HOW ENTREPRENEURIAL VENTURES MAKE MONEY: CAPTURING THE ECONOMIC MODEL OF THE FIRM (INTERACTIVE PAPER)

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INTERACTIVE PAPER SESSION

HOW ENTREPRENEURIAL VENTURES MAKE MONEY: CAPTURING THE ECONOMIC MODEL OF THE FIRM

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Principal Topic

Central to most conceptualizations of a business model is the firm’s approach to making money, or its economic model (Rayport & Jaworski, 2001). Surprisingly, no framework exists for capturing the entrepreneur’s economic model (Gunter and McGrath, 2005). In this research, a four-component framework is developed and tested. These four components include margins, volumes, operating leverage, and revenue drivers. Margins, volumes (transaction size and frequency), and operating leverage (extent to which cost structure is dominated by fixed versus variable costs) were classified as high, medium, or low. The firm’s revenue drivers were classified as high, medium, or low flexibility, and high, medium, or low in number of product lines. The development of this framework integrates these four elements and indicates which combinations should lead to highly successful ventures while others should result in more marginal firms.

Method

It was hypothesized that prototypical combinations of these four elements could be identified within a given industry, and that performance differences can be found based on the various combinations employed. To test the framework and hypotheses, a cross-sectional mail survey involving twelve hundred retail establishments was undertaken. Self-report measures utilizing multiple indicators determined each firm’s approach to margins, volumes, operating leverage, and revenue drivers, as well as financial performance. Completed surveys were received from 140 retailers. These results were then coded into the equivalent of high, medium, and low categories for each of the model components. Cluster analysis was used to identify predominate combinations of the model components.

Results and Implications

A number of common models were identified based on the emergence of different clusters. Further, some evidence of performance differences linked to the type of model employed was revealed. As such, it becomes possible to perform sensitivity analysis and identify problematic combinations of the four model components, enabling the characterization of the inherent risk in a venture and growth potential evaluation. The framework and measurement approach can also have important implications for strategic and operating decisions (e.g., what is sold, to whom, how it is produced and distributed) that affect the four elements of the firm’s economic model.

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