing relations with customers, sellers and buyers.

Permanent improvement of operational efficiency helped Amazon preserve its competitive advantage.

## **Outbound logistics**

Amazon ships 95% of products the same day that they are ordered. This shortens the shipping times. The company invested heavily in warehousing and material handling systems to achieve multifold improvement in throughput. Amazon stores its inventory in climate-controlled inventory centers. From the inventory centers orders are processed in a timely manner to the customers. Amazon struggled to make profit particularly because of the





variable costs incurred by multiple delivery attempts as well as the so-called reverse logistics. Reverse logistics, meaning returns of items previously sent to the customers, disrupted the logistic cycle of Amazon at the begging. Numerous delivery attempts on their own cost the company approximately 20-30 percent of the total costs for home deliveries. Nonetheless, ultimately Amazon worked out best practices for dealing with such occurrences.

## **Marketing and sales**

Amazons key success factors are strong brand, providing customers with outstanding value and a superior shopping experience.

The company has made many efforts to strengthen its brand recognition and build brand equity. The Amazon brand was worth approximately 21,294 million dollars in 2009 what made it 26<sup>th</sup> most valuable brand according to the Brandz Top (MilwordBrown Optimore, 2009)

The company relays largely on word-of-mouth promotion and repetitive customer visits. The company also employ's a variety of advertising, which consists primarily of online advertising, associate programs, sponsored search, portal advertising, email campaigns and other initiatives. Its associate program directs customers to Amazon's websites by enabling independent websites to make millions of products available to their customers.

Amazon is the pioneer of affiliate marketing. It was the first online retailer to operate an affiliate program that allowed owners of other websites to refer customers to Amazon in return for a referral fee when customers complete book purchases using the links on their websites (Amazon, 2010). Amazon has over 900,000 members from all over the world in its affiliate program. The company invites bloggers and website owners to participate in the Amazon Associates Program. In return they embed samples of for example Kindle books on their websites, advertisements etc. Circa 40 percent of Amazon's sales come from affiliate marketing called Amazon Associates and third-party sellers who sell products on Amazon (Amazon, 2010).

Amazon strives to be customer-centric. Thus, it keeps track of what the customers look for and may look for in the future. It tries to give the customers tips on what they might like and liked in the past. Following shopping habits is it a part of Amazon's market research that allows the company to adjust its product offering to customers.



## Service

Thanks to the use of internet technology, Amazon was able to lower the prices, provide enhanced selections, high quality content, a high level of consumer service, and personalized customer care. Amazon uses information technology to offer supreme customer service. The company offers a range of complementary services such as book reviews from other customers, from staffs, as well from its editors. In addition, many featured books contain descriptions, highlights, a chance to see the content of the books and interviews posted by authors.

Amazon builds customer loyalty through small services that tie the customer emotionally to its offering. For example Amazon has a personal notification service to email its clients. It is a small thing, but keeps customers in touch with the company. Amazon also possess a recommendation section, an awards section containing award winning books, and an associate program with other sites.

Search facility gives Amazon's customers some ideas about what they might be interested in. It is a great sales-engine. What is more, this well-developed software helps improve customer experience. Thus, Amazon adds innovative value to its services also through innovation in experiences with the portal.

Search facility gives Amazon's customers some ideas about what they might be interested in. It is a great sales-engine. What is more, this well-developed software helps improve customer experience. Thus, Amazon adds innovative value to its services also through innovation in experiences with the portal.

To compete with businesses like eBay, Amazon offers a program that enables customers to sell their products on through Amazon. It allows other customers to shop for products owned by customers-sellers using features and technologies, and enables individual customers to complete transactions that include multiple sellers in a single checkout process. Amazon earns fixed fees on every seller item sold. Withal, additional services draw attention of potential buyers to Amazon's core product offering.

Amazon "Mechanical Turk" is another service of innovative value introduced by Amazon. This service helps companies that need menial tasks done to find online temp workers. The service finds appreciation and draws attentions of companies and temp workers.



## **Secondary activities**

### **Procurement**

Amazon cut its inventory costs and reduced internal overhead costs such as operating expenses by purchasing majority of its products from two major wholesalers, Ingram Inc and B&T.

Amazon's CEO claims that the company wants to organize our internal resources in such a way the retail partners would be treated like customers. Great partnerships of Amazon of the partnership with Toys "R" Us, then with Borders, Circuit City, Marshall Field's, Office Depot and Target have brought about mutual benefits and generated synergies. What is more, Circuit City is takes advantage of Amazon's technology. Target, on the other hand, has been integrated into Amazon's own Web site. Target provides some systems and fulfillment.

Because of purchasing large volumes of inventory directly from publishers, the company can offer a wide selections of assortment and receive attractive discounts from suppliers.

The warehouses of Amazon are situated in the United States, China, Germany, Japan, France. The inventory stored there is sent worldwide.

### **Human Resource Management**

The company owes much of its success to the well qualified people it employs. It constantly trains its employees and tries to employ only the best specialists.

The company would not have been as successful if it was not for its senior management team. Jeffrey P. Bezos, President, CEO, and Chairman is a character that shaped Amazon as an organization (Byers, 2006). He has had a vision for the company and pushed it forward. It is a big believer in business model innovation. Therefore, he experiments with Amazon's business model and offerings. He supported development and introduction of Kinde as well as the development of Elastic Cloud Computing. What is more, he played a big role in designing the new business models for these innovations. If it was not for managing to find viable business models for Kindle and Elastic Cloud Computing, the technological advancement of these gadgets on its own would not be enough to create a market for these innovations.



The organization culture of Amazon allows for experimenting and making mistakes. The engineers who developed Elastic Cloud Computing failed with their other projects at the beginning of their career at Amazon. The tolerance for making errors and culture of innovation has helped the company to preserve an opinion of an innovator.

### **Technology development**

Technological innovation has always been important for Amazon. Therefore, it employs a team of software engineers, computer scientists, merchandisers, and management team that drives technological innovation.

They do this by offering easy to use functionality, fast and reliable fulfillment, timely customer service, featured rich and authoritative content, and a trusted transaction environment. Key features of their website includes editorial and customer reviews, products information, personalized web pages and secure payment system.

Amazon invests in several areas of technology and content including seller platforms, web services, digital initiatives, and expansion of new and existing product categories, as well as technology infrastructure, so that they can progressively enhance customer experience, improve efficiency of processes and operations and support infrastructure web services.

Amazon has also developed Kindle - an electronic reader that downloads books' content from the Internet and gives customer a possibility to read the electronic content from its thin screen. Kindle allows Amazon to grow sales of electronic content. It shows how Amazon looks for new ways of growth. This product innovation has been embedded in a business model that generates profits from fees for downloading content.

Amazon has not only developed the Elastic Compute Cloud for its own needs, but leases computing horsepower to Internet entrepreneurs. Amazon has made it very convenient and affordable for starting entrepreneurs to use its infrastructure, as an equivalent of one server over the web costs circa 10 cents per hour. The striking comparison is that a year-round power equivalent to one server of similar standard normally costs at least 900 USD. The Elastic computer Cloud is a product innovation embedded in a business model innovation. As a result of combining these two types of innovations, an innovative value offering is sold in an innovative manner.



## **Firm infrastructure**

Amazon not only possesses highly-computerized, modern IT infrastructure that allows it to manage its operations, but it also rents its infrastructures to individual entrepreneurs and companies wishing to run a business with its use or utilize capacity of Amazon's servers. Amazon provides cloud infrastructure as a service. Elastic Compute Cloud (so-called Amazon EC2) is a web service that provides resizable compute capacity in the cloud (Elsenpeter *et al.*, 2009). It is designed to make web-scale computing easier for developers. The main advantage of Amazon EC2 is that it reduces amount of time required to obtain and boot new server instances to minutes (Elsenpeter *et al.*, 2009). Therefore, users can scale capacity, as their computing requirements change and customers pay only for capacity they actually use.

Amazon experimented with different business models and services. It opened zShops - a gallery of independent merchants on its site. However, this idea did not meet with much enthusiasm. At the end of 2000 Amazon came up with an idea to invite third-party sellers to use Amazon's trading platform. Thanks to this outside sellers could offer their wares on the same page as Amazon's own products. Establishing a different profit formula for this model has helped Amazon make money. Now about one third of Amazon's sales revenues come from third-party sellers. Furthermore, Amazon can be proud to possess a selling platform for third-party sellers that is said to be second to none

## **ANALYSIS OF AMAZON'S BUSINESS MODEL**

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The main model applied by Amazon is the e-business model of a distribution e-channel member. The business model of Amazon has become its main source of competitive advantage over rivals such as Barnes and Noble or Borders who pay premium rents for central locations and hire sales representatives. Amazon does not possess comparably high overheads. What is more, customers see purchasing books in a model applied by Amazon as time-saving and cost-saving. What is more, no store fronts are capable of holding as many books as Amazon's large central warehouses. Even though Barnes and Noble as well as Borders started to sell books online, they struggle to compete with reputation of an online book retailer such as Amazon.

## **VALUE PROPOSITION**

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Convenience and competitive pricing are the core value propositions of the company. It sells books through Internet and has its own distribution system. Similarly, Amazon does not have to spend too much money on properties and other operations because it is an Internet-based business. Thus, it can reduce its inventory expenses.

Search facility owned by Amazon gives its customers convenience and ease in finding the books they want. What is more, Amazon possess a long range of products, even many niche items. Its long-tail strategy attracts many customers that are not able to find what they look for in traditional stores.

Amazon also possesses strong customer established customer loyalty. It has achieved that thanks to being customer-focused, innovative and search for efficiency in every process and operation.

Offering customers a possibility to sell through Amazon's website their own items adds more value to the company in the eyes of customers. This service facilitates customers shopping for products owned by other customers using features and technologies possessed by Amazon. The customers can complete transactions that include multiple sellers in a single checkout process through Amazon. The convenience provided by Amazon's structure is insurmountable. Same operations would not have been possible without the genius infrastructure of Amazon.

Introduction an electronic reader called Kindle added more value to Amazon's services. Kindle and Kindly for the Web grow sales of electronic content allowing customers to read books electronically, without wasting paper and carrying extra weight.

What is more, Amazon facilitates customers to publish their own books, videos or music records and make the content available to a wide audience through CreateSpace. It possesses manufacturing-on-demand. Because of that products are produced as customers order them. Therefore, writers and artists do not have to make any up-front investments in the inventory. This adds value to Amazon's services and shows its focus on serving customers' needs.

Amazon also owns an online music store called Amazon MP3. It sells downloadable MP3 files without digital rights management. Amazon MP3 was the very first online offering of DRM-free music from all four major record companies. This offering can be considered a product innovation.



More value is offered to customers by AmazonFresh which is a grocery service offering perishable and nonperishable foods. The service allows customers to have orders delivered to their homes during at a specified time. This service innovation is now available only to residents of major American cities, but it constitutes a new promising direction of Amazon's growth.

## PROFIT FORMULA

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Amazon's business plan assumed that the company would not make profit in the first four to five years. Its first profit appeared in the fourth quarter of 2001. It was equal to \$5million what made just 1c per share, on revenues of more than \$1 billion. Amazon remained profitable ever since thanks to its diversification and international presence.

Amazon earns money thanks to offering massive sales volume and realizing economies of scale. It possesses a long-tail of products, but the volume it sells makes up for costs of niche products it offers.

Withal, the affiliate programs generate streams of revenue too. Amazon reported that approximately 40 percent of its sales come from affiliate marketing and third-party sellers who sell products on Amazon (Amazon, 2010).

The main stream of revenue for Amazon is generated by charging commission in form of a small percentage of the sale price for each item sold through Amazon's website. In comparison to eBay, Amazon does not charge an insertion fee for listing items. Therefore, Amazon's model does not require any payments from the seller unless something sells. The countless number of transactions conducted through Amazon, makes Amazon a profitable company. What is more, year by year Amazon is increasing its market share as users leave other selling platforms, for example Bay, to sell exclusively on Amazon.

Amazon also generates revenue through co-branded credit card agreements and through marketing and promotional services, such as online advertising. Amazon recognizes gross revenue from items they sell from their inventory and recognizes a net share of revenue of items sold by other sellers. They direct customers to their website primarily through a number of targeted online marketing channels, such as their associate programs, sponsored search, portal advertising, email campaigns, and other initiatives.



"Pay as you go" elastic computing infrastructure is another source of Amazon's profits. As start-ups take off, computers clone themselves to scale with the growth of the business. As companies shrink, the costs shrink as one only pays for what they actually use.

Amazon utilized economy of scale. Even though the company leases digital storage at only 15 cents per gigabyte per month, this service is profitable on a large scale. This strategy has also been evident in the pricing of Elastic Compute Cloud for at 10 cents an hour for an equivalent of one server.

A minor share of Amazon's revenues come from leasing storing space. Amazon offers warehousing and order fulfillment for third party sellers for example Target.

Amazon also has a great number of warehouses. It even offers warehousing and order fulfillment for third party sellers for example Target.

#### KEY RESOURCES AND OPERATIONS

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One of the company's key resource is its network of partnerships. It would not have been able to perform its operations and create the same value for customers if the partners would not cooperate with in the process of value creation. Other online retailers lack the partnerships Amazon has established over the years.

One of the most important resources for Amazon is its executive team with its founder and CEO Jeff Bezos. The company has recruited top executives with thorough experience and knowledge in different areas.

Amazon also has a great number of efficiently operated warehouses. These warehouses have been a key resource on which Amazon has built its success.

Another key resource of Amazon is a vast and wide collections of books. The long-tail of products would not feel into any shopping window or shelves of a traditional bookstore.

Seller platforms, patent-protected technology and infrastructure of web services are the resources that allow eBay to function.

The customer review system is an important resource to Amazon that allows the customers to choose products that are most likely satisfying. What is more, it helped the company to gather data on the market and shopping trends.





The large and still growing database of customers is a resource that helps the company succeed.

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#### 4.7. MERLIN-A POLISH COPY OF AMAZON

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Marling seem to have copied the business concept from Amazon. It has been very successful in that attempt. What is more, Marlin and Allegro are believed to be the icons of Polish e-commerce.

Merlin was established in 1999 with Polish capital only. It started to be profitable after 5 years. The company began with selling four main categories of products: books, CDs with music, movies and multimedia. Sales of books is instantly growing at a rate of above 10 percent a year. Nonetheless, at present goods from the beauty, electronics and toys' department comprise a large share of Merlin's revenues. The success of the venture is assigned to competitive pricing and appropriate approach to the customers. In March 2004 Merlin reached one million orders. In the same year Merlin got the first place in Deloitte and Touch ranking for the fastest growing IT firm in Central and Eastern Europe. Contrary to other online book sellers who went online after running traditional businesses, Merlin has been selling goods online from the very beginning, but established physical stores six years after. The stores are called "pick-up points". Currently the company has 3 such stores in Warsaw, where its headquarters is located, and one in Piaseczno, where Merlin's warehouse is situated.

In the future Merlin plans to diversify its assortment. In 2007 Merlin acquired a photo and video store called e-cyfrowe.pl to diversify its portfolio of products and find new ways for growth.

#### **Primary activities**

#### **Inbound logistics**

Merlin heavily invested in development of warehouses, work automation and organization of efficient logistic system. Zbigniew Sukulski, who started Merlin, visited the warehouse of Amazon's warehouse and organized Merlin's warehouse accordingly to the standards utilized by Amazon.



## **Operations**

Merlin's operations are focused on managing the inventory and logistics. Since the company sells to buyers in Poland and abroad, its delivery system needs to work flawlessly and efficiently.

## **Outbound logistics**

Investments in work automation and technological solutions has allowed Merlin to organized efficient outbound logistics. In effect, the company is capable of sending out a few thousand packages a day to 70 different countries. Customers may choose to pick up the purchased good at one of Merlin's pick-up points. Merlin delivers orders for over 80 PLN for free. At the check-out customers receive information when they would receive the purchased good.

## **Marketing and Sales**

In 2006 and 2007 Merlin launched marketing campaigns that helped to increase brand recognition and brand equity.

In recent years that company has changed its marketing strategy. It decided to invest in easy-to-measure Internet marketing actions. What is more, it gave up on image campaigns.

Each day the company's website is visited by 100 thousand users. Contrary to Allegro, Merlin never strived to build a loyal community. The company believes that supreme service altogether with competitive pricing are enough of a reason to choose its offering. Nonetheless, Merlin is existent in social networks such as Facebook, Twitter and Blip.

## **Service**

Customers may receive help from Merlin's staff through e-mail. Customers may be consulted about any problems. They are willing to give information and respond very quickly.



Returns of purchased goods are possible after up to 30 days after the actual delivery. The return policy is a service that even an online book retailer needs to deal with.

## **Support activities**

### **Procurement**

The company stocks its inventory in a large warehouse located in Piaseczno with two rooms, each 840 quadrature meters. The company invests in a long-tail of products. It wants to be able to offer niche books as well as the worldwide bestsellers. Currently it offers 300 thousand different products classified into 10 main categories.

### **Technology development**

Merlin has developed advanced IT systems. It invested both in hardware and software, what has allowed the company to handle increasing traffic and ensure security of online transactions.

The IT infrastructure allows customers to browse inventory according to their preferences. What is more, the current technology advancement facilitates doing online transactions in a safe and convenient way.

### **Human resources**

In 2007 Anna Bogdańska became the new CEO of Merlin. She has managed to grow the business and shape its development on the basis of market needs. Former CEO and the owner of the Zbigniew Sykulski developed the company and created its corporate culture. Up to the current day he stays on the board of the company and serves with his advice for running Merlin.

For the first few years of activity the company employed 30 to 40 people whereas at the moment it has over 200 full-time employees.

Over the years Merlin increased automation and reduced the number of employees especially in logistics.

## **Merlin's business model**

Merlin applied a e-business model of distribution channel member. As the owner of the business Zbigniew Sukulski admits, the concept for the company was conceived out of inspiration by Amazon's business model. Nonetheless, the foreign concept was effectively adjusted to the needs of the Polish market.

## **Value proposition**

Merlin's services were innovative for this part of Europe. The new form of selling book matches today's life style, trends and habits of technology- conscious demographics.

Merlin offers a wide range of books sold online all day long. Browsing, purchasing and delivering are simplified to the maximum and take little effort on the side of customers.

A long tail of products including best sellers and niche books make Marlin an attractive online bookstore for a great number of customers.

Being first on the market, helped the company to develop brand recognition and become a synonym for an online bookstore. The early adopters of Internet technology embraced the opportunity to purchase books and multimedia online.

Quick and almost flawless delivery system represents high value proposition for the customers. As much as 40 percent of Merlin's sales happen just before Christmas. At that period of time the company is put to a test and challenge. Nonetheless, reliable delivery service has become the domain of the company. Thus, customers see value in the fact that they may trust their online book store that the purchased goods would arrive on pre-set time.

Adding more product categories to the product portfolio has helped Merlin to grow and increase the overall value of the enterprise in the eyes of its customers and stakeholders. Though, Merlin's product portfolio is not nearly as diverse as the product portfolio of Amazon. Toys, cosmetics electronic gadgets and widgets, home accessories are enough of diversity for Merlin. The company says it does not strive to become a retailers of practically everything as Amazon has done.



Merlin believes that it is a company with imagination. As a matter of fact the company indeed developed its business creatively and instantly looks for new products that would meet the customers' needs and match Merlin's core competencies. The introduction of beauty products was an experiment that paid off, even though cosmetics were not a commodity usually sold by bookstores, the company's competencies were a fit with its core competencies. In addition, that additional product offering increased the value proposition for end-customers who already shopped with Merlin and attracted new customers for whom cosmetics were an incentive to sign up for Merlin's services.

Customers also value the detailed product descriptions provided by Merlin. What is more, customers may choose to listen to songs available on CDs with music listed on the portal before they decide to make any purchase. This additional service shows Merlin's focus on customers' needs and good will.

### **Profit formula**

The company sells goods from its standard offer at price that is approximately from 5 to 20 percent lower from that of its retail competitors. The goods from its special offer are sold at a price up to 75 percent lower than the price offered by competitors.

The company incurs more costs than Allegro as it runs physical warehouses, but its business concept still manages to stay profitable and ahead of competition.

### **Key resources and key operations**

Merlin's executive team that gives the company a direction for growth is a key resource of the company. If it was not for the founder and then the current CEO, Merlin would not have been able to keep its competitive edge.

The well-managed warehouses are significant resources to Merlin. The company manages to keep the costs of stocking relatively low. At the same time, the operations related to the conduct of the warehouses, stay of the highest quality,

The wide collections of books and partnerships with publishers are certainly contributing to the success of Merlin. Managing the network of partners is one of the key operations for a business like Merlin.

The platform for browsing and purchasing is a resource essential for Merlin's existence. It is constantly improved and adjusted. Over the years it has been becoming more and more advanced and customer-friendly.

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#### 4.8. COMPARISON OF AMAZON AND MERLIN

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The business model applied by Merlin and Amazon is the e-business model of a distribution e-channel member. That business model has become the main source of competitive advantage over traditional bookstores.

Merlin has been said to have copied and adopted for the needs of the Polish market the distribution channel member e-business model. The most renown all over the world for application of the very same model is Amazon.com. Since the founder of Merlin started his company after a visit to Amazon's warehouse, the assumption that he purposefully emulated the global leader's business model innovation is well-grounded on facts.

Both businesses have a lot in common. Both started as online book retailers, but eventually expanded the portfolio of products into electronics, cosmetics etc. Merlin as well as Amazon run warehouses, manage inventory outbound and inbound logistics. The viability of this business model calls for tight cooperation with suppliers, particularly publishers. Both companies outsource part of the delivery services and supervise customer relations.

A major share of revenues in case of Merlin and Amazon come from selling books. Nonetheless, both companies diversified their portfolio of products into other categories. Amazon has gone as far as selling Elastic Compute Cloud and renting its storing space. Merlin seem more conservative and wants to stick to services that are related to its core competencies. Merlin does not strive to become a retailer of practically everything as Amazon has done. Adding more product categories to the product portfolio has helped Merlin to grown and increased the overall value of the store in the eyes of its customers. Though, Merlin's product portfolio is not nearly as diverse as the product portfolio of Amazon. Toys, cosmetics electronic gadgets and widgets, home accessories are enough of diversity for Merlin.

Both companies depended in a great way on word-of-the-mouth advertising especially at the beginning and utilized affiliate programs. They have a tendency to believe that their value proposition is so enticing that excess advertising would be a waste of resources. Therefore, even though these companies launched advertising campaigns in the past, there was very few of them and they mainly aimed at increasing brand recognition.



Merlin is existent in social networks such as Facebook, Twitter and Blip. Amazon also utilized this channel of communication and set up Amazon fan groups on Facebook and other popular social networks. This shows openness of both companies to new methods for promotion and willingness to experiment with new media.

Interestingly, the user interfaces of both Amazon and Merlin have been kept in a similar, simple and humble fashion. Even the palette of colors used for website design seems somehow similar. Both companies use predominantly white and orange on their websites.

Contrary to Allegro and eBay, Merlin and Amazon have different policy for building customer base. They never strived to build such loyal communities as the online auctioneers, but tried to compete with its reliable services, developed technology and new offerings.

The main difference between Merlin and Amazon seem to be the scope of operation and speed of growth. Amazon expanded globally, experimented with its business model, introduced far more innovations than Merlin did. Captivatingly, in the ranking of popularity of online retailers in Poland Merlin takes the first place, but Amazon takes third place. Even though Amazon does not have a Polish version of its web site, it is popular with Polish customers who order books with it. Merlin appears to be more conservative. It offers mainly books in Polish. It has become the leader of the online book retail business on its domestic market and strives to keep that position and not more into new areas. It could be concluded that Merlin stayed behind Amazon of development of its services, as it seem content with the stage of advancement it has achieved. Amazon, on the other hand, is a highly entrepreneurial and innovative firm that hires the best people to constantly provide new solutions and stay far ahead of competition.

#### STRENGTHS OF DISTRIBUTION CHANNEL MEMBER E-BUSINESS MODEL

This business model allowed for reshaping of the retail industry. Gaining leadership on a certain market with this business model means bright perspectives for growth in any chosen field of retail. It is scalable, flexible, applicable to multiple situations, sustainable, superior to the competition and difficult to replicate with the same amount of success.



This model facilitate discounted pricing. The lower pricing strategy is totally justified for this business model. Due to lower overheads, the companies with this business model could afford to take advantage of the economy of scale without ripping off its customers.

The strengths of the business model lie mainly in shopping convenience that has been facilitated by the Internet nature of transaction process.

Ease of purchasing and browsing inventory is an inherent strength for this particular business model. Purchase might be made from any place in the world at any time, therefore traditional retailers find it very challenging to compete with such value proposition.

Speed from making the purchasing decision to completing the transaction is a strength of this business model. Thus, many customers choose to purchase goods in this model for the short duration of the entire process.

What is more, in this business model companies provide decision-enabling information to customers. The necessary data is all up on the corporate website and in case of doubt, online consultant may assist customers with processes and operations.

A wide selection of niche products as well as best-sellers is a definite strength of the business model implemented by Amazon and Merlin. Through just one portal with the use of one account, single user name and password users may purchase various things what strengthens the customer value proposition.

This business model seems to enable customer-orientation. The flexibility of the model facilitates selling of various goods accordingly to market demand and customer preferences. It has the capability to adjust to the market situation. Therefore, this model is suitable for companies who wish to be customer-focused.

Retailers can use this business model and benefit from the software program embedded in the model regardless of their category.

Reliability of order fulfillment is a strength this business model adds to the enterprise.

Companies with this business model do not incur high overheads. What is more, customers see purchasing books in a model applied by Amazon as time-saving and cost-saving. What is more, no store fronts are capable of holding as many books as Amazon's large central warehouses. Even though Barnes and Noble as well as Borders started to sell





books online, they struggle to compete with reputation of an online book retailer such as Amazon.

New innovations can be created within this business model and commercialized with the use of this distribution channel. Amazon's Kindle is an example of a new product that has been successfully commercialized with the use of Amazon's existing business model and offering of electronic content. Lower priced reader hardware makes a profit combined with sales of Kindle books. Although many electronic readers have been developed by companies specializing in electronics, Amazon's business model has provided Kindle with insurmountable value proposition and competitive advantage of complimentary services.

#### WEAKNESSES OF DISTRIBUTION CHANNEL MEMBER E-BUSINESS MODEL

Viability of the business model is dependent on partners' willingness to cooperate and the quality of cooperation with suppliers, wholesalers and other members of the distribution channel.

Taking the product and service into the virtual environment requires initial investments in the technological infrastructure that may pay off only after a while.

The weakness of the model is that the maintenance and building of the warehouse is capital-intensive and hard to handle logistically. Both Amazon and Merlin had to face challenges of managing their procurement and shipment to end-customers which were among.

Some people may see a weakness of this model in its dependency on creativity and innovative spirit of employed individuals. Therefore, the model is best utilized when combined with resourceful team and excellent leadership. Unless excellent people take part in development of the business, even the innovative business model will not suffice for success.

#### APPLIED INNOVATIONS AND THEIR INNOVATIVE VALUE

As Clayton Christensen (2009) explains innovation in general is an activity embarked upon to achieve growth. Both Amazon and Merlin embarked on many such activities to achieve growth.

Amazon started off by pursuing a low-end disruption strategy. Low costs, long-tail of products, constantly upgraded technology made Amazon a leader in its industry. As the company grew, it extended to new markets, diversified its portfolio of products. The



traditional book sellers have been permanently disrupted by Amazon, as they could not compete with such omnipresent low-end disruption. Trials to go online with its offering made by traditional bookstores, for example by Barnes and Nobles, did not bring about much positive results and did not treat Amazon's position, as they were not disruptive in nature and came too late to fight with the incumbent of online book retailer Amazon.

Both companies applied technological, organizational, product and marketing innovations. They started small, experimented, introduced new solutions to its portals and outgrew its competitors.

Merely the fact that the founder of Amazon Joe Bazos built his distribution channel on the Internet technology instead of using traditional distribution channels, is a disruptive organizational, operational an service innovation on its own. At the time that Bazos started Amazon usage of such distribution channels was a move against the rules. Amazon has become the Wal-Mart of the Internet world.

Merlin and Amazon built their glory on business model innovation. Particularly Amazon as a first entrant on the American market with this business model earned the opinion of breakthrough innovator. It has managed to introduce numerous minor and more substantial innovations since it launched. The company understands that to grow and keep the competitive advantage It is a phenomenal example of a business that excels at different kinds of innovations from creating new ways of doing business to making small changes that improve the online store. All these new solutions have been successfully commercialized because of being embedded in innovative business models.

Jeff Bezos understands that the key to sustained success is business model innovation. Amazon has moves into new categories and new markets with flexibility and creativity. Amazon consistently looks for ways to leverage core capabilities and monetize excess capacity to create potentially disruptive businesses. Undoubtedly, Amazon must be sure to keep its core retailing operation healthy and should not over-commit to new ventures before they prove profitable, but investors should take comfort in the fact that Bezos has an uncanny knack for this most elusive of innovation disciplines.

When it comes to innovativeness, Merlin's business models does not seem so brand new and innovative in scope. However, it was a disruptive innovation on the Polish market. Therefore, it can still be lawfully called a business model innovator. Merlin used its first-mover's advantage to capitalize on the innovative solutions. As the company grew it



introduced a whole series of incremental innovations such the wish list, shopping coupons or online consultants' assistance that all make up for the innovative service and innovation in customer's experience.

Amazon is a premier service innovator. It listens to its customers, observes their behaviors and gradually introduces new solutions. Some new services catch attention and help customers, others are not as well received and eventually withdrawn from the market. Most importantly, Amazon is not afraid of experimenting. Renting computer horsepower so called Elastic Compute Cloud is a prominent example of disruptive service and technological innovation embedded in a business model innovation. Nonetheless, Amazon has also launched some minor service innovations such as personal notification service to email its clients. It also possess a recommendation section, an awards section containing award winning books, and an associate program with other sites which carry innovative value, too.

The search facility developed by Amazon is a technological innovation. It has undergone many improvements that resulted in innovations of incremental nature. The Amazon's search facility gives its customers some ideas about what they might be interested in. It is a great sales-engine. What is more, this well-developed software helps improve customer experience. Thus, Amazon adds innovative value to its services also through innovation in experiences with the portal. In the process of innovation development Amazon applied the open innovation framework. It asked customers about their idea on how to enhance the service and what they might be interested in. The open innovation helped Amazon generate product and service innovations. Merlin's search facility is not as advanced as Amazon's, but it has taken a lot after Amazon and compared with other benchmarks on the Polish market it still seems to have quite competitive search facility.

The advanced software is not only technological innovation. Amazon adds innovative value to its services also through innovation in experiences with the portal. I can be said that not only Apple, but also Amazon managed to develop innovation in customers' experience with the company.

It is said the COE of Amazon Bazos invented the affiliate program, because he could not afford to advertise. This way of advertising could be classified as marketing innovation of disruptive nature.



Presence in social media of both Amazon and Merlin shows their openness to new ways of reaching customers and innovative value in approach to customers.

The management of warehouses forced on Amazon and Merlin implementation of process and organizations innovations. As the companies grew, they found new ways to make its operations more efficient and serve the growing demand supremely.

Amazon “Mechanical Turk” is another service of innovative value introduced by Amazon. This service helps companies that need menial tasks done to find online temp workers. The service finds appreciation and draws attentions of companies and temp workers.

Introduction of Kindle has been a self-evident example of disruptive product innovation embedded in an innovative business model. Amazon has also developed Kindle - an electronic reader that downloads books’ content from the Internet and gives customer a possibility to read the electronic content from its thin screen. Kindle allows Amazon to grow sales of electronic content. It shows how Amazon looks for new ways of growth. This product innovation has been embedded in a business model that generates profits from fees for downloading content.

Amazon has not only developed the Elastic Compute Cloud for its own needs, but leases computing horsepower to Internet entrepreneurs. Amazon has made it very convenient and affordable for starting entrepreneurs to use its infrastructure, as an equivalent of one server over the web costs circa 10 cents per hour. The striking comparison is that a year-round power equivalent to one server of similar standard normally costs at least 900 USD. The Elastic computer Cloud is a product innovation embedded in a business model innovation. As a result of combining these two types of innovations, an innovative value offering is sold in an innovative manner.

Amazon also developed an innovation comparable to Apple’ iTunes’ in form of an online music store called Amazon MP3. It sells downloadable MP3 files without digital rights management. Amazon MP3 was the very first online offering of DRM-free music from all four major record companies. This offering can be considered a product and service innovation.

AmazonFresh - a grocery service offering perishable and nonperishable foods, is a service innovation, too. The service allows customers to have orders delivered to their homes during at a specified time. This service innovation is now available only to residents



of major American cities, but it constitutes a new promising direction of Amazon's growth. Even though the same kind of services have been offered by other companies, AmazonFresh introduced its services with new operations and processes that make it unique for an online retail company.

Allowing customers to write their own books and publish them with Amazon is a service innovation. The business model in which this innovation has been embedded gives it competitive advantage over other self-publishing facilities.

Compared with Amazon, Merlin seem to be a great imitator, a very diligent one. However, Merlin has not been so bold in experimenting with service and product innovation. In my opinion Merlin lacks serious competition that would motivate Merlin for more innovation. Merlin appears to have embraced the role of an incumbent who does not see opportunities beyond its core value proposition. Merlin enjoys innovations of incremental nature, but no radical innovations. It has been gossiped that at the beginning of 2011 Merlin will merge with a leader of traditional book retailing Empik. Maybe that merger will create synergies and result in higher level of innovativeness. There is also a threat that merger with a traditional bookstore will hamper Merlin's ability to innovate. The merged companies will possess a major share in the undisrupted book retail market, only a new disruptive market could motivate these companies to look for new source .



## 5. CONCLUSIONS

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The main aim of the thesis was to discuss the concept of business model and to identify and evaluate business models in the selected enterprises.

**The in-depth research has allowed me to find answers to following questions stated at the begging of my thesis:**

1. What are major approaches to business models?
2. What is the business model innovation?
3. What types of business models and innovations are applied by the companies under research?
4. What are strengths and weaknesses of the business models studied? What is their innovative value?

**During the course of research I have reached the following conclusions that are direct answers to the questions cited above:**

1. The major approaches to business models depict how companies deliver value and capture it for themselves in monetary form. A successful business model has a common set of attributes. Therefore, academic researchers believe that a viable business model is the foundation of profitability and commercial success. Clayton Christensen argues that a business model consists of four interlocking elements: customer value proposition, profit formula, key resources, key processes that altogether, create and deliver value. Gary Hamel is a representative of approach to business modeling in which a business model consists of four components: core strategy, strategic resources, customer interface, and value network. Barringer and Ireland, on the other hand, have developed an approach that describe a business model that consists of four components: core strategy, strategic resources, partnership network. Chesbrough's approach to business models focuses on how a company captures value from innovation by designing a business model suitable for it. In his opinion, the business model serves to connect the entrepreneurial inputs to the economic outputs. Johnson has a simple approach to business models that advocates for viewing them as plan for how a company competes, uses its resources, structures, its relationships, interfaces with customers and create value to sustain itself on the



basis of profits it generates. All these major approaches seem to be consistent in their core nature.

2. The business model innovation is the process by which a company delivers radically new value to existing or new customers by devising dramatically new business models that deliver profits in new ways. Innovation and business models are interrelated and create the effect of synergy when they occur simultaneously. Business model innovation is required to maximize profits from commercialization of innovation. Implementation of business model innovation focuses on testing and validating assumptions while integrating the key resources and processes required to deliver the customer value proposition and the profit formula. Business model innovations have demonstrated the propensity to reshape entire industries and redistribute revenues. Business model innovation has proven to be a recipe for transformative growth and renewal as well sustaining competitive advantage and market leadership. Creation and successful implementation of new business models takes more than deployment of new technology tools and applications. In my opinion creation of innovative models demands rethinking of managerial and organizational practices, new capabilities, competencies as well as an assessment of supply chain relationships for establishing the governance mechanisms, level of collaboration among firms, the intensity and density of interaction and coordination modalities.
3. The companies under research have applied two major business models: the brokerage model and a distribution e-channel member.

In the model of an online brokers companies under research play a role of a market-maker. Their primary job is to bring buyers and sellers together and facilitate transactions. They are the integral elements of business-to-business (B2B), business-to-consumer (B2C), or consumer-to-consumer (C2C) business models.

In the model of distribution e-channel member companies under research perform activities of retailers, wholesalers and manufacturers with the use of the Internet. These companies create distribution systems of delivering products to end users. They take products offerings into the virtual environment of the Internet.



The range of innovations applied by the companies under research include disruptive as well as incremental innovations that could be classified as product, marketing, service and technological innovation. These companies have applied all kinds of innovations and embedded them in their innovative business models.

4. The strengths of the studied business models are: flexibility, scalability, low-price, customer accessibility, congruence with the needs and expectations of technology-savvy, busy demographics as well as competitive value proposition combined with viable profit formula.

The weaknesses of the business models studied are: dependency on Information technology, dependency on access to the Internet and dependency on relations with business partners. The weakness of this business model also lies in constant need for investments in improvements and R&D.

The innovative value of these business models comes from their ability to reach a countless number of customers from all over the world, democratize trade, quickly adjust demand to supply and provide unlimited access to products and services.





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