

Topic 4: How do business models work?

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Business modeling provides the building blocks for organizational and consumer value creation. Models help define communities of participation, and then help the groups proof their concepts at a high level before engaging in the participatory design, or research and development process. Business models often use a series of mechanics to create competitive advantage. Mechanics can include: “switching costs, recurring revenue, earning vs spending, game-changing cost structure, get others to do the work, scalability, and protection from competitors.”¹⁾ Let’s take a moment to explore a few common examples of business models and mechanics behind the products and services, we use within our own homes.

Amazon Prime

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Switching costs is one of the seven business model mechanics defined in the Business Model Ontology²⁾. This mechanism finds ways to keep customers by creating a high cost for switching to a different service provider. Amazon Prime (AP) is an excellent example of a business model that uses the switching cost mechanism. If you have purchased movies on AP, you will know that you cannot easily or efficiently download your movies for watching without the Amazon app or website.

This means that you are locked in to being an Amazon user if you intend to continue enjoying your movie purchases. Another common mechanism is recurring revenue.

Cell Phone Service Providers

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Cell phone service providers like AT&T often use recurring revenue as a method to maintain a competitive advantage. When you sign up for a contract you generally receive a lower monthly rate, and the provider benefits from the increased certainty they will receive revenue for a defined period of time. If you have ever received a free phone in exchange for a two-year service contract, you’ve experienced both switching costs and recurring revenue mechanisms. If you want to switch to a different service provider, the cost of paying back the phone and buying out the contract can be a huge deterrent.

¹⁾

Amarsy, Nabila. Why Some Business Models Are Better Than Others, Strategyzer, Accessed: February 28, 2020,

<https://www.strategyzer.com/blog/posts/2015/4/7/why-are-some-business-models-better-than-others>

²⁾

Osterwalder, Alexander, The Business Model Ontology a Proposition in a Design Science Approach, 2004, http://www.hec.unil.ch/aosterwa/PhD/Osterwalder_PhD_BM_Ontology.pdf

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