

Strategy and Business Models: What's the Difference¹?

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Abstract

This paper examines in detail the meaning of two frequently used—and misused—terms, namely, “business model” and “strategy”. It is argued that as used by leading thinkers these two terms might reasonably be interpreted as having roughly equivalent meanings. However, we argue that there is another distinct and potentially useful role for the term “business model”. In this role, strategies would be treated as grounded firmly in the real world, whereas business models would be treated as abstractions of firms’ real-world strategies. Such abstractions, it is argued, have attracted the attention of so many researchers because they are useful for evaluating alternative possible future ways of building profitable businesses.

Keywords

Strategy, business model, competitive advantage

“Today, “business model” and “strategy” are among the most sloppily used terms in business; they are often stretched to mean everything—and end up meaning nothing. But as the experience of companies like Dell and Wal-Mart show, these are concepts of enormous practical value.” (Magretta 2002)

“The definition of a business model is murky at best. Most often, it seems to refer to a loose conception of how a company does business and generates revenue. Yet simply having a business model is an exceedingly low bar to set for building a company. Generating revenue is a far cry from creating economic value ...” (Porter 2001, p.73)

Introduction

The term “business model” has been used with rapidly increasing frequency since the mid-1990s as more and more businesses have asked if they, too, can make money using the Internet². A web search using Google in February 2003 found one million web pages using

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² Some early references to the term “business model”, in the sense used in this paper, appear in articles like Kavner (1994) and Crotty (1995). Hamel and Prahalad (1994), quoting the “chairman of one of the world’s most successful pharmaceutical companies” use the closely-related term “model of the business” in the same sense at the current meaning of “business model”.

the term “business model”, and 17 million using the term “strategy”. However, as Joan Magretta and Michael Porter make clear in the quotations above, although both terms are widely used, the terms “business model” and “strategy” are often poorly defined. A review of the literature, examining leading authors’ definitions of both terms reveals that there is a lot of overlap between these two terms. So the initial question one is tempted to ask is: “In terms of the Venn diagrams in Figure 1, which is more correct: A, B, C, D or E?”

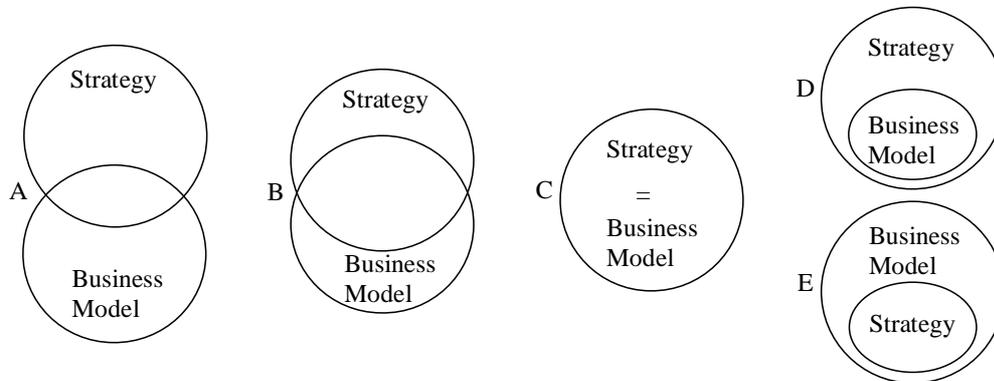


Figure 1. Possible overlap between the concepts “strategy” and “business model”

Our purpose in this paper, however, is to argue that the question posed above is not helpful. It is not helpful because the more carefully one compares the sets of concepts discussed by the experts on business models and the experts on strategy, the more one concludes that the two sets of concepts are substantially the same. Yes, there are nuances of difference. Yes, as the terms are commonly used, strategy seems more concerned with competition between firms, whereas business models are more concerned with the “core logic” (Linder and Cantrell 2000) that enables a firm to create value for its customers and owners. Perhaps people with an information technology (IT) background tend to use the term “business model” more often than those from a management background (who use “strategy”), but across a broad range of papers, the concept-by-concept mapping³ is so close that one would feel justified in concluding that business models and strategy are just two sides of the one coin, i.e., that Figure 1C is correct. If this perspective is correct, the term “business model” really adds no value; it should be consigned to the dustbin along with the other “hype” terms of the late 1990s, such as “new economy” and “the internet changes everything”.

However, in this paper we shall argue that there is a view of the term “business model”, consistent with the usage of many of the experts who have used the term, that is different from strategy, and therefore does add value. That view is depicted in the three-dimensional diagram in Figure 2. In Figure 2, a vertical axis, labelled “increasing abstraction” has been added to the two-dimensional Figure 1, and the Venn diagram ellipses are drawn in *different* parallel planes. Our goal in this diagram is to suggest that it might be helpful to view the difference between a business model and a strategy as a difference in the level of abstraction. In words: *A business model is an abstract representation of some aspect of a firm’s strategy.*

Why view a strategy as less abstract than a business model? Our answer is that, at least as defined by Porter (1996), a firm’s strategy is deeply rooted in that *particular* firm’s

³ By “concept-by-concept comparison” we mean that when author A says business models are about x, y, and z, one then asks if author B says that strategy is also about x, y, and z. If all concepts match, the situation depicted in Figure 1C would describe the relationship between the terms.

competitive environment. When one thinks of, say, Dell's strategy, one is immediately placed in a highly situated context, with *particular* competitors, *particular* customers, *particular* suppliers, *particular* ways of assembling, delivering, and charging for computers, *particular* ways of responding to market changes, and so on. Everything has to fit together for the company to make money. By contrast, the goal of business models, at least as we are proposing here, is to abstract from all the detail. The reason for wanting to abstract from all the detail is the reason for all abstractions, namely, to draw attention to the factors of interest to the modeller, and to suppress extraneous information. By suppressing irrelevant detail, it is possible to say that many firms have the same business model. It is in this sense of being abstractions from any particular firm's strategy that business models are "models" of "an organization's core logic for creating value" (Linder and Cantrell 2000).

In Figure 2, strategy is represented with a larger ellipse than that for either of the two business models because much more information is required to represent a firm's strategy than is required to represent a business model. Figure 2 also depicts two business models representing different views of the one firm's strategy, because there is literally an unlimited number of different models one can build based on the one firm's strategy.

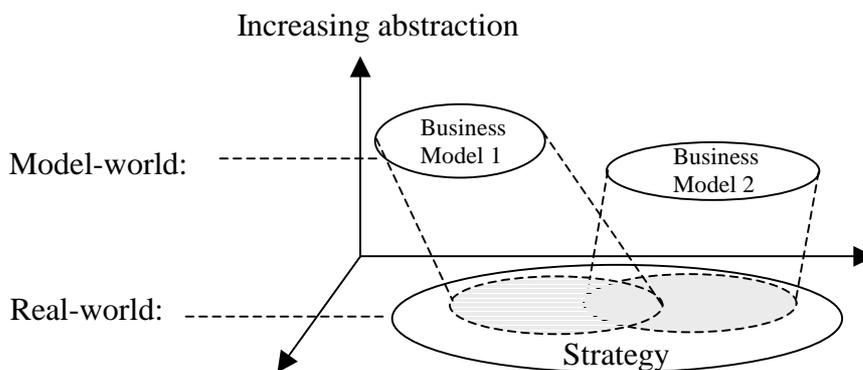


Figure 2. The relationship between the concepts "business model" and "strategy"

The remainder of this paper is devoted to explaining why it might be useful to view the relationship between business models and strategy as depicted in Figure 2. Although we do summarize some of the literature on strategy and business models our goal is not to do that. Others, e.g., Grant (1996) for strategy, and Pateli (2002) for business models, have done a much better job than us. Our goal is simply to explain why it might be useful to use the term "business model" to mean an abstraction, not specific to any one firm, and "strategy" to mean a particular firm's plan for making superior return on investment.

What is Strategy?

Definitions of strategy are legion—corporate strategy, business strategy, functional strategy, the process school, the analytic school, competitive strategy, resource-based strategy—to name but some. In addition, the world's understanding of what "strategy" means in a business context has evolved considerably over the last fifty years. For example, Ghemawat (2002) explains in some detail how what might be termed "the Harvard school's"

conceptualisation of strategy⁴ evolved from the atheoretical SWOT (Strengths, Weaknesses, Opportunities, and Threats) analysis of the 1960s (Andrews 1971) to today's view which includes deep insights from both the Industrial Organization Economics literature (von Neumann and Morgenstern 1944; Bain 1956; Tirole 1988) and Organizational Economics literature (Williamson 1975; Wernerfelt 1984; Barney 1991). This evolution of the Harvard school's understanding of strategy through two major infusions of new ideas (B and C in Figure 3) is depicted in Figure 3.

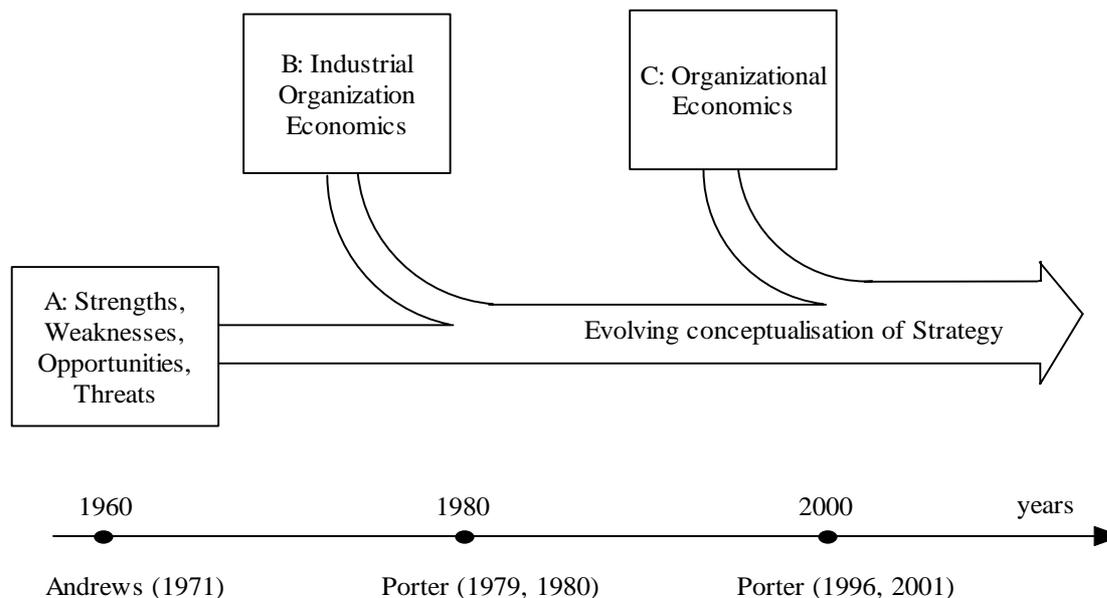


Figure 3. Evolution of the Harvard School's conceptualisation of "strategy"

Since the Harvard school is probably the world's thought leader on strategy, and Porter is one of its primary spokespersons, it follows that Porter's most recent work, e.g., his 1996 paper "What is Strategy?" and his 2001 paper "Strategy and the Internet", provides what is arguably the most authoritative, up-to-date conceptualisation of the strategy available. The following quotations from Porter (1996) and Porter (2001)⁵ capture the gist of this most recent thinking:

1. "The goal of strategy is to achieve a "superior long-term return on investment." "Economic value is created when customers are willing to pay a price for a product or service that exceeds the cost of producing it." (Porter 2001, p.71)
2. "Competitive strategy is about being different." (Porter 1996, p.64)
3. "Strategy is the creation of a unique and valuable position, involving a different set of activities.... different from rivals" (Porter 1996, p.68)
4. "Strategy is making tradeoffs in competing" (Porter 1996, p.70)

⁴ By "the Harvard school", we mean the work of a series of thought leaders, including academics and consultants, such as Christensen (Learned et al. 1965), Andrews (1971), Porter (1980, 1985, 1996, 2001), Ghemawat (1991), the Boston Consulting Group, McKinsey & Company, associated with Harvard.

⁵ Tapscott (2001) believes that "Michael Porter is Wrong about the Internet".

5. “Strategy defines how all the elements of what a company does fit together.” (Porter 2001, p.71)
6. “Operational effectiveness and strategy are both essential to superior performance, which, after all, is the primary goal of any enterprise. But they work in different ways.” (Porter 1996, p.61)
7. “Operational effectiveness means performing similar activities *better* than rivals perform them.” (Porter 1996, p.62)
8. “Strategy involves continuity of direction.” (Porter 2001, p.71)

In essence, Porter argues that strategy involves defining a company’s long-term *position* in the marketplace, making the hard *trade-offs* about what the company will and will not do to provide value to customers, and forging hard-to-replicate *fit* among parts of the “*activity system*” the firm constructs to deliver value to customers, all with a view to making a superior *return on investment*. (The five terms in italics are key to this definition.) Operational excellence of the activity system, Porter says, is just a given.

Graphic techniques for representation of business models and strategy are important to this paper. Porter has developed three diagrammatic representations of strategy. First his five-forces diagram, e.g., Porter (1980 and 2001, p.67), showing the influences of suppliers, buyers, threat of substitutes, barriers to entry and rivalry among existing competitors assists with thinking about competitive positioning at the industry level. Second, his value chain model, e.g., Porter and Millar (1985), Porter (2001, p.75), showing inbound infrastructure, operations, outbound logistics, marketing and sales, and after-sales service supported by firm infrastructure, human resources management, technology development, and procurement processes assists with thinking about organizational processes and the way information can be used to achieve competitive advantage. Third, towards the end of his 1996 paper, as part of a five-page discussion of fit (see point 5 above), Porter presents three diagrams that he calls “activity system maps”. These diagrams are so close to what many people might call business models that an example is included here. Figure 4 shows an example diagram based on Porter’s activity system map for Southwest Airlines (Porter 1996, p.73). According to Porter (1996, p.71),

“Activity system maps,... show how a company’s strategic position is contained in a set of tailored activities designed to deliver it. In companies with a clear strategic position, a number of higher-order strategic themes (in dark purple) can be identified and implemented through clusters of tightly linked activities (in light purple).”

After considering the meaning of various definitions of “business model” in the next section, we return to this third technique for representing strategy and ask if one of Porter’s activity system maps could be considered to be a business model.

Summarizing, the definitions of strategy in Porter (1996, 2001) represent the current end point of a fifty-year evolution of thinking on strategy by people who belong to what we have termed the Harvard school. Key points from the current conceptualisation are summarized by the eight points about listed above and activity system maps like that in Figure 4. We do not argue that the Harvard-school conceptualisation of strategy is the only possible interpretation, but we do believe it is a good one. It is therefore this latest Harvard-school conceptualisation of strategy that we use in the next section as our reference when comparing various authors’ conceptualisations of “business models” with strategy.

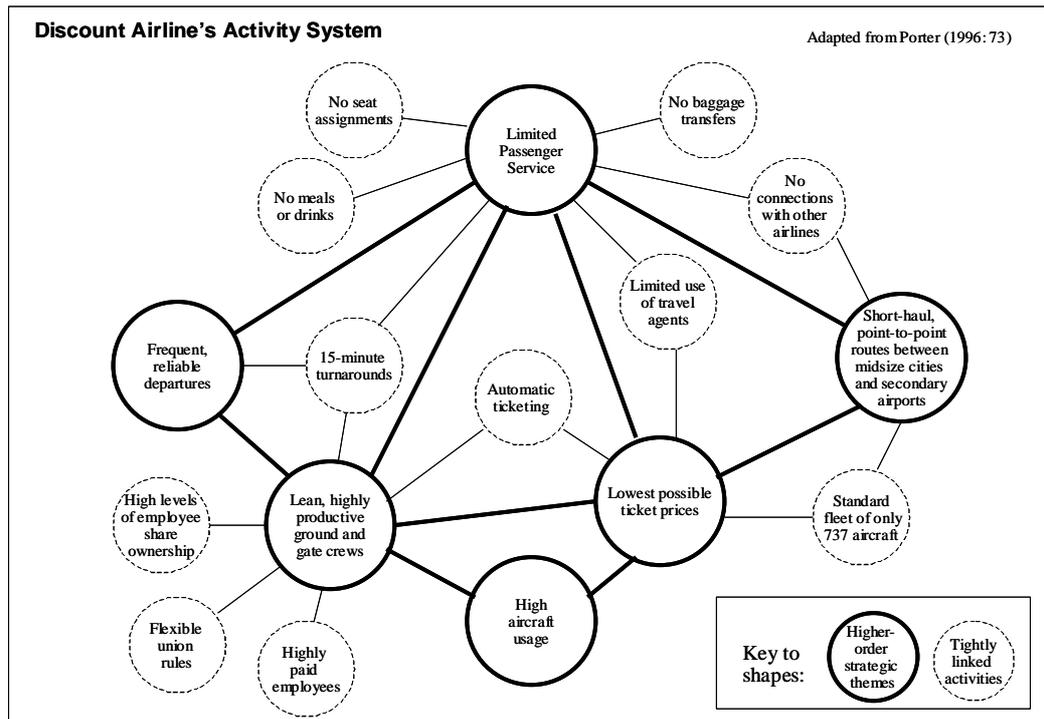


Figure 4. An example activity system map, adapted from Porter (1996, p.73)

What is a Business Model?

Our argument in this paper is that it is useful to view a business model as an abstract representation of some aspect of a firm's strategy; "strategy" being as defined by Porter (1996, 2001). Such abstractions are valuable, we argue, because they enable those thinking about building new businesses to think in high-level terms as they attempt to visualize new possibilities.

How does Porter's (1996, 2001) definition of strategy compare to a "business model"? To answer this question, we examine three authoritative definitions of "business model", from Magretta (2002), Weill and Vitale (2000), and Applegate (2000, 2003).

First, according to Magretta (2002) business models

"are, at heart, stories – stories that explain how enterprises work. A good business model answers Peter Drucker's age-old questions: Who is the customer? And what does the customer value? It also answers the fundamental questions every manager must ask: How do we make money in this business? What is the underlying economic logic that explains how we can deliver value to customers at an appropriate cost?" (p.92)

Few would disagree that these same questions could be asked of a firm's strategy, which suggests that business models and strategy are conceptually very similar. But Magretta goes on to say:

"But a business model isn't the same thing as strategy, even though many people use the terms interchangeably today. Business models describe, as a system, how the pieces of a business fit together. But they don't factor in one critical dimension of performance: competition. Sooner or later—and it is usually sooner—every enterprise runs into

competitors. Dealing with that reality is strategy’s job.... A competitive strategy explains how you will do better than your rivals.” (p.94)

Saying that “business models describe, as a system, how the pieces of a business fit together” is so close to point 5 from the above summary of Porter, i.e., “how all the elements of what a company does fit together” as to be indistinguishable. However, Magretta also says that business models do not consider competition. Combining these two ideas, Figure 1D would appear to be the best description of Magretta’s view of business models. But Figure 2 is also consistent with Magretta. In the Figure 2 view, one simply chooses not to model the firm’s competitive-position information (and possibly many other details as well) in constructing Magretta’s interpretation of a business model. For reasons that will become clearer as we work through the next two examples, we believe that Figure 2 is the more helpful view.

Second, Weill and Vitale’s (2001) book on eBusiness models presents much more detailed descriptions and examples of business models than most authors. Weill and Vitale explain their eight atomic e-business models using a specially-developed diagramming technique called e-business model schematics, such as the example in Figure 5 (which is a business model schematic for an eMarketplace such as eBay). In these diagrams, Weill and Vitale (2001) focus on *stakeholders* and *product and information flows*, but make no mention of strategy. Combining atomic models into molecular models, they suggest, provides a convenient shorthand for quickly considering a wide range of possible e-business

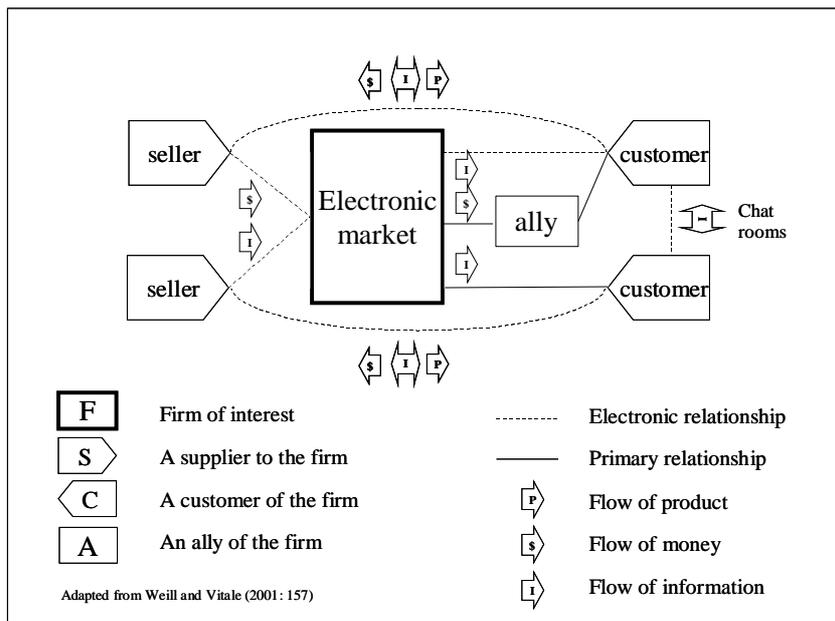


Figure 5. Example e-Business Model Schematic based on Weill and Vitale (2001: 157).

opportunities.

So how do Weill and Vitale (2001) define business models? According to Weill and Vitale (2001), an “e-business model” is:

“A description of the roles and relationships among a firm’s consumers, customers, allies, and suppliers that identifies the major flows of product, information, and money, and the

major benefits to participants.” (p.34)⁶

What is interesting here is that neither this definition, nor any of Weill and Vitale’s diagrams of atomic business models, make any mention of either strategy or competition. Weill and Vitale focus on *the who* (consumers, customers, allies, suppliers, and of course, the firm’s employees and owners) and *the what* (major flows of product, information, and money). Their business models are much more process and stakeholder focused than Porter’s conception of strategy. However, in their key table 12-3 (pp.265-7) where they summarize the properties of their eight atomic e-business models, Weill and Vitale (2001) use the term “strategic objectives” as a column heading when contrasting attributes of their atomic e-business models. Furthermore, they include a three-page section on “E-Business Strategizing” in the subsequent chapter (pp.298-300). So from Weill and Vitale’s point of view, business models have strategic objectives.

Which diagram, if any, in Figure 1 describes the Weill and Vitale’s distinction between “business model” and strategy? It is hard to say from the small amount of evidence just given, but one might well conclude that Figure 1A describes Weill and Vitale’s position. In other words, there is some overlap between the terms, but not a lot.

Again, however, we argue that Figure 1A is not helpful. If one steps back from concept-by-concept comparisons, it is apparent that the whole idea of “atomic business models” is that they can be applied to many different businesses. What Weill and Vitale describe are abstractions, not the strategies of real firms. Therefore, we argue, Figure 2 is a more helpful way of viewing of the relationship between business model and strategy than any diagram in Figure 1.

Third, Applegate’s work provides one very helpful, and one less helpful description of the term “business model”. In her 2000 paper, Applegate (2000) asks “What is a model?”. She answers by saying that in the world of business a model is

“A description of a complex business that enables study of its structure, the relationships among structural elements, and how it will respond in the real world.” (2000, p.53)

She then goes on to say that one of the properties of models is that they

“can be built before the real system to help predict how the system might respond if we change the structure, relationships, and assumptions.” (2000, p.53).

This is very helpful because it makes it clear that for Applegate, a business model is just that, a model, not a synonym for what Porter calls strategy. Although she does not discuss how business models compare to strategy, her view here is clearly more consistent with our Figure 2 than any of the possibilities in Figure 1.

However, the preceding distinction between model and strategy is not as clear in Applegate, Austin, and McFarlan (2003). In their 32-page Chapter 2, “Crafting Business Models”, there are six tables containing many detailed examples of different business models—focused distributor business models (e.g., retailer, marketplace, aggregator, infomediary, exchange), portal business models (e.g., horizontal, vertical, and affinity portals), producer business models (e.g., manufacturers, service providers, educators, advisors, information and news services, producer portals), etc.—plus examples of actual companies that have used each

⁶ Weill and Vitale (2001) explain that their definition is also very similar to Timmers (1998), another frequently-cited author on e-business models.

business model. For example, eBay.com and Freemarkets.com are firms using what Applegate et al. describe as the “Exchange” “focused distributor” business model.

The common characteristics of all these models are summarized in Applegate et al.’s (2003, p.47) Figure 2.1, which describes a business model as having three components:

- the *concept*, which “describes the opportunity and strategy”;
- *capabilities*, which “define resources necessary to execute strategy”;
- the *value* proposition, which explains “the benefits to investors and other stakeholders”

Note that the notion of business model *as model* is absent from the above description. Note also that in a concept-by-concept comparison, there is little to distinguish Applegate et al.’s (2003) “business model” from Porter’s “strategy”. In fact, the two definitions correspond so closely that we seem to have a Figure 1C situation.

Again, however, we argue that the concept-by-concept approach to understanding the relationship between business model and strategy, as depicted in Figure 1, is not helpful. Rather, Figure 2 provides a much more helpful perspective. From a Figure 2 perspective, the close correspondence between Applegate’s definition of “business model” and Porter’s definition of “strategy” is because one is just an abstraction of the other. What Applegate et al.’s (2003) tables provide are groups of abstractions of various organizations’ “core logic for creating value” (Linder and Cantrell 2000). We know from data modelling (Simsion, 2000) that hierarchies of abstractions are always linked by the term “is-a” relationship. For example, a researcher is-a person, and a person is-a living thing. Similarly, in Applegate’s example of eBay above, the business model of eBay.com *is-a* Exchange business model, which in turn, *is-a* “Focused Distributor” business model. These is-a relationships are simply signals of increasing levels of abstraction.

Summarizing, it would seem to be in accord with all the thinking above if a business model were defined as an abstract representation of a firm’s strategy. What is not clear what levels of abstraction are useful, what sort of representations should be used, and how business models should be used. These questions are so central to the question of “What is a business model?”, and so difficult to answer, that they are the topic for the next section.

Which come first: strategy or business models?

The arguments above suggest that a Figure-2 perspective may provide a more useful way of visualizing the relationship between business model and strategy than any of the diagrams in Figure 1. But what the above discussion has not addressed is: Which comes first, strategy or business models? Let us return to our three authorities on business models to see what they say on this question.

Magretta (2002) describes both business models and strategy as being of “enormous practical value”. Using examples like the traveller’s cheque business model (which led to the creation of American Express), the Dell Computer business model, and the Wal-Mart business model, she argues that thinking at these high levels of abstraction enables managers to first, conceive, and second, test out, the viability of possible new ways of doing business. For Magretta, therefore, new strategies would seem to emerge from thinking in terms of business models.

Weill and Vitale (2001) present much more detailed models. They articulate and explain their eight atomic e-business models using a specially-developed diagramming technique called e-business model schematics. As with any abstraction, they have to make choices about what to model, and what to ignore. Weill and Vitale (2001) chose to focus on stakeholders and product and information flows, and to ignore, for example, the competitive aspects of strategy. Combining atomic models into molecular models as they suggest seems to provide a convenient shorthand for quickly considering a wide range of possible e-business opportunities. So again, for Weill and Vitale, new strategies would seem to emerge from thinking in terms of combinations of atomic business models.

Finally, Applegate et al.'s (2003) six tables are, in effect, a taxonomy of the business models of many different firms, not just those running e-businesses. The purpose of their taxonomy seems to be to invite readers to compare and contrast the huge range of business models that underlie business organizations today. Abstracting from the complexity of real-world strategy simplifies these comparisons and contrasts.

A common theme in the above three articles, most evident in Weill and Vitale (2001), is that of mixing and matching various components of a business model to see which ones work and which ones don't, which suggests that strategy follows business model thinking. This idea has close parallels to the use of *patterns* and *pattern languages* in both the Architecture (Alexander et al. 1975, 1979) and Software Engineering (Coplien 1996, Manns 2001) literatures⁷. Alexander et al. (1977) define a pattern as follows:

“Each pattern describes a problem which occurs over and over again in our environment, and then describes the core of the solution to that problem, in such a way that you can use this solution a million times over, without doing it the same way twice.”

Alexander's patterns are insightful rules of thumb that capture, in a nutshell, successful principles for designing places for people to live and work⁸.

In the early 1990's Alexander's idea of *patterns* was taken up enthusiastically by a group of software engineers (Gamma et al. 1994, Coplien 1996, Manns 2001) who recognized that much of the code they wrote had regularities or patterns that were reusable in other contexts. Identifying and cataloguing patterns together with evidence of their success, they argued, provided a way of making knowledge of these patterns available to a wider community. Following Alexander, they also suggested that patterns could be combined to create a design language. According to Manns (2001), for instance:

While each pattern focuses on a specific problem, the real power becomes apparent when relationships between individual patterns are noted, forming what is known as a pattern language. While one pattern captures one successful practice, a language of patterns will document a collection of related practices, allowing truly complex problems to be solved. (Manns 2001, p.32)

The mixing and matching of business models discussed above seems like a similar idea. If each business model captures an essential insight of some way of creating economic value, business models may then, perhaps, be combined to create more complex models, and

⁷ Veryard (2000, 2001) draws a similar parallel between business models and patterns.

⁸ Examples of Alexander's patterns may be found at:

<http://www.patternlanguage.com/apl/aplsample/apl159/apl159.htm>, and

<http://www.jacana.demon.co.uk/pattern/P0.htm>.

ultimately strategies. So in answer to the question “Which comes first: strategy or business model?” it seems to us that business models come first. Like *patterns* in architecture and software engineering, they may be thought of as known successful building blocks for conceptualizing and building strategy. What those who work with business models seem to hope is that by developing taxonomies (e.g., induced from successful existing firms) and/or defining atomic and molecular business models, it will be possible to combine these to identify and evaluate new and potentially attractive strategies more quickly than in the past.

Conclusion

The terms “business model” and “strategy” are being used by millions of people but their definitions are fuzzy. If one accepts Porter’s (1996) definition of strategy as valid, then compares definitions of “business model” from a broad cross-section of the literature, e.g., as Pateli (2002) and Freeman (2003) have done, it is really quite hard from a Figure 1 perspective to distinguish between the terms. In his condemnation of the term “business model”, Porter (2001, p.73) seems to have come to the same conclusion.

But the contribution of this article is to show that there is a meaningful alternative to Figure 1 thinking. That alternative view is simply the suggestion that it may be more helpful to view a business model as an abstract representation of a firm’s strategy, as depicted in Figure 2. To understand Figure 2, one has to accept that a firm’s strategy is always firmly anchored in its own particular competitive environment. So a firm’s strategy is specific to that firm and that firm alone. By contrast, a business model can be conceived as an abstraction of a firm’s strategy. This same business model could then apply to more than one firm. Equally well, a firm’s strategy can be represented by any number of business models. Combining this idea with Magretta’s (2002) suggestion that a business model describes an organization’s “core logic” for creating value suggests the following definition for a business model:

A business model is an abstract representation of some aspect of a firm’s strategy; it outlines the essential details one needs to know to understand how a firm can successfully deliver value to its customers.

Towards the end of the paper we asked: Which comes first, strategy or business models? Our answer was that because business models are like *patterns* in architecture and software engineering (Alexander 1977, Coplien 1996, Veryard 2001)—i.e., as successful solutions to some way in which firms create value—business models come first. Just as pattern languages can be used for designing software, so, we suggest, combinations of business models could be used for “designing” strategy: thinking in terms of combinations of business models could enable strategists to mix and match various combinations of business models to create new strategies for new and existing businesses.

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