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8 TYPES OF BUSINESS MODELS & THE VALUE THEY DELIVER

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Patrick Healy | Staff

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You want to start a company but aren't sure about a viable business model. How might you create something that people are willing to pay for and could earn you a profit?

Before diving into potential strategies, it's important to understand what a business is and does. At its heart, a business generates value for its customers. A **business model** is a specific method used to create and deliver this value.

WHAT IS VALUE IN BUSINESS?

A successful business creates something of **value**. The world is filled with opportunities to fulfill people's wants and needs, and your job as an entrepreneur is to find a way to capitalize on these opportunities.

A viable business model is one that allows a business to charge a price for the value it's creating, such that the business brings in enough money to make it worthwhile and continue operating over time. Whatever the business is offering must also satisfy the customer's needs and quality expectations.

It's important to note that value is subjective. What's valuable to one person may not be to another. Moreover, the concept of value excludes any moral judgments about the intrinsic worth of an offering. For example, while most would agree that human life is more valuable than sports, some professional athletes make far more money than the average brain surgeon.

Nonetheless, the concept of value provides a useful bedrock on which to begin building your business model. In particular, consider what forms of value people are willing to pay for. Here are eight potential business models and the forms of value they deliver—as well as the pros and cons of each—to help you get started.

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8 TYPES OF BUSINESS MODELS TO EXPLORE

1. Product

A **product** is a tangible item of value. To run a successful product-focused business, try to produce the item for as low a cost as possible while maintaining a reasonable level of quality. Once the item is produced, your objective should be to sell as many units as you can for as high a price as people are willing to pay to maximize profit.

Products are all around us. From laptops to books to HBS Online courses (products don't have to be physical), products are a classic form of value with high upside if you can get them right.

- **Pros:** Many products can be easily duplicated. Thus, firms can achieve economies of scale after bearing some upfront costs of production.
- **Cons:** Physical products need to be stored as inventory, which can increase costs. They can also be damaged or lost more easily than, say, a service.

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2. Service

A **service** involves offering assistance to someone else for a fee. To make money from your service, provide a skill to others that they either can't or don't want to do themselves. If possible, repeatedly provide this benefit to them at a high quality.

Like products, services are in abundance, especially in the knowledge economy. From hairdressers to construction workers to consultants to teachers, people with lucrative skills can earn good money for their time.

- **Pros:** If you have a skill in high demand or a skill that very few others have, you can charge a fair price for your time and stand out in your field.
- **Cons:** If you don't charge enough for your services, or many people have your skill, your business may not be as lucrative.

3. Shared Assets

A **shared asset** is a resource that many people can use. Such resources allow the owner to create or purchase the item once and then charge customers for its use. To run a profitable business around shared assets, you need to balance the tradeoff of serving as many customers as you can without affecting the overall quality of the experience.

For instance, think of a fitness center. A gym typically buys treadmills, ellipticals, free weights, bikes, and other equipment and charges customers monthly membership fees for access to these shared assets. The key is to charge customers enough to maintain and, if needed, replace their assets over time. Finding the right range of customers is the key to making a shared asset model work.

- **Pros:** This model provides people access to a lot of assets they wouldn't otherwise have access to. In addition, many people are willing to pay a lot for access to trendy social spaces.

- **Cons:** Because they don't own the assets, customers have little incentive to treat your resources well. Make sure you have enough in your budget for quick fixes, if necessary.

4. Subscription

A **subscription** is a type of program in which a user pays a recurring fee for access to certain specified benefits. These benefits often include the recurring provision of products or services. Unlike a shared asset, however, your experience with the product or service isn't affected by others.

To have a successful subscription-based offering, build a subscriber base by providing reliable value over time while attracting new customers.

The number of subscription services has exploded in recent years. From magazines to streaming services to grocery and wine delivery subscriptions, businesses are turning to the subscription-based model, often with great success.

- **Pros:** This model provides certainty in the form of predictable revenue streams, making financial forecasting a bit easier. It also benefits from a loyal customer base and customer inertia (for instance, customers may forget to cancel their subscription).
- **Cons:** To run this model, your business operations must be strong. If you can't deliver value consistently over time, you may want to consider a different business model.

5. Lease/Rental

A **lease** involves obtaining an asset and renting it out for an agreed-upon amount of time in exchange for a fee. You can lease virtually anything, but it's in your best interest to rent assets that are durable enough to be returned in good condition. This ensures you can lease the good multiple times and, perhaps, eventually sell it.

To profit from leases, the key is to ensure that the revenue you get from leasing the asset before it loses value is greater than the purchase price. This requires you to price the rental of the item strategically and potentially not lease to those who may not return it in good condition. This is why many rentals of high-value items require references, credit checks, or other background information that can predict how someone may return the leased item.

- **Pros:** You don't have to have a novel idea to make money using a lease business model. You can purchase assets and rent them to others who wouldn't buy them for full value and earn a premium.
- **Cons:** You need to protect yourself from unexpected damage to your assets. One way to do so is through insurance.

6. Insurance

Insurance entails the transfer of risk from a customer to a seller of an insurance policy. In exchange for the insurance company (the seller of the policy) taking on the risk of a specified event occurring, they receive periodic payments ("premiums" in insurance lingo) from the policyholder. If the specified event doesn't happen, the insurance company keeps the money, but if it does, the company has to pay the policyholder.

In a sense, insurance is the sale of safety—it provides value by protecting people from unlikely, but catastrophic, risks. Policyholders can take insurance out on almost anything: life, health, house, car, boat, and more. To run a successful insurance company, you have to accurately estimate the likelihood of bad events occurring and charge higher premiums than the claims you pay out to your customers.

- **Pros:** If you calculate risk accurately, you're guaranteed to make money using the insurance business model.
- **Cons:** It can be difficult to accurately calculate the likelihood of specific events occurring. Insurance only works because it spreads risk over large numbers of policyholders. Insurance companies can fail if a large portion of policyholders is impacted by a widespread, negative event they didn't see coming (for example, the Global financial crisis in 2007 and 2008).

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7. Reselling

Reselling is the purchasing of an asset from one seller and the subsequent sale of that asset to an end buyer at a premium price. Reselling is the process through which most major retailers purchase the products they then sell to buyers. For example, think of farmers supplying fruits and vegetables to a grocery store or manufacturers selling goods to a hardware store.

Companies make money through resale by purchasing large quantities of items (usually at a bulk discount) from wholesalers and selling single items for a higher price to individuals. This price raise is called a markup.

- **Pros:** Markups can often be high for retail sales, enabling you to earn a profit on the items you resell. For example, a bottle of water might cost 10 cents to produce, whereas a customer may be willing to pay $1.50 or more for the same bottle.
- **Cons:** You need to be able to gain access to quality products at low costs for the reselling business model to work. You'll also need the physical space to store inventory to manage sales cycles.

8. Agency/Promotion

Agents create value by marketing an asset, which they don't own, to an interested buyer. They then earn a fee or a commission for bringing the buyer and seller together. Thus, instead of using their own assets to create value, they team up with others to help promote them to the world.

Running a successful agency requires good connections, excellent negotiation skills, and a willingness to work with a diverse set of individuals. One example is a sports agent who promotes players to teams and negotiates on their behalf to get the best deal. In return, they typically receive compensation equal to a certain percentage of the contract.

- **Pros:** You can highly profit from expertise and connections in your industry, be it publishing, acting, advertising, or something else.
- **Cons:** You only get paid if you seal the deal, so you have to be able to live with some uncertainty.

SETTING YOUR BUSINESS UP FOR SUCCESS

These eight types of business models each have pros and cons and deliver value in their own ways. If you're looking to start a business and need a place to start, one of these could be the best fit for your venture and entrepreneurial skill set.

Interested in honing your entrepreneurial skills? Explore our four-week online course Entrepreneurship Essentials and our other entrepreneurship and innovation courses to learn the language of the business world.

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About the Author

Pat served as a member of the HBS Online Course Delivery Team and worked on the Economics for Managers course for the Credential of Readiness (CORe) program, Management Essentials, and Negotiation Mastery. Pat holds a B.A. in Economics and Government from Dartmouth College. In his free time, he enjoys playing tennis and strumming the guitar.