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From Strategy to Business Models and onto Tactics

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Strategy scholars have used the notion of the Business Model to refer to the 'logic of the firm' – how it operates and creates value for its stakeholders. On the surface, this notion appears to be similar to that of strategy. We present a conceptual framework to separate and relate the concepts of *strategy* and *business model*: a business model, we argue, is a *reflection* of the firm's *realized* strategy. We find that in simple competitive situations there is a one-to-one mapping between strategy and business model, which makes it difficult to separate the two notions. We show that the concepts of strategy and business model differ when there are important contingencies on which a well-designed strategy must be based. Our framework also delivers a clear distinction between *strategy* and *tactics*, made possible because strategy and business model are different constructs.

Introduction

The field of strategy has evolved substantially in the past twenty-five years. Firms have learned to analyze their competitive environment, define their position, develop competitive and corporate advantages, and understand better how to sustain advantage in the face of competitive challenges and threats. Different approaches - including industrial organization theory, the resource-based view, dynamic capabilities and game theory - have helped academicians and practitioners understand the dynamics of competition and develop recommendations about how firms should define their competitive and corporate strategies. But drivers such as globalization, deregulation and technological change (to mention only a few) are profoundly changing the competitive game. Scholars and practitioners agree that the fastest growing firms in this new environment appear to be those that have taken advantage of these structural changes to innovate in their *business models* so they can compete 'differently'. IBM's *Global CEO Studies* for 2006 and 2008, for example, show that top management in a broad range of industries are actively seeking guidance on how to innovate in their business models to improve their ability to both create and capture value.[1]

In addition to the business model innovation drivers noted above, much recent interest has come from two other environmental shifts. Advances in ICT have been a major force behind the recent

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interest in business model innovation. Many e-businesses are based on new business models — Shafer, Smith and Linder find that eight of the twelve recent business model definitions they present relate to e-business.[2] New strategies for the 'bottom of the pyramid' in emerging markets have also steered researchers and practitioners towards the systematic study of business models. Academicians working in this area agree that firms need to develop novel business models to be effective in such specific and challenging environments (see work by Thompson and MacMillan, as well as by Yunus et al. in this issue), and socially motivated enterprises constitute a second important source of recent business model innovations.[3]

Advances in ICT and the demands of socially motivated enterprises constitute important sources of recent business model innovations.

While it has become uncontroversial to argue that managers must have a good understanding of how business models work if their organizations are to thrive, the academic community has only offered early insights on the issue to date, and there is (as yet) no agreement as to the distinctive features of superior business models. We believe this is partly because of a lack of a clear distinction between the notions of *strategy, business models* and *tactics*, and the purpose of this article is to contribute to this literature by presenting an integrative framework to distinguish and relate these three concepts. Put succinctly:

- *Business Model* refers to the logic of the firm, the way it operates and how it creates value for its stakeholders; and
- *Strategy* refers to the choice of business model through which the firm will compete in the marketplace; while
- *Tactics* refers to the residual choices open to a firm by virtue of the business model it chooses to employ.

To integrate these three concepts, we introduce a *generic two-stage competitive process framework*, as depicted in Figure 1. In the first stage, firms choose a 'logic of value creation and value capture' (i.e., choose their business model), and in the second, make tactical choices guided by their goals (which, in most cases, entail some form of stakeholder value maximization). Figure 1 thus presents our organizing framework: the object of strategy is the choice of business model, and the business model employed determines the tactics available to the firm to compete against, or cooperate with, other firms in the marketplace.

The article is organized as follows. In the next section we define and discuss the notion of *business models* and present a tool to represent them, while the following section considers the stage two 'choice' in our framework, presenting and discussing the notion of *tactics* in relation to that of business model. The following section then moves back to examine the first — *strategy* — stage, after

Figure 1. Generic two-stage competitive process framework

which we revisit our process framework to integrate the three notions. We discuss the connection between strategy and business model, arguing that both notions can be clearly separated. A detailed example is developed in the following stage, followed by some concluding remarks.

Business models

Although the expression 'business model' has gained in prominence only in the last decade, the term has been part of the business jargon for a long time, its origins going back to the writings of Peter Drucker. Although (as Markides points out) there is no widely accepted definition, Magretta defines business models as *'stories that explain how enterprises work'*, and follows Drucker in defining 'a good business model' as the one that provides answers to the following questions: 'Who is the customer and what does the costumer value?' and 'What is the underlying economic logic that explains how we can deliver value to customers at an appropriate cost?' While not formal, her implicit idea is that a business model is about how an organization earns money by addressing these two fundamental issues — how it identifies and creates value for customers, and how it captures some of this value as its profit in the process.[4]

Amit and Zott's definition, in contrast, is less broad (as it focuses on e-businesses) but more precise. Reviewing the contributions of several theories - including virtual markets, Schumpeterian innovation, value chain analysis, the resource-based view of the firm, dynamic capabilities, transaction cost economics and strategic networks - they point out that each contributes elements to the notion, but that none, by itself, explains business models completely. They analyze a sample of U.S. and European e-business models to highlight the drivers of value creation, and present the following integrative definition: *'A business model depicts the content, structure, and governance of transactions designed so as to create value through the exploitation of business opportunities.'* The *content* of a transaction refers to the goods or information exchanged, as well as to resources and capabilities required; the *structure* refers to the parties that participate, their links, and the way they choose to operate, and *governance* refers to the way flows of information, resources and goods are controlled by the relevant parties, the legal form of organization, and the incentives to the participants.[5] In this issue, they build on this definition to propose an 'activity system perspective' for the design of business models, arguing that activity systems capture the essence of business models and proposing two sets of aspects for designers to consider: *design elements* (content, structure and governance) that describe the activity system's architecture, and *design themes* (novelty, lock-in, complementarities, and efficiency) that describe its sources of value creation. The common thread across all of these approximations to the notion of business model is well captured by Baden-Fuller, MacMillan, Demil and Lecocq in their definition *'the logic of the firm, the way it operates and how it creates value for its stakeholders'*, and we adopt their definition as the starting point for our argument.[6]

To make progress toward understanding business models, we find it helpful to use the analogy of a machine — by which we mean a mechanical device that transmits energy to perform tasks. (Of course, real organizations are different from machines in many important respects, but the comparison is helpful, especially to our thinking in contrasting the notions of strategy and business models.) Any given machine has a particular logic of operation (the way the different components are assembled and relate to one another), and operates in a particular way to create value for its user. To be more concrete, different automobile designs have different specific logics of operation - conventional engines operate quite differently from hybrids, and standard transmissions from automatics - and create different value for their 'stakeholders,' the drivers. Some may prefer a small car that allows them to navigate congested city streets easily, while others may prefer a large SUV with a powerful engine to enjoy the countryside to the fullest. Automobiles are made of parts - wheels, engines, seats, electronics, windshields, and the like. To assess how well a particular automobile works - or to create a new one - one must consider its components and how they relate to one another, just as, to better understand business models, one needs to understand their component parts and their relationships. (We return to this analogy during the paper: readers will gain more value from it if they understand the design and building of the car as representing strategy; the car itself as the business model; and the driving of the car as the available set of tactics.)

Business models *are made of concrete* choices *and the* consequences *of these choices … different designs have different specific logics of operation and create different value for their stakeholders.*

The question arises: what 'parts' are business models made of? We contend that they are composed of two different sets of elements: (a) the concrete *choices* made by management about how the organization must operate, and (b) the *consequences* of these choices. The choices include (but are not limited to) compensation practices, procurement contracts, location of facilities, assets employed, extent of vertical integration, and sales and marketing initiatives. Every choice has some consequences: for example, offering high-level incentives (a choice) has implications regarding the willingness of employees to exert effort or to cooperate with co-workers (consequences). Likewise, pricing policies (choices) have obvious implications regarding sales volumes, which in turn, affect the economies of scale and bargaining power enjoyed by the firm (as two of its consequences).

We distinguish three types of choices: policies, assets and governance structures. *Policy choices* refer to courses of action that the firm adopts for all aspects of its operation — for instance, opposing the emergence of unions; locating plants in rural areas; encouraging employees to fly tourist class, providing high-powered monetary incentives, or airlines using secondary airports as a way to cut their costs. *Asset choices* refer to decisions about tangible resources, such as manufacturing facilities, a satellite system for communicating between offices, or an airline's use of a particular aircraft model. *Governance choices* refer to the structure of contractual arrangements that confer decision rights over policies or assets. For example, a given business model may contain (as a choice) the use of certain assets such as a fleet of trucks, which leads onto a governance choice for the firm as to whether it should own the fleet or lease it from a third party. Transaction cost economics suggests that seemingly slight differences in the governance of policies and assets can have dramatic effects on value creation and/or value capture.[7]

To illustrate our notion of business model and to introduce a tool to represent business models, consider the famous case of Ryanair.[8] Important choices in its business model — and their consequences - as illustrated in Table 1. A useful way to represent business models is by means of a *causal loop diagram*, where choices and consequences are linked by arrows based on causality theories (as

Table 1. Some distinctive features of Ryanair's business model

Choice		Consequence
Secondary airports	→	Low airport fees
Lowest ticket prices	→	Large volume
Low commissions to travel agents	→	Low cost
Standardized fleet of 737s	→	Bargaining power with suppliers
Single-class	→	Economies of scale
High-powered incentives	→	Attracts combative team
No meals	→	Faster turnaround
Nothing free	→	Additional revenue
Spartan headquarters	→	Low fixed cost
No unions	→	Flexibility in rostering staff

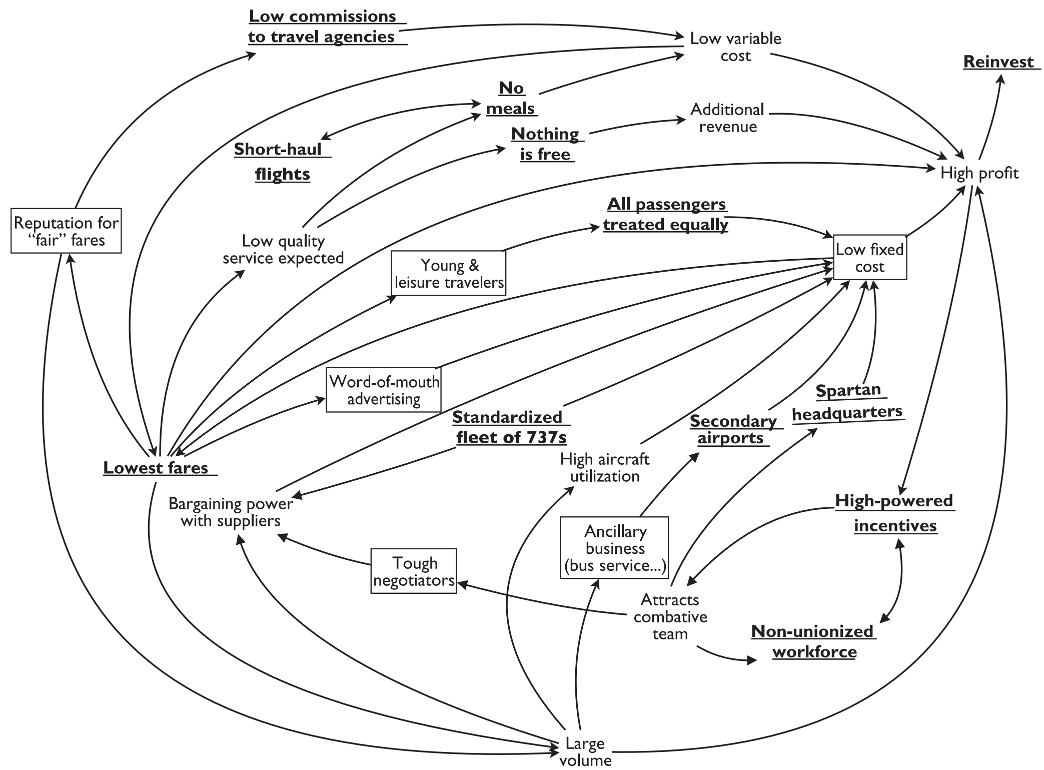

Figure 2. Ryanair business model representation

discussed above).[9] Figure 2 is a representation of Ryanair's business model, where underlined elements are choices and non-underlined elements are consequences. Consequences in boxes are 'rigid,' those not in boxes are 'flexible'. A consequence is *flexible* if it is highly sensitive to the choices that generate it. For example, 'large sales volume' is a consequence of the policy choice 'low prices' - if the policy were to change to high prices, volume would be likely to fall rapidly. In contrast, a *rigid* consequence is one that does not change rapidly with the choices that generate it; thus a 'reputation for "fair" fares' is a consequence that changes only slowly with changes in the choices that generate it.[10]

Recalling the machine analogy: a machine to perform a given task might be designed and assembled in many ways, with different levels of redundancy, specific mechanisms, quality of components, etc. Whichever configuration is chosen will have different direct consequences affecting its overall efficiency (input efficiency, output quality, speed, noise and so on). Figure 2 illustrates how the Ryanair 'machine' is assembled and how it works. Other airlines are 'put together' differently: they have a different logic, a different way of operating and of creating value for their stakeholders — they have different business models.

Business models often generate *virtuous cycles*, feedback loops that strengthen some components of the model at every iteration (some virtuous cycles in Ryanair's case are illustrated in Figure 3). While virtuous cycles are not part of the definition of a business model, they can be crucial elements in their successful operation. As the cycles spin, rigid consequences become more significant, and such virtuous cycles can develop valuable resources and capabilities. For example, as Ryanair's volume increases (because of its low fares), its bargaining power with its suppliers (airport authorities, Boeing, Airbus, etc.) grows, resulting in improvements to Ryanair's overall advantage.[11] Such interconnections between business model elements are also central to the dynamic RCOV view of a business model developed by Lecocq, Demil and Warnier, which focuses on value creation/capture. The RCOV model has three interacting components, which the authors emphasize are permanently

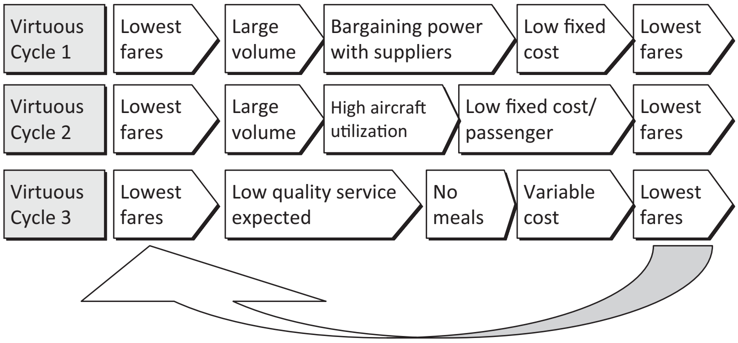

Figure 3. Some virtuous cycles in Ryanair's business model

interrelated - Resources and Competences (RC), internal and external Organization (O), and Value propositions (V) - that connect in a virtuous cycle. The value propositions provide the volume and structure of revenues, while the internal and external organizations provide the volume and structure of costs, thus jointly explaining margins.[12]

Complete business models are often too complex and unwieldy to represent for working with, so the analyst must simplify their representation. There are two main ways to move from the full, true detail to a tractable representation of a business model: aggregation and decomposition.

- *Aggregation*. We can think of aggregation as 'zooming out' and looking at the (real) business model from a distance, 'bunching together' detailed choices and consequences into larger constructs. An analyst studying a particular organization's business model will often be unable to process the complete model because it is too complex (there are too many choices and consequences). But, by zooming out, although details blur, larger 'chunks' - aggregations of those details - become clearer. Finding the 'right distance' from which to assess a given business model is more an art than a science. Looking from too close at every choice and consequence, the analyst will miss the larger picture of how the business model works in overall terms — but looking from too far away will mean all interesting details are lost.

  The analyst must select the *key choices* (from either the complete set or a focal, decomposed subset), and then observe (or conjecture) the *main consequences* derived from those choices. Effectively, the analyst makes use of *theories* (assumptions or beliefs) to provide the rationale for connecting choices to consequences: the resulting map (of a subset of key choices and their main consequences, connected by theory) is a *business model representation*, i.e. the analyst's (best) guess as to how the business model's key elements interact.[13] As an example, Figure 4 shows a highly aggregated representation of Ryanair's business model.
- *Decomposition*. Some business models are decomposable, in the sense that different groups of choices and consequences do not interact with one another and thus can be analyzed in isolation. Depending on the question to be addressed, representing just a few parts of an organization's business model may be appropriate.

every *organization has a business model … [it] makes* some *choices, which have consequences. [But]* not *every organization has a strategy - a plan of action for different contingencies that may arise.*

To return to the matter of definitions, two aspects of our development deserve further discussion. First, note that our approach implies that *every* organization has a business model. This is because every organization makes *some* choices, and these choices have some consequences. Of course, this

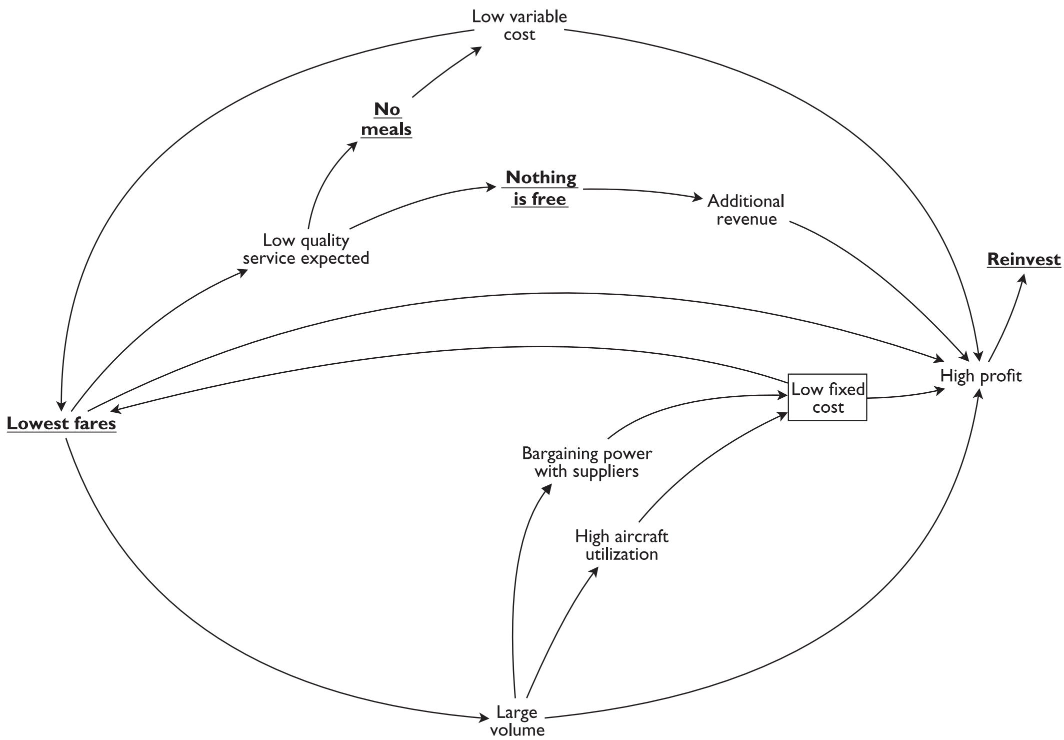

Figure 4. Ryanair simplified business model representation

does *not* mean that every business model is satisfactory - or even viable in the long run. Other authors define business models normatively, implying that a business model has to consider particular aspects. For example, Johnson, Christensen and Kagermann argue that business models consist of four elements: a customer value proposition, a profit formula, key resources, and key processes. Likewise, Chesbrough and Rosenbloom, in offering a '*detailed and operational definition*' state:

> *the functions of a business model are to: articulate the value proposition, identify a market segment, define the structure of the value chain, estimate the cost structure and profit potential, describe the position of the firm within the value network, and formulate the competitive strategy.*[14]

Teece (again in this issue) follows a similar approach, proposing that good business model design involves determining: which market segments should be targeted; what benefits the product/service will deliver to the customer; which features/technologies will be embedded within it and how they can be best assembled and offered to the customer; how the business's revenue and cost structures should be designed (and, if necessary, redesigned); and how value will be captured and competitive advantage sustained. '*These issues are all interrelated … and lie at the core of the fundamental question asked by business strategists, which is - how does one build a sustainable competitive advantage*'.[15] While normative definitions may offer valuable guidance as to what managers should be thinking about when designing their business models, we suggest such approaches implicitly impose bounds on what a complete business model 'is'. Our notion is less demanding: we do not consider any *a priori* categories or variables, and thus define business models independently of any features of goodness and/or effectiveness.

Second, according to our conceptualization, an organization's business model is an objective (real) entity: choices are made in every organization, all of which will have consequences. The particular set of choices an organization makes about policies, assets and governance - and their associated consequences — *are* the organization's business model, because they determine '*the logic of the firm, the way it operates and how it creates value for its stakeholders*'.

Tactics

Tactics are the residual choices open to a firm by virtue of the business model that it employs. Consider Metro, the world's largest newspaper (measured by circulation), published in more than 100 cities in 18 countries. Being ad-sponsored, it is free to readers, and so competes with local newspapers sold at positive prices. In each city, Metro can make choices about its advertising rates, as well as the precise number of ads and pages in each edition, the exact balance between news and opinion pieces, and so on: all of these choices are part of Metro's tactics. But Metro's ad-sponsored business model dictates it must be sold at zero price and so precludes Metro from using 'selling price' as a variable that can be changed depending on the intensity of competition and other external factors. Therefore, 'price of the newspaper' is not part of Metro's set of tactics.[16]

Or consider the case of the competition for MBA students between Harvard Business School (HBS) and Stanford Graduate School of Business. In recent years, Stanford has begun offering a 'tailored MBA': there is essentially no 'core' curriculum, and every student is offered a personalized MBA curriculum to suit their background and professional goals. But Harvard's business model involves a strong core curriculum, with several faculty members co-teaching core courses, and assets including classrooms laid out for case discussions by large groups. Classes may have over 900 students and sections more than 90: in this environment, it is just impossible for HBS to offer a personalized MBA similar to Stanford's — it is simply not a tactic available within Harvard's business model. Matching Stanford on this dimension would involve HBS modifying its business model so as to make this a tactical choice. Different business models give rise to different tactics available for competition and/or cooperation.

Tactics - *the residual choices open to a firm after choosing its business model - are crucial in determining firms' value creation and capture.*

Tactics are important, as they play a crucial role in determining how much value is created and captured by firms. In the case of Metro, for example, advertising rates and the number of ads displayed in the free newspaper end up affecting the readership and advertising revenues. Including more and more ads risks readers become increasingly irritated and less willing to read the newspaper. Likewise, if the advertising rate increases, fewer advertisers will want to advertise, which will affect Metro's revenues, profits and value capture. Therefore, not only does a firm's business model determine what range of tactics are available to it, but also its tactics play a central role in how much value the firm will be able to create and capture at the end of the day. (We can return to the business model-as-automobile analogy. Clearly, the way the automobile is built - its size and shape - places constraints on what the driver can do: it determines the *action set* for tactics. A small, low-powered compact would create more value for the driver who wants to navigate the narrow streets of Barcelona's Gothic Quarter than a large, powerful SUV, in which the task would be simply impossible - not in the action set.)

We have argued that tactics are important because, at the end of the day, tactical choices determine how much value is created and captured by the firm. But there is more to tactics than this - in reality, a firm's tactical choices also affect the value creation and value capture of *other* firms with which it interacts, either in cooperation or in competition. *Tactical interaction* refers to the way organizations affect each other when acting within the bounds set by their own business models. Using the imagery of business model representations, tactical interactions occur when one firm's business model is in contact with that of another firm, leading to consequences for both - so feedback to the rest of the system is determined not only by the focal firm's choices, but by the choices of the other firm as well.

In short, the business model employed by a firm determines the tactics available to the firm to compete against, or to cooperate with, other firms in the marketplace. Therefore, business models and tactics are intimately related. Consider the example of a discount retailer competing against a local 'mom-and-pop' store, with both engaging in a tactical pricing battle to win customers. Their interaction is captured in Figure 5, which displays both business models connected at market share, and competing (as the dotted arrow shows) on prices. The discount retailer's (lower) prices affect value capture for *both* the discounter *and* the mom-and-pop, and vice versa. While both firms use prices in their tactical interaction, the discount retailer brings superior weapons to the fight because of its business model - specifically, the range of prices it can profitably set is much broader than that of a competitor laden with a high-cost operating model. The battle is over before the combatants even engage — it is won at the business model level.[17]

Strategy

Strategy is often defined as a contingent *plan of action* designed to achieve a particular goal. As Caves and Ghemawat both point out, an essential element of strategy is the set of 'committed choices' made by management. Porter states similarly: '*strategy is the* creation *of a unique and valuable position, involving a different set of activities*' (emphasis added). The word 'creation' implies a *choice* as to the particular way in which the firm competes. Thus, while the resulting (created) activity system is a *reflection* of the firm's strategy; strategy proper is *not* the activity system — that is the business model - but the *creation* of that system.[18] Consistent with this notion, strategy refers, in our development, to the *contingent plan* as to what business model to use. Strategy is a high-order choice that has profound implications on competitive outcomes. Choosing a particular business model means choosing a particular way to compete, a particular logic of the firm, a particular way to operate and to create value for the firm's stakeholders.

When Ryanair was at the brink of bankruptcy in the early 90s, their *strategy* was a plan of action to transform their business model from that of a standard (though small) full-service airline to a radically different type of operation, by adopting Southwest's no-frills business model. Jan Rivkin vividly describes how in 1991, Ryanair's top management considered four alternative *plans of action* to escape near-bankruptcy: (1) become the Southwest of Europe, (2) add business class, (3) become a 'feeder' airline operating from Shannon airport, or (4) exit the industry. Each of the first three

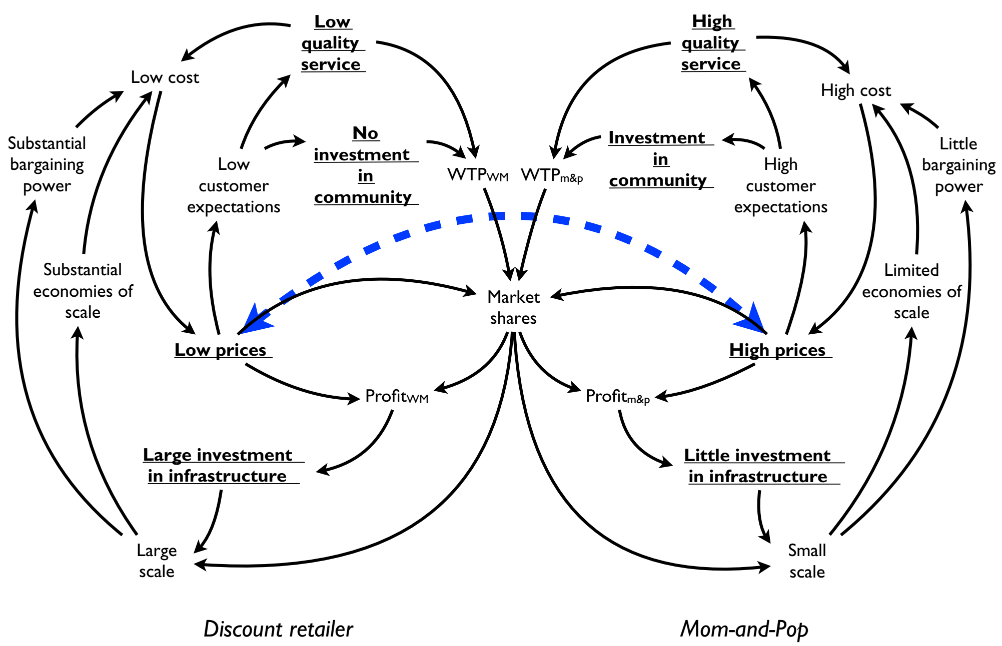

Figure 5. Interaction between a discount retailer and a mom-and-pop store
Tactical price interaction denoted by dotted double arrow

options entailed building a different business model. The high-level election to *'become the Southwest of Europe'* was the company's *strategy* — its plan of action to create a unique and valuable position by engaging in a new set of activities. The particular way in which Ryanair executed such plans was its *realized strategy*. The resulting *business model* - with its new logic, new way to operate, and new way to create value for its stakeholders — *was* the new Ryanair.[19]

Thus, *strategy* refers to a firm's contingent plan as to which business model it will use. It is important to note the word 'contingent' - strategies should contain provisions against a range of environmental contingencies, whether they take place or not. An outside observer will only be able to observe the *realized* strategy, rather than the entire contingent plan.

Strategy *is a firm's contingent plan as to the business model it will use*

Discussion

Integrating strategy, business model and tactics

Having introduced the notions of strategy, business models and tactics separately, we use our organizing framework to integrate and relate them. Figure 6 presents a more nuanced version of the Figure 1 generic two-stage competitive process framework to show the relations between these concepts in more detail. As previously discussed, it shows strategy and business model as related, but different, concepts. A strategy is a contingent plan of action as to what business model to use. The firm's available actions for strategy are *choices* (of policies, assets or governance structures) that constitute the raw material of business models. Thus, strategy entails designing business models (and redesigning them as contingencies occur) to allow the organization to reach its goals. Business models are *reflections* of the realized strategy. In the same way (but at a lower, more detailed scale) *tactics* are also plans of action, which take place within the bounds drawn by the firm's business model.

To cement the three notions, consider once again the automobile analogy (where the automobile corresponds to the business model, and driving it to tactics). Imagine that, prior to operating the automobile, the driver could modify the features of the car: shape, power, consumption, seats, A/C system... Such modifications would not be tactical — detailed changes in how the car is driven — they would constitute 'strategies', because they would entail changing the machine (the 'business model') itself.

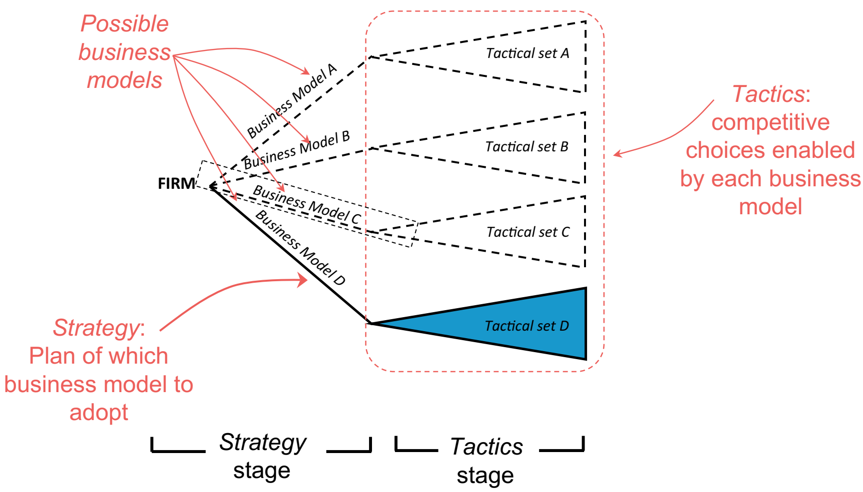

Figure 6. Strategy, business model, and tactics

Comparing strategy and business model

We have argued that a firm's business model is a reflection of its realized strategy. If this is the case, what do we gain from having two separate concepts? Specifically, if, in the situation captured in Figure 6, we see that the firm competes through business model D, we then know the obvious fact that that is its strategy. In this case, it appears that little is gained from separating the two notions.[20] Indeed, there is little to be gained from their separation when there are no contingencies on which to base the choice of business model, because, in this case, there is a one-to-one mapping from strategy onto business models. Essentially, strategy coincides with business model, so that an outside observer can know the firm's strategy by looking at its business model. The substantive difference between strategy and business model arises when the firm's plan of action calls for modifications to the business model (changes in policies and/or assets and/or governance) when particular contingencies take place. When this is the case, strategy and business model no longer coincide — regardless of whether the business model modifications involved are substantial or only minor.

a business model is a reflection of a firm's realized strategy. Little is gained from separating the concepts when strategy maps one-to-one onto business model … The substantive difference arises when the firm's contingent strategy calls for business model modifications

There are many possible sources of contingencies on which strategies may be based, which generally involve the realizations of events outside the control of the firm. For example, one contingency many firms are currently considering is the possibility of a recovery from the recession. Firms have plans as to how their business models must be tweaked (changes in policies, assets and/or their governance) in the event of a strong economic recovery. Such plans are part of the firms' strategies. Note that by observing the *current* business model of a firm we do not know how it might be changed (as prescribed by the firm's strategy) if the economy recovers - all that we observe is the current business model, which is what the firm's strategy prescribes for the current state of the economy. Therefore, business model and strategy do not coincide in this case.

Another source of the contingencies on which strategies may be based is actions by other industry players (competitors, complementors, buyers or suppliers) - again, these are usually beyond the focal firm's control. Consider Figure 6, and suppose that the focal firm is an incumbent that has chosen to compete through business model A. It becomes aware of the possible entry into its market of a potential competitor. Whether or not the potential competitor decides to enter thus represents an important contingency, and the focal firm must base its plan of action (its strategy) as to what business model it will use as depending on how this contingency is resolved. What should its strategy be? One possible contingent plan of action is: *'if the potential entrant stays out, then I should stick with business model A - but if the competitor enters, I should reconfigure my business model to B'*.[21] Then (if the potential competitor stays out) an external analyst will only observe the incumbent as continuing to compete through business model A. The contingency where the competitor *does* enter - and the incumbent responds by reconfiguring its business model to model B - has not occurred. Thus the analyst will *not* observe the incumbent's complete contingent strategy.

To summarize, strategy is much more than the mere selection of a business model; it is a contingent plan as to how the business model should be configured, depending on contingencies that might occur. An organization's business model is the reflection of its *realized* strategy. In simple situations (when there are no contingencies on which to base strategy choices, but merely competitive adjustments that can be handled via tactics), strategy may 'coincide' with the organization's business model and little is gained from separating the two notions.

As a corollary, a second difference between strategy and business model is that, while *every* organization has some business model (because every organization makes some choices and the choices have consequences), *not* every organization has a strategy - a plan of action for different contingencies that may arise.

Comparing strategy and tactics

It is also worth discussing the difference between strategic choices (those which occur at the 'Strategy Stage' of our process framework) and tactical choices (which occur in the 'Tactics Stage'). As noted above, we follow Caves' and Ghemawat's observations that an essential element of strategy is the set of 'committed choices' (of policies, assets and of their governance structures) made by management in setting the business model up, which often are not easily reversible. (This is not to say they *cannot* be reversed or changed, but doing so is generally costly.) Tactical choices — such as prices, the intensity of advertising or of R&D, minor product modifications and so on - on the other hand, are relatively easy to change.

the set of strategy choices made in setting the business model up are not easily reversible … tactical choices are relatively easy to change.

Strategic policy choices identify the particular way a firm intends to focus a particular activity or function. Thus, while Walmart's price policy is described by the motto 'Every Day Low Prices', the actual implementation of this policy - in terms of particular pricing decisions - is tactical: each store sets its prices in a particular way depending on local market conditions, but coherent with the established policy. Asset choices concern how the firm intends to invest and, therefore involve key organizational commitments. For instance, Walmart is committed to large investments into information technologies and distribution centers. The particular timing of these investments, how each will be financed, etc. are tactical aspects to be decided later on in the game. Governance choices are the third category of business model choices: giving powerful incentives to store managers, for example, is a Walmart strategy choice, whereas specific contracts for particular store managers are tactical decisions.

Again, in the Metro example, its *strategic* choices include being ad-sponsored and charging zero price for the newspaper, whether to own paper print facilities or to outsource this function, and *general* policies about how many ads Metro newspapers will carry and at what rates, the balance between news and opinion pieces, etc.. *Precise* choices about advertising rates, numbers of pages and ads in each edition, the balance between news and opinion pieces etc., are all *tactical* choices, which can be adjusted (within the limits imposed by Metro's business model), depending on local market conditions. Strategic choices set up the business model, which then places constraints on the tactics available to Metro to compete in the marketplace.[22] (To further illustrate the distinction, consider Teece's description of Blockbuster's reaction to Netflix's entry as an online DVD rental service. Blockbuster eventually realized that, to fight Netflix effectively, it had to go beyond simple tactical moves - as enabled by its original business model - and change the way the Blockbuster 'machine' was set up to include online rental combined with the return-to-store option.[23])

In the analogy of the automobile, strategy is about changing features of the automobile such as shape, engine power, wheels, seats, etc... Tactics, however, are about what one does with the automobile, such as driving it fast or slow, or with the windows down… Reconfigurations to the car are possible, but costly, but tactical changes are usually (comparatively) easy to implement in the short term.

An example: TDC vs. Telmore[24]

We illustrate our framework with a consideration of the TDC vs. Telmore case. Telmore, first founded in 1999 by a team around Frank Rasmussen and located on the outskirts of Copenhagen, entered the Danish mobile telecom market as a no-frills Mobile Virtual Network Operator (MVNO) in October 2000. Prior to its MVNO entry, Telmore had struck an agreement with TDC (Denmark's largest network operator) to act as a service provider on TDC's network for a charge of DKK 0.50 per minute.[25]

Business models

The most important choices in TDC's business model are given in Table 2, while Figure 7 puts these choices and their most important consequences together to represent its business model at a high level of aggregation. The figure shows how the TDC's 'machine' was set up, the logic of the firm. Many alternative business models were available to Telmore when Rasmussen considered his entry into the Danish mobile telephony industry. Table 3 shows the most important business model choices made by Telmore's top management team, which resulted in a rock-bottom cost structure that gave it a formidable competitive advantage among the segment of customers looking for a simple, transparent and low price offering, without being locked into long-term agreements. The Figure 8 representation puts these choices together to show Telmore's logic, making explicit the most important consequences and the feedback loops.

Tactics

As a no-frills competitor, an important choice in Telmore's business model was its 'low prices' policy. (Note that the policy does not prescribe a specific price, just that they should be low.) Within this business model choice, the precise rates Telmore charged its customers were *tactics*. However TDC's charge for using its network set a boundary on how low Telmore's prices could go - below DKK 0.50 per minute would have been lower than marginal cost. This illustrates the crucial point that *the tactical set was constrained by the business model.*

After Telmore entered the market, TDC and Telmore's business models became interdependent, and there were inevitable elements of tactical interaction. Figure 9 (below) shows the many points of contact between the two business models, with connecting arrows showing where they affected each another: solid lines representing 'positive interactions' and dotted lines 'negative interactions', operating in the direction of the arrow. The most important of these were:

- *Volume:* Telmore stole customers from TDC, decreasing its customer base. In acquiring new customers, TDC similarly decreased Telmore's customer base (although probably to a lesser extent);
- *Handsets:* Telmore neither provided nor subsidized handsets for its customers, so the existence of a large number of TDC customers with handsets was a necessary condition for Telmore's business model to function properly, as this group of users represented part of its pool of potential new customers;
- *Willingness to pay:* Telmore's simple, low price offering decreased the willingness to pay of those TDC's customers attracted by Telmore's style of offering;
- *Network utilization:* TDC's investment in setting the network up was a necessary precondition underpinning Telmore's MVNO operations. By purchasing wholesale minutes from TDC,

Table 2. TDC Business Model Choices

Choice	Explanation
Heavy network/ infrastructure investment	TDC was granted bandwidth rights by national regulators and constructed, operated and maintained a national cellular network. The costs of building a greenfield network infrastructure were estimated at DKK 2-3bn.
Multiple products, plans, and service offerings	TDC offered its customers a wide range of products and plans, allowing it to target more customer segments and thus capture more users. Price discrimination also allowed it to extract more value from each customer.
Subsidized handsets	New handsets were expensive, so TDC subsidized prices to customers to encourage increased adoption. Handsets were locked to prevent them being used on different networks (although it was relatively easy to unlock phones in Denmark at the time).
Long-term contracts	TDC's customers were required to sign long-term contracts to obtain subsidized phones, although Danish law limited their length to six months.
Extensive retail distribution and heavy advertisement	TDC distributed its handsets and service plans through an extensive retail network of TDC-owned shops and exclusive and non-exclusive third-party oulets.

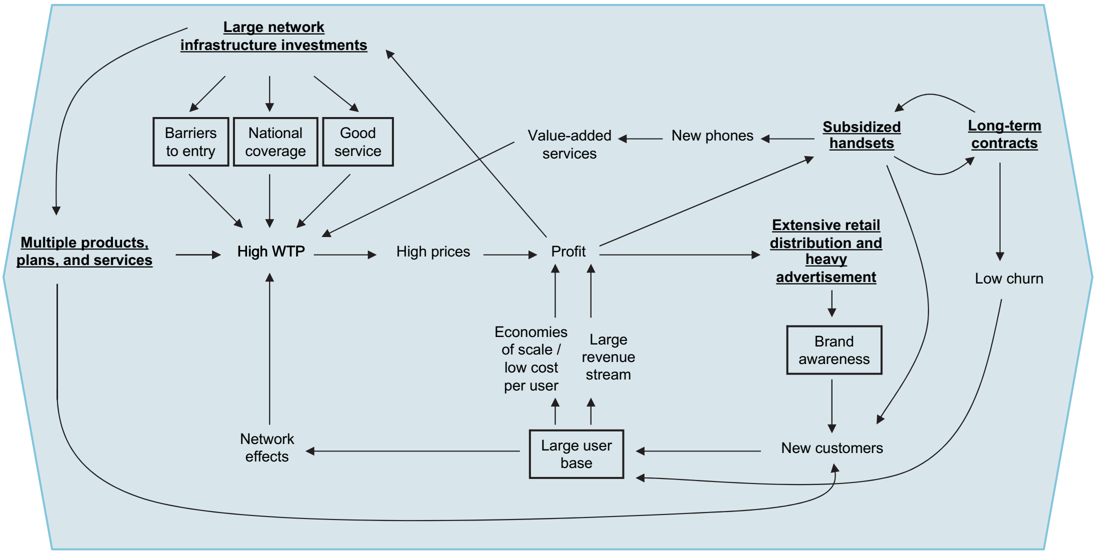

Figure 7. TDC's business model representation

Telmore lowered TDC's costs by allowing it to increase its network utilization rate and spread its fixed costs among a larger user base.

Because both business models were connected, *tactical actions by one firm would affect how well the other firm's business model worked*. For example, the more TDC subsidized the acquisition of new handsets, the better Telmore's business model would work, as its pool of potential subscribers expanded. Likewise, when Telmore's low prices attracted customers from *other* incumbents, TDC benefitted from the per-minute charges they paid - and so on.

How could TDC react to the effects that Telmore's operations had on its business model? It could reconfigure its business model — but that would be costly and have taken time. Or, it could make tactical changes, such as:

- *Lower prices:* if TDC lowered its prices, its margins would have been reduced, but the move would also translate into a smaller loss of customers to Telmore, and could possibly expand the market as a whole;
- *Reduce subsidies for handsets:* but this would have gone against the company's goal of providing premium services, which required customers to own advanced handsets;
- *Reduce investments in network infrastructure*. The problem with this tactical move was that new network infrastructure was needed to offer the latest digital services, which was necessary to maintain TDC's policy of offering multiple products, plans and services;
- *Reduce costs;* TDC could decrease its advertising, distribution, after-sale and other costs so as to match the actual added-value provided to its customers in this new competitive environment;
- *Raise prices and offer more value-added services*. TDC could focus on serving higher-value customers and extracting more value from them, leaving the price sensitive segment to Telmore. (TDC would still earn money from this segment through their wholesale minutes contracts with Telmore).

None of these actions by TDC would have entailed a change in its business model - the logic of the firm does not change with tactical moves.

Strategy

Telmore's business model choices were 180 degrees away from TDC's: Table 4 shows some of the key differences. This bears out the notion that there are many different ways to compete in an industry, and that business model innovation can pay off handsomely. As argued above, all that we

Table 3. Temore Business Model Choices

Choice	Explanation
No infrastructure investment	Unlike a traditional network operator, Telmore didn't invest in its own infrastructure, acting instead as an MVNO, or service provider. Thus Telmore operated at a much smaller scale than traditional operators and avoided the huge investment costs required to set up a network, effectively transforming a large amount of fixed costs into variable costs. It negotiated wholesale rates to utilize TDC's network at ave. call costs of DKK 0.50 per minute, and DKK 0.80 per text.
One simple low price plan	Telmore's offer was very transparent to customers. Its one simple plan charged DKK 1.25 per minute for all national calls (any time, to any network) and DKK 0.25 per text message, with no monthly subscription.
No handset subsidies	Relying on customers to utilize phones they already owned allowed Telmore to avoid subsidizing handsets, a choice which drastically lowered its customer acquisition costs, making new customers immediately profitable. All Telmore's sales were via the web, eliminating the need for a distribution channel.
No long-term contracts	Telmore did not require its customers to enter into long-term contracts - partly because it did not subsidize handsets - resulting in high customer satisfaction, but possibly also higher levels of customer churn.
Little advertisement expense/ guerilla marketing	Telmore's straightforward ads emphasized the simplicity of its model, leveraging the confusion caused by the complexity of incumbents' plans. It also engaged in 'guerilla' marketing tactics, obtaining significant free press coverage and publicity, all of which resulted in significant word of mouth and increased brand awareness.
Only pre-paid plans offered	Not offering post-paid plans meant Telmore eliminated customer credit risk and collection, credit check and billing costs, resulting in considerable lower overall costs. Telmore's working capital requirements were significantly reduced by receiving payments before providing services.
Web-only sign up and no distribution network	Telmore decided against the traditional extensive retail distribution network. Customers could only sign up through the web and were sent their new SIM card through the mail. They could only recharge their balance online: purchasing vouchers at retail locations was not an option.
No paper bills	Telmore did not send paper bills ? customers could only check statements online.
Web-based customer service, limited off-line customer service	Telmore's customer service center opened only specific hours (rather than 24/7), customers were funneled towards email or the website for problem resolution.
Non-unionized students hired as customer service operators	Telmore's customer service operators were young (ave. 24 yrs.) and given bonuses to ensure fast, friendly and attentive customer service.
High-powered incentives for employees	5% of Telmore's profits were distributed equally among all employees, encouraging increases in productivity and profitability, building a sense of community and ownership, and creating flexibility in the company's cost structure.
Flat structure and generalist employees as opposed to specialists	Telmore employees were non-specialized and rotated through various functions and projects. The organization was mostly flat, characterized by several cross-functional projects. Call center operators were also generalists, and staff were cross-trained to provide customer service during demand ?spikes? (even CEO answered phones), so desired service levels were achieved with fewer operators.
Simple IT systems	As an MVNO, Telmore's operations were reduced to customer acquisition, billing and after-sale service. This reduced its IT needs, as did its offer simplicity.

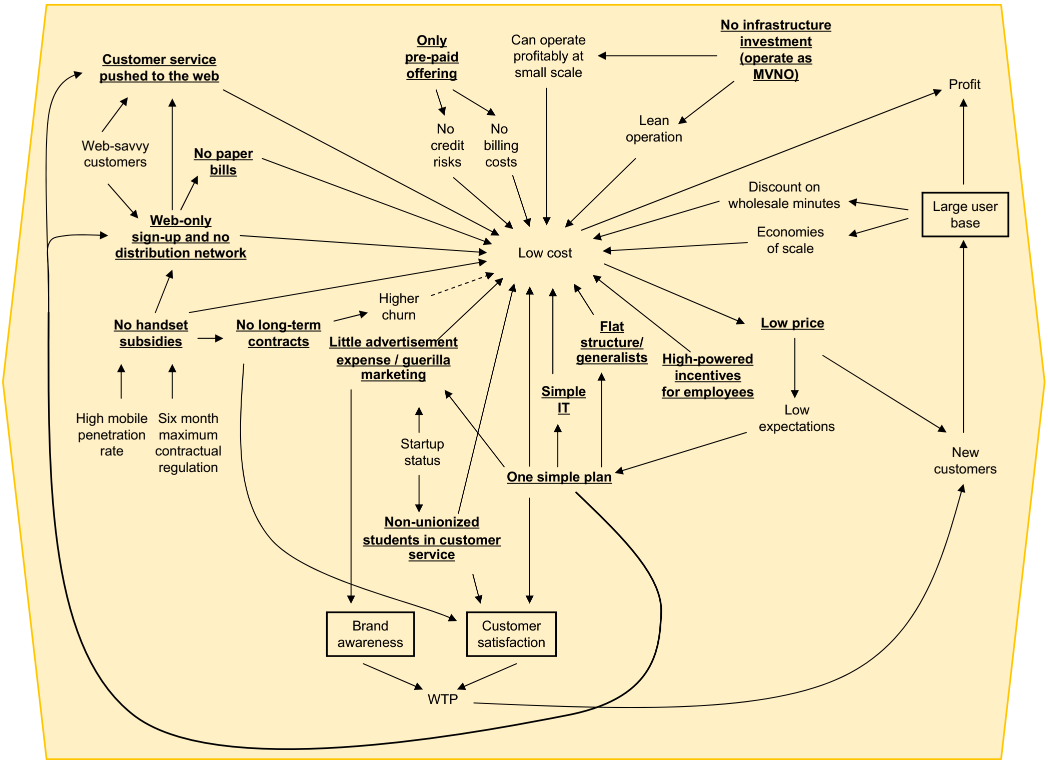

Figure 8. Telmore's business model representation

can observe is the *realized* strategy; we do not observe the complete plan of action as to how Telmore's business model was to be reconfigured contingent on actions by TDC and other industry players. However, with the benefit of hindsight, we know that Telmore did not change its business model, even though there were many changes in the industry at the time. In all likelihood, there was little contingent planning at Telmore, and its business model - see Figure 8 - actually coincided with its strategy.

From TDC's point of view, Telmore's disruptive entry into the market brought a great deal of attention to its business model, rapidly encouraging other low-cost players to enter the market, thus triggering a ferocious price war. TDC rapidly lost subscribers and market prices generally went into a downward spiral. Equity analysts concluded that TDC's mobile phone business was under serious pressure and adjusted their expectations downward in anticipation of declining margins. TDC knew it had to react.

The range of tactical moves allowed by TDC's business model (some of which we have described above) was insufficient for it to confront the no-frills entrants effectively. Indeed, TDC eventually created a 'no-frills' service provider, and then (in 2003) acquired Telmore for about DKK 400 m. Telmore continued to be run as a separate brand within TDC, but most importantly, control over pricing was now in TDC's hands. This represented a fundamental change in its business model, so that TDC was now running (in Markides' terminology) a *dual* business model,[26] which entailed a new set of choices (policies, assets and governance). The key point here is that, when *tactical*

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tactical changes (within the business model) proved insufficient to confront the new competitive situation, [so] TDC moved to strategic change, by modifying its business model.

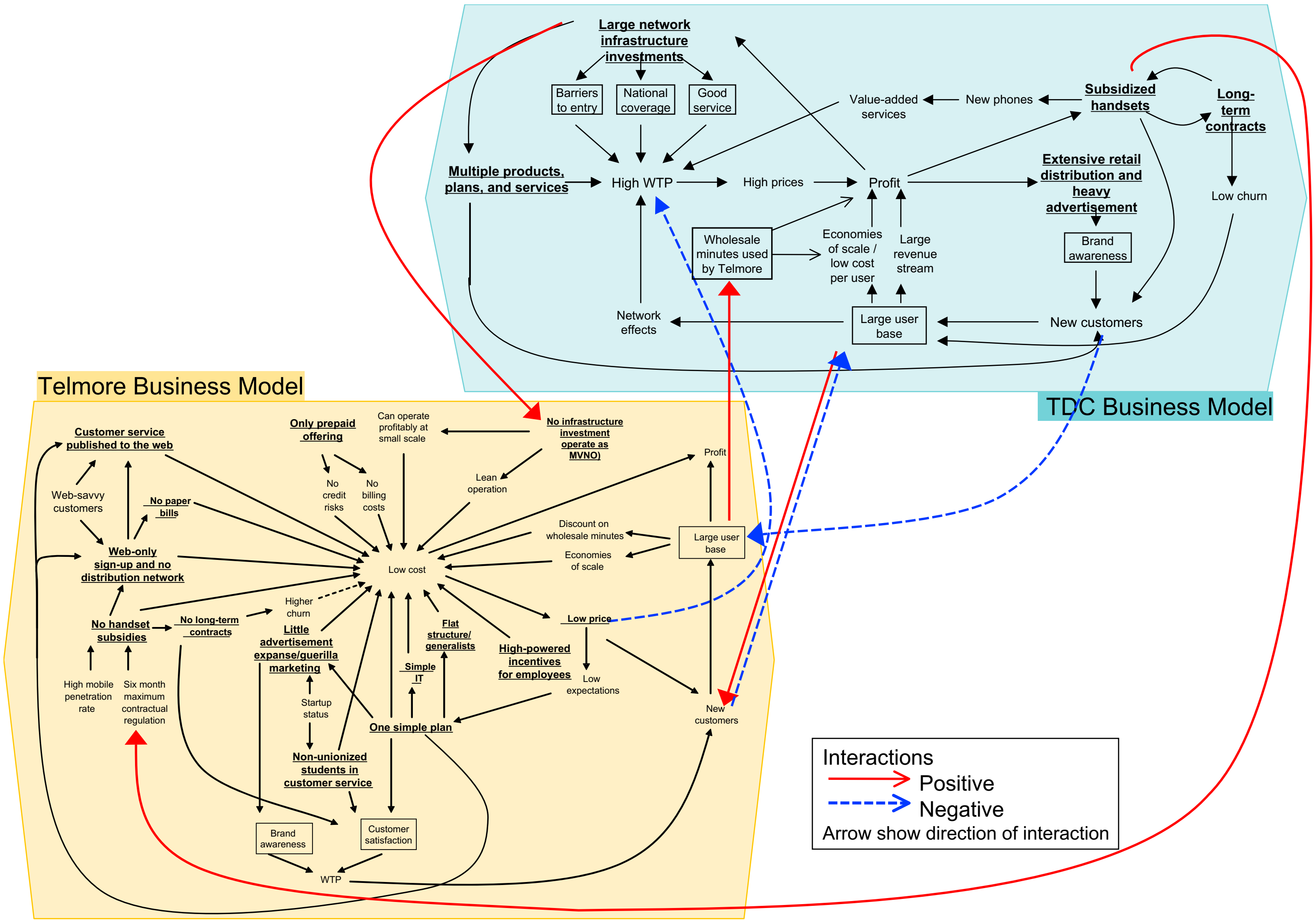

Figure 9. Interactions between TDC and Telmore's Business Models

Table 4. TDC and Temore Business Model Choices: Main Differences

TDC		Telmore
Heavy network/infrastructure investment	→	No infrastructure investment
Multiple products, plans, and service offerings	→	One simple plan
High price	→	Low price
Subsidized handsets	→	No handset subsidies
Long-term contracts	→	No long-term contracts
Extensive retail distribution and heavy advertisement	→	Little advertisement expense/guerilla marketing

changes (within its business model) proved insufficient to confront the new competitive situation, TDC moved to *strategic* change, by modifying its business model.

Conclusions

We have presented a framework that allows a simple integration of the notions of strategy, business model and tactics. In our formulation, strategy and business model, though related, are different concepts: a business model is the direct result of strategy but is not, itself, strategy. Our framework also distinguishes between tactics and strategy, a separation that is possible because strategy and business model are different constructs.

Tactical interaction (where organizations affect each other when acting within the bounds set by their business models) has well-defined rules of play (action sets are well-understood: the mapping from actions to payoffs are easy to discern, and best responses can be easily figured out) because business models constrain the tactical sets and game theory can easily be applied to predict competitive dynamics and outcomes. Strategic interaction (organizations affecting each other through strategy - that is, by changing their business models) is more complex. First, the rules of the game in this case are not well-defined, as there are few constraints as to how business models can be assembled. Second, the mapping between strategic choices and payoffs is much more complicated than in the case of tactics because, for every business model modification, the designer needs to assess the effects that it will have on tactics (as the final payoffs are always determined as the outcome of tactical interactions). Finally, it is usually hard to predict how a rival will react to a particular set of strategic moves as, for all practical purposes, business model best-responses become impossible to pin down.

The proliferation of managerial books on strategy innovation is related to the difficulty in deriving best responses for strategy. Much of the recent managerial literature on innovation is concerned with altering business models. Yip claims that strategy practice can be enlightened by understanding business models, while other recent authors - such as McGrath (another contributor to this issue) and MacMillan or Govindojaran and Trimble - have developed techniques to help companies come up with such strategies. Even operations management scholars (such as Lee) have pointed out that radical changes in some parts of a firm's business model can have tremendous performance implications.[27]

designing new business models is closer to an art than a science. [Understanding] how strategy, business models and tactics interconnect and affect each other can help guide the search for novel, interesting and profitable new ways to compete.

We conclude that the exercise of designing new business models is closer to an art than to a science. From an academic point of view, we believe that having clear definitions of the constructs that we employ and analyze is a necessary condition for progress in the field. From the practitioners' perspective, it is our hope that having an integrative framework that cleanly separates the realms of strategy, business models and tactics — and illustrates how they interconnect and affect each other - can help guide the search for novel, interesting and profitable new ways to compete.

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7. Notice that intangible assets such as experience, brand equity, or even the value of patents are consequences (generally rigid), not choices. On transaction cost economics, see O. E. Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting*, Free Press, New York; Collier Macmillan, London (1985).
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9. J. A. C. Baum and J. V. Singh, Organization-Environment Coevolution, in J. A. C. Baum and J. V. Singh (eds.), *Evolutionary Dynamics of Organizations*, Oxford University Press, N.Y, (1994) There are many other ways in which business models may be represented: standard strategy tools such as Andrews' Strategy Wheel, Porter's Value Chain and Activity System, McKinsey's Business System and Value Delivery System are some of the most prominent examples. While these tools are truly helpful to understand competitive advantage, complementarities and barriers to imitation, they are not ideal for our purpose, as they do not facilitate the study of tactical interactions between two particular firms.
10. Perhaps a more tangible example would be an 'installed base of PCs' which is (partly) a consequence of prices set by Intel and Microsoft for their microprocessors and operating systems. As these prices change, the installed base changes slowly: it is a rigid consequence. Clearly, no consequence is purely flexible or purely rigid - all are somewhere in between.
11. Technically, cause-and-effect pathways can be vicious as well as virtuous. These synergetic relationships become negative when they are interrupted or, worse, reversed. For example, a low cost virtuous cycle could become vicious if Ryanair's employees unionized and it could no longer offer the lowest fares. It would then lose volume, and its aircraft utilization would fall. Since Ryanair's investment in its fleet is based on the assumption of high utilization, this could have a magnified effect on the firm's profitability. In this case the synergy works in the opposite direction, quickly eroding competitive advantage. The possibility of virtuousness turning into viciousness is particularly important in competitive analysis, because interaction with a competitor (such as another low cost airline challenging Ryanair's pricing dominance) can disrupt an incumbent's established pathways.
12. X. Lecoq, B. Demil and V. Warnier, Le Business Model, un Outil d'Analyse Stratégique, *L'Expansion Management Review* **123**, 50—59 (2006).
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17. At this level of aggregation the two business models seem to be composed of parallel but opposite choices. The discounter has made little investment in quality service or in the community but has emphasized infrastructure, whereas the mom-and-pop has emphasized service and the community at the expense of infrastructure. A less aggregated depiction would show the business models as not entirely parallel, but the comparison clearly illustrates how firms use different strategic choices to compete in the same marketplace, leading to profit in different ways. The discounter's choice to reinvest profits to attain larger scale leads to higher purchasing power and lower costs, enabling low prices that drive greater market share and profit, which is again reinvested in scale, in a continuous virtuous value loop. The mom-and-pop's distinct strategy is based on high-quality service and commitment to the community, choices that drive a high cost structure, which constrains its ability to compete on price. It derives some benefit from its community commitment (people are willing to pay a slight premium to shop there), which may or may not be enough to overcome its cost disadvantage.
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20. While our focus has been on the deliberate aspects of strategy, the business model as reflection of realized strategy leaves the door open to consider the impact of emergent strategy on the configuration of a business model, a route that we have only followed implicitly but which is clearly coherent with our proposed framework.

21. As argued above, the difference between business models A and B may be minor or substantial. This is unimportant for our development. What is important is that there is at least one difference in policies or assets or governance between business models A and B.
22. While the distinction between strategy and tactical choices is clear in each particular example that we have presented, the level of aggregation that we use for a particular purpose can affect the conceptual separation about these two notions. This provides flexibility to the use of the framework. The analyst must use judgment in choosing the right level of aggregation and determining the natural frontier between strategic and tactical choices.
23. D. Teece (2010) op. cit. at Ref. 15. For further examples, see C. Markides (2008), op. cit. at Ref. 4.
24. For a detailed description and analysis of this case, see Casadesus-Masanell R, Fernandez C, Jobke M, *Launching Telmore (A)*, Harvard Business School Case 708-414 and Teaching Note 708-520 (2007). While the first was a 'library' case (the main information sources were publicly available materials), the teaching case version had an element of field research, as Jobke consulted a German network operator that had considered entering the Danish mobile market at the time of Telmore's successful entry and interviewed several of the key players. Therefore, although we did not have access to Telmore's management, he developed a deep knowledge of the issues Telmore and the incumbents had faced at the time.
25. TDC was the mobile communications business of the former state-owned Tele Denmark. With 42% market share of subscribers, it was the dominant player in the Danish mobile market, providing primarily fixed-line and wireless communication services in Denmark and also possessing a sizable international business, which accounted for 41.5% of its revenues in 2000.
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