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BUSINESS MODEL EVALUATION – A CONCEPTUAL APPROACH

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Abstract: *There has been an increased interest in business models and their use by both start-ups and existing companies in recent years due to changing and emerging business environment.*
Although there has been an important amount of research on business models, defining the business model concept, taxonomy of business models, decomposing business models and identifying their components, ontology and design tools; the research on business model is still an area that has not been sufficiently investigated. In addition, there is a certain gap between the academic perspective to business models and the entrepreneur's perspective, there being an ever-growing need for practical and operational instruments.
We present in this paper the results of a review analysis on business model evaluation methods and their utility for entrepreneurs in developing and evaluating their business models.
Keywords*: Business models, evaluation methods, entrepreneurship.*
JEL Classificiation*: L26, O21*

1 INTRODUCTION

There is a rich literature discussing diverse aspects of the business models. Some authors speak about "Internet business models", others about "e-Business models" or "Business models on the Web", and others refer to business models in general. Regardless of the terminology used, most agree that the accelerating growth of Information and Communication Technologies has raised the interest for changing traditional business models or developing new ones that better exploit the opportunities offered by technological innovations.

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In addition, living in an entrepreneurial context where there is a high rate of failure among companies showing a growing need for methods and instruments that would help them develop, evaluate and redesign their business models in order to become more adapted to the market and become more competitive.

This is the reason why in last few years, the discussions about business models and the impact of the Internet on them have become more advanced.

2 BUSINESS MODEL

2.1 Literature Review on the Evolution of Business Model Concept and its Definition

Reviewing literature on business models has become a significant task, considering the large quantity of papers published in the recent years. A DOAJ database search for "business model" from October 2014 generated 4411 titles published between 2005 and 2014. The same search on Google Academic revealed 276.000 hits for 2013 and 2014 alone, proving an increased interest on the subject not only from an academic perspective but also from an entrepreneurial one.

The term business model has been used for the first time in the Operations Research (1957) magazine in the article „On the Construction of a Multi-Stage, Multi-Person Business Game" (Bellman et al. 1957) and later on in the title and abstract of the "Educators, Electrons and Business Models: A Problem in Synthesis" (Jones 1960) paper.

Ghaziani and Ventresca (2005) show that the categories of meaning (frames) used in business model discussions vary significantly with respect to the considered time period and the related community of discourse. Their data reveal that the major shift in the frequency of use of specific business model frames is accompanied with the advent of the New Economy in the mid-1990s. At the same time, the business model concept increasingly gained importance on the research agenda of business and management science scholars. With the advent of the Internet, firms were enabled to abandon conventional ways of doing business and to develop new value creation logics (Mahadevan, 2000).

The term "business model" has started to be frequently used in literature between 1996 and 2001 since the tech boom and bust and it was considered to be the logical frame in which the organization operates and creates value for the

involved stakeholders; however, consensus on a clearly accepted definition of the term has eluded academics since the emergence of business model research in strategic management studies at the turn of the 21st century.

In Gordijn et al. (2005) opinion the concept of business models can be seen as having progressed in 5 stages: In the initial phase, the term "business model" started to gain more interest in the literature and so a number of authors recommended definitions and classifications of the concept. In the second phase, several authors begun to propose other elements that belong to business models, at first, as simple shopping lists, just mentioning the components of a business model without any clarifications or details. Only in a third phase, the components started to have detailed descriptions of their characteristics (Hamel 2000; Weill and Vitale 2001; Afuah & Tucci 2003). In the fourth phase researchers started to model the components conceptually in detailed business model ontologies. Another aspect particular to this stage is the fact that the models also started to be more meticulously analyzed, evaluated or tested. Finally, in the fifth phase, the reference models are being applied in management and IS applications.

While the term business model is widely discussed in today's business environment, it is rarely defined explicitly (Chesbrough & Rosenbloom, 2002) and in spite of the consensus among theorists and practitioners that a good business model is essential to every organization (Magretta, 2002), no definition of the term has yet been generally accepted (Morris et al., 2005; Shafer et al. 2005; Ho et al. 2010; Muller et al. 2011).

The plethora of definitions creates significant challenges for understanding the concept and the essential components of a business model, which leads to confusion in terminology as *''business model, strategy, business concept, revenue model and economic model are often used interchangeably… (and moreover) the business model has been referred to as architecture, design, pattern, plan, method, assumption and statement''* (Morris et al. 2005). The lack of definitional clarity is a constant source of confusion, promoting dispersion rather than convergence of perspectives and obstructing cumulative research progress on business models (Zott et al, 2011).

Timmers (1998) is one of the first authors to have proposed a definition for business models. In his oppinion *"a business model includes an architecture for the*

product or service, an information flow, a description of the benefits for the business actors involved, and a description of the sources of revenue" (Timmers, 1998).

In the past years, business models have basically been related to value creation and appropriation. Thus, according to Shafer, Smith, & Linder (2005), the business model is the representation of a firm's underlying logic and strategic choices to create and capture value within a value network.

Recently, the business model has become more a matter of revenue generation (Weill, Malone, D'Urso, Herman, & Woerner, 2004; Tikkanen, Lamberg, Parvinen, & Kallunki, 2005; Demil & Lecocq, 2008). The business model explains the way a company organizes itself to make money. In the most basic sense, a business model is the method of doing business by which a company can sustain itself – that is, generate revenues (Rappa, 2003).

One of the most comprehensive definitions of the business model concept is offered by Osterwalder's (2004) who states that "*A business model is a conceptual tool that contains a set of elements and their relationships and allows expressing a company's logic of earning money. It is a description of the value a company offers to one or several segments of customers and the architecture of the firm and its network of partners for creating, marketing, and delivering this value and relationship capital, in order to generate profitable and sustainable revenue streams"*.

After an extensive analysis of 35 business models definitions, we have concluded that the definitions of the concept range from the perspective where the business model represents only the logic behind the revenue generation process (Rappa, 2003; Ple, Lecocq & Angot, 2010) to that where the main elements are not only the processes but also the actors involved (Timmers, 1998). However an element common to all definitions is the way the company generates revenue (Rappa, 2003; Davenport, 2006; Malone et al., 2006; Ple, Lecocq & Angot, 2010; Teece, 2010) by means of using ideas, resources and technology (Chesbrough, 2006) and the way the company generates value (Petrovic et al.2001; Afuah, 2004; Weill et al., 2004; Shafer et al, 2005; Morgan, 2010; Osterwalder & Pigneur, 2010; Teece, 2010; Sorescu et al., 2011).

3 BUSINESS MODEL EVALUATION

3.1 The Need for Business Model Evaluation

According to Osterwalder and Pigneur (2002), it is necessary to understand and use business models in the current increasingly dynamic and uncertain business environment. Business models help entrepreneurs to abstract from all the details and get a clear image of the big picture, to identify and understand the relevant elements in a specific domain and the relationships between them (Ushold et al., 1995; Morecroft, 1994) and can assist managers in communicating and sharing their understanding of business among stakeholders (Fensel, 2001).

The need to develop evaluation methods for business models is reasoned primarily by the fact that companies are faced with the problem to use the results from business model analysis for business process modeling improvement and (re-)design (Ballon, 2007; Harreld et al, 2007).

But the increased interest of entrepreneurs in business modeling raised other purposes of the evaluation methods such as the possibility of comparison with competitors in business model terms, the assessment of alternative business models for implementation by the same firm, the identification of risks and potential pressure areas for a firm pursuing innovation, the evaluation of an innovative business model in terms of feasibility and profitability.

A consistent method to analyze the structure, the behavior and the dynamics of a business model should allow practitioners to identify possible optimizations to the rules governing the business models behavior, to assess the impact of innovative changes to the structure of the business model and to identify critical success factors of a new or redesigned business model before the changes are implemented within a particular market (Grasl, 2008).

3.2 Business Model Evaluation Approaches

In this section, we analyze and compare several business model evaluation approaches in order to determine their utility from an entrepreneurial perspective. We have excluded from this part of the research the commercial products focusing on business model evaluation. After an extensive analysis of the research literature, it is our opinion that the business model evaluation domain has not been sufficiently investigated.

A number of authors have written on this matter, putting forward different evaluation methods (Hamel 2000, 2007; Gordijn 2002; Gordjin & Akkermans, 2003; Afuah and Tucci 2003, Amitt, Zott, 2001; Weil & Vitale, 2001; Wohltorf 2005; Horsti, 2007; Shi & Manning, 2009; Osterwalder&Pigneur, 2010), their approaches varying depending on their academic background (management, accounting, ITC).

Hamel (2000) is one of the first authors to suggest an evaluation approach which is based on his own definition of the business model: *"Business model is simply a business concept which is the capacity to imagine dramatically new ways of differentiating existing business concept".* His approach consists of four key elements (customer interface, core strategy, strategic resources and value network) that are linked by three bridges (customer benefit, configurations and company boundaries).

The quality of this business model can be measured using four criteria, namely efficiency, uniqueness, fit and profit boosters. Efficiency refers to the extent to which the business concept is an efficient way of delivering customer benefits; uniqueness refers to the extent to which the business concept is unique and differentiation is of immense importance because the more similar business models, the less probable are chances for above-average profits. Fit refers to the degree of fit between business models elements; in order for a business model to present internal consistency, all the parts have to work together for the same end goal. The last factor from this model is profit boosters that refers to the degree to which the business concept exploits profit boosters (increasing returns, competitor lock-out, strategic economies, strategic flexibility), which have the potential to generate above-average returns. This is a criterion well elaborated by Hamel and supported by subcategories, namely network effects, positive feedback effects, learning effects, pre-emption, choke points, customer lock-in, scale, focus, scope, portfolio breadth, operating agility and lower breakeven.

This approach in one of the few that have practical guidelines on how to evaluate the business model using the four evaluation criteria efficiency, uniqueness, fit and profitability. Another important practical aspect consists in the bridges (customer benefit, configurations and company boundaries) that connect the business model elements offering a perspective over the dynamic elements of the business model and the relationships created between the business model elements.

This method can be a useful tool for entrepreneurs also because it provides detailed explanations for each item mentioned in the process.

Another evaluation approach, proposed by Amit and Zott (2001, 2007) is based on their own definitions of business models that state that *"A business model depicts the content, structure, and governance of transactions designed as to create value through the exploitation of business opportunities."* (2001) and „*Further, a business model elucidates how an organization is linked to external stakeholders, and how it engages in economic exchanges with them to create value for all exchange partners. Business model design is defined as the design of an organizations boundary-spanning transaction".*

The authors' proposition suggests three perspectives from which to approach the business evaluation process: content, structure and governance, named business model "design elements". In addition they propose four sources of value: novelty which refers to the possibility to adopt new activities (content), to manage and connect them in new ways (structure), and to define new ways of managing them (governance), lock-in, which refers to finding new ways have their stakeholders (customers, vendors, and partners) locked into the business by managing a switching cost that prevents the stakeholders from trying other products or market offerings; complementarities, which refers to the bundles of goods that provide more value than the total separate value of each single good and efficiency that refers to transaction efficiency in terms of reduced costs. They name these sources "design themes" of a business model.

Business models contain all three design elements and all four design themes. Depending on their profile, different businesses will focus on different themes of this cluster. In their opinion, the novelty-centered and efficiency-centered business models have a positive impact on entrepreneurial firms (Amit & Zott, 2007).

The advantage of this proposal is that the system design parameters and the configuration theme provide a comprehensive way of understanding how to design a successful business model. However their method is primarily qualitative and it doesn't offer instruments/criteria to measure each element of the process making it rather challenging to use for entrepreneurs.

Afuah and Tucci (2003) propose an evaluation method that appraises business models on three levels: profitability measures, profitability predictor

measures and business model component attribute measures. The first level embraces earnings and cash flows, two frequently used indicators by analysts. If a company's earnings or cash flows are better than those of its competitors, this would mean that it has a competitive advantage. The second level comprises profit margins, revenue market share and revenue growth. In this case also, for a firm to have a competitive advantage these measures should show a better performance than the competition. The third and capital level provides benchmark questions for each of Afuah and Tucci's business model components.

Table 1 Appraising a Business Model: Component Measures

Component of Business Model	**Benchmark Questions**
Customer Value	Is customer value distinct from that of the competitors? If not, is the firm's level of value higher than that of competitors? Is the firm's rate of increase in customer value high relative to that of competitors?
Scope	Is the growth rate of market segments high? Is the firm's market share in each segment high relative to that of competitors'? Is potential erosion of products high? If so, in what segments?
Pricing	Is the quality-adjusted price low?
Revenue Source	Are margins and market share in each revenue source high? Are margins and market share in each revenue source increasing? Is the firm's value in each source of revenue distinctive? If not, is the level of value higher than that of competitors?
Connected Activities	What is the extent to which activities: Are consistent with customer value and scope? Reinforce each other? Take advantage of industry success drivers? Are consistent with the firm's distinctive capabilities? Make the industry more attractive for the firm?
Implementation	Is the quality of the team high?
Capabilities	To what extent are the firm's capabilities: Distinctive? Inimitable? Extendable to other product markets?
Sustainability	Has the firm been able to maintain or extend its lead in its industry?

The method suggested by Afuah and Tucci (2003) has the advantage of having both a quantitative and a qualitative approach, but its' utility is highly based on the possibility to compare the business model that is under evaluation with those of its competitors, so, entrepreneurs would need to have access to information regarding their competitors

Probably the most advanced proposition for evaluating business models is outlined by Gordijn and Akkermans (2001, 2003) and is part of their e3-value ontology, a value model which shows actors who are exchanging things of economic value with each other. Their method focuses on studying the economic feasibility of an e-business idea in quantitative terms based on an assessment of the value of objects for all actors involved by creating a profit sheet and assessing the value of objects for all actors involved by assigning a value expressed in monetary units. Business model feasibility represents the possibility of all the actors involved to make a profit or to increase their economic utility.

The authors admit that this evaluation serves for building confidence in an e-business idea rather than calculating precise profit estimations, which would be unrealistic.

Further, the authors introduce an additional confidence building step through the elaboration of "what-if" scenarios. This helps stakeholders understand the sensitivity of e-business models with respect to its parameters, such as financials, future trends or customer behavior. In many cases, this sensitivity analysis can potentially be of greater interest than the numbers themselves.

The main advantage of this quantitative evaluation method is that it focuses on the analysis of the expenses and benefits of the e-commerce idea to all actors involved and is realistic because all the relations and dependencies between components of the e3-value ontology are taken into account.

Companies can use the "what-if" scenarios to analyze the financial effects of different pricing models, number of employees, etc. Also, based on the scenario-based evaluation entrepreneurs can perform sensitivity analysis. However, there is a certain difficulty in finding a generic scenario for all business models, which can be problem of this evaluation method.

Another business model evaluation tool is the "Scoring-Model for Success Evaluation of Ubiquitous Services" developed by Wohltorf's (2005) which focuses mainly on services and is based on critical success factors. In Wohltorf's opinion

there are three domains to which the success factors can be allocated: user, competition, and technology.

After determining the adequate success factors, Wohltorf's tool gives quantitative values from 1 to 6 to these success factors. 1 − 2 are good, 3 − 4 are middle, and 5 − 6 are bad. Afterwards these values are weighted, and the three main domains become the average value of the regarded success factors. The values of the three main domains are also weighted and the overall value comes out. The business model is considered to be successful if the overall value is bigger than a threshold.

One of the advantages of this instrument is that it is an MS-Excel based tool, but one of the main disadvantages is that the approach ignores the relations and dependencies between success factors. Moreover, the domains considered are limited and it doesn't offer the possibility to do a profitability check which is an important aspect when evaluating a business model.

This particular instrument is more appropriate to evaluate new services rather than business models.

Morris, Schindehutte, Richardson and Allen (2006) stated that "limited progress has been made in establishing criteria for evaluating models or their underlying components" so they suggest seven performance indicators for evaluating the overall business model: uniqueness, profit potential, internal consistency, comprehensiveness, imitability, robustness, adaptability and sustainability.

However, they don't propose any method for quantifying and applying them, so it is not clear how it can be operationalized.

A business model is according to Ballon et al "*a description of how a company or a set of companies intends to create and capture value with a product or service. A business model defines the architecture of the product or service, the roles and relations of the company, its customers, partners and suppliers, and the physical, virtual and financial flows between them*" (Ballon, Kern, Poel, Tee, & Munck, 2005).

Based on this definition of the concept, a multitude of aspects of the architecture of a business model must be considered in order to be able to evaluate it in a holistic and meaningful way and even more so to generate an improved version of it. Ballon et al proposes a framework of five steps to evaluate a business model which is presented in table no. 2.

Table 2 Framework for business model evaluation (Poel, Renda, & Ballon, 2007)

Steps	Activities	Sources	Results
1. Objectives and scope	Decide on objectives of the study, scope (which services, markets, innovations, policy domains), case study selection	Discussion with client, plus desk research (e.g. for case selection)	Study implementation plan
2. Business models	For each case: analyze the design of business models: value proposition, value network, functional architecture, financial model	Desk research, to be validated in interviews with representatives of the cases/organizations	Business model descriptions
3. Market developments	Aggregate business model analysis (cases) to the level of market developments	Desk research, across all cases, to be confronted with existing studies	Overview of market developments
4. Innovation topics	Aggregate business model analysis (cases) to the level of innovation topics	Desk research, across all cases, to be confronted with existing studies	List of innovation topics
5. Bottlenecks	Identify position and explore perceived bottlenecks in the business model framework: what and where are the bottlenecks?	Interviews with representatives of the cases/organizations	Overview of bottlenecks and how they are linked to the business model

When approaching the development of the system the authors considered the primary use of the system should be to enable a dynamic, multi-domain and multi-stakeholder approach, focusing on identifying and possibly remedying bottlenecks and systemic failures of a current business model (Poel, Renda, & Ballon, 2007, p. 88).

The framework presented by Ballon et al provides a systematic approach to evaluate business models, completed with instruments and clear steps to be followed by entrepreneurs during the evaluation process.

Another author Horsti (2007) presents an evaluation tool for e-business models based on critical success factors gathered from a literature review on management research and an empirical study on five e-business models from

different industries. The management research consists of business model framework, critical success factors, and life cycle model literature.

In his tool, Horsti adopts the categorization of Hedman & Kalling's (2003) framework as which includes seven components that are causally related: customers, competitors, activities and organization, resources, offering, supply of factor and production input, and management scope. The first six components are cross-sectional and can be studied at a given point in time. The management scope is included to cover the dynamics of the business model over time, and the cognitive and cultural constraints that managers have to cope with.

Like Wohltorf, Horsti also gives quantitative values to individual success factors and uses a threshold, but unlike him, he does not give weights to the values. In Horsti's instrument the success factors are not ranked according to their importance, they are presented as a flat list and are categorized under business model components. Plus the instrument doesn't present a clear image of the causal inter-relations between the business model elements.

A very important feature of his method is that the success factors are analyzed very deeply and it is clear how they are gathered. Plus, the method allows entrepreneurs to do a profitability check.

One of the most complex business evaluation models is offered by Osterwalder and Pigneur (2010) and is based on their Business Model Canvas. The Business Model Canvas serves to create a common and shared understanding of a business model throughout the organization and all its stakeholders. It is a graphical description of how an organization goes from value proposition to satisfied customer and it consists of nine important building blocks, which define the current business model in a structured way, focusing on four main areas of a business: customers, offer, infrastructure and financial viability. The complete nine building blocks are: customer segments, value proposition, channels, customer relationships, revenue streams, key resources, key activities, key partnerships and cost structure.

The evaluation method consists in two types of assessments: the first one is a big picture assessment using the Business Model Canvas. In the second phase they use a set of checklist for assessing a business model's strengths, weaknesses, opportunities, and threats (SWOT) in order to evaluate each Building Block. They

point out that "*assessing a business model from a big picture perspective and assessing it from a Building Block perspective are complementary activities."*

<table>
<tr><td rowspan="2">Key Partners</td><td>Key Activities</td><td rowspan="2">Value Propositions</td><td>Customer Relationships</td><td rowspan="2">Customer Segments</td></tr>
<tr><td>Key Resources</td><td>Channels</td></tr>
<tr><td colspan="3">Cost structure</td><td colspan="2">Revenue Streams</td></tr>
</table>

Figure 1 Business Model Canvas

Table 3 Business Modal Canvas with details (Osterwalder and Pigneur, 2010)

Key Partners	Who are our Key Partners? Who are our key suppliers? Which Key Resources are we acquiring from partners? Which Key Activities do partners perform?
Key Activities	What Key Activities do our Value Propositions require? Our Distribution Channels? Customer Relationships? Revenue streams?
Key Resources	What Key Resources do our Value Propositions require? Our Distribution Channels? Customer Relationships? Revenue Streams?
Value Propositions	What value do we deliver to the customer? Which one of our customer's problems are we helping to solve? What bundles of products and services are we offering to each Customer Segment? Which customer needs are we satisfying?
Customer Relationships	What type of relationship does each of our Customer Segments expect us to establish and maintain with them? Which ones have we established? How are they integrated with the rest of our business model? How costly are they?
Customer Segments	For whom are we creating value? Who are our most important customers?
Channels	Through which Channels do our Customer Segments want to be reached? How are we reaching them now? How are our Channels integrated?

Cost structure	Which ones work best? Which ones are most cost-efficient? How are we integrating them with customer routines? What are the most important costs inherent in our business model? What Key Resources are most expensive? What Key Activities are most expensive?
Revenue Streams	For what value are our costumers willing to pay? For what do they currently pay? How are they currently paying? How would they prefer to pay? How much does each Revenue Stream contribute to overall revenues?

Osterwalder & Pigneur's evaluation is carried out by using SWOT analysis. They ask questions for each building block in Business Model Canvas. They answer the questions by giving quantitative values from +5 to -5 to the individual strength and weakness points. They also quantify their importance to the business model and the certainty of evaluation between 1 and 10.

The Business Model Canvas is an instrument designed and perfected by entrepreneurs for entrepreneurs and it brings clarity and simplicity to an area that can be complicated and technical. However there are some downsides to it: first of all the method offers little direction concerning which aspects of an organization to analyze or mode detailed descriprion on how it should be performed, , secondly, it is not possible to see how the output of the assessment would look like.

Based on Business Model Canvas several other business model evaluation instruments have been developed, such as the Service Business Model Canvas (Zolnowski & Böhmann, 2013; Zolnowski et al., 2014) or the Lean Canvas (Ash Maurya, 2009).

4 CONCLUSIONS

The study we carried out showed that the evaluation of business models has not been sufficiently researched, business and accounting theory depending on the academic background of the authors who developed it.

Just like when it comes to the definition of the business model concept, there is no common bases for business model evaluation and the fact that a lot of authors put forward new and personal instruments without taking into account previously

designed tools leads to losing good and useful ideas, repeating others and making literature dealing with the subject seem inconsistent.

There is also an important gap between the academic perspective and the practical needs of entrepreneurs, who want to develop, evaluate and redesign their business models. There is a need for simple and versatile instruments that are easy to understand and use by entrepreneurs. In practice, most of them use different combinations of the two or most of the methods presented above.

However, there is a trend in literature researching business models that points out an increased interest toward the evaluation process of business models motivated by the fact that the dynamic business environment is in a constant need for solutions and instruments used to understand why some businesses perform better than others and how can they transform/adjust their business model in order to become more competitive.

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