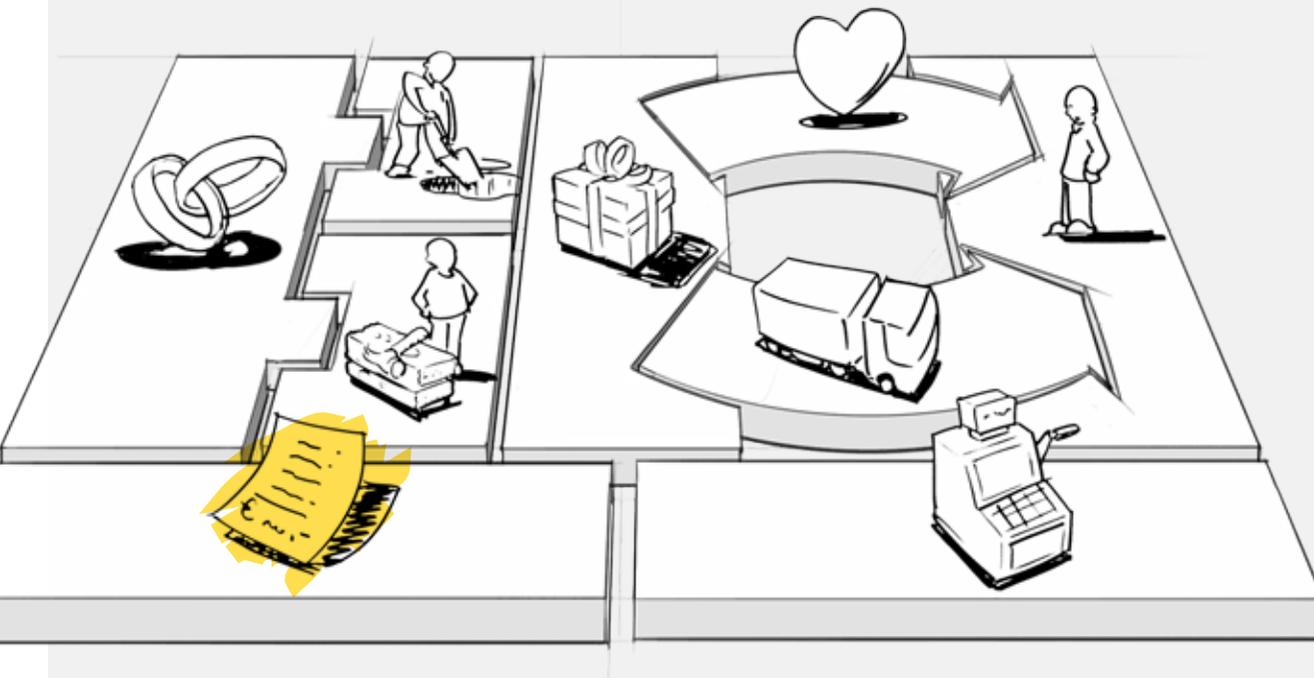


# 9 Cost Structure

## **The Cost Structure describes all costs incurred to operate a business model**

This building block describes the most important costs incurred while operating under a particular business model. Creating and delivering value, maintaining Customer Relationships, and generating revenue all incur costs. Such costs can be calculated relatively easily after defining Key Resources, Key Activities, and Key Partnerships. Some business models, though, are more cost-driven than others. So-called “no frills” airlines, for instance, have built business models entirely around low Cost Structures.



# What are the most important costs inherent in our business model? Which Key Resources are most expensive? Which Key Activities are most expensive?

*Naturally enough, costs should be minimized in every business model. But low Cost Structures are more important to some business models than to others. Therefore it can be useful to distinguish between two broad classes of business model Cost Structures: cost-driven and value-driven (many business models fall in between these two extremes):*

## **Cost-driven**

Cost-driven business models focus on minimizing costs wherever possible. This approach aims at creating and maintaining the leanest possible Cost Structure, using low price Value Propositions, maximum automation, and extensive outsourcing. No frills airlines, such as Southwest, easyJet, and Ryanair typify cost-driven business models.

## **Value-driven**

Some companies are less concerned with the cost implications of a particular business model design, and instead focus on value creation. Premium Value Propositions and a high degree of personalized service usually characterize value-driven business models. Luxury hotels, with their lavish facilities and exclusive services, fall into this category.

*Cost Structures can have the following characteristics:*

## **Fixed costs**

Costs that remain the same despite the volume of goods or services produced. Examples include salaries, rents, and physical manufacturing facilities. Some businesses, such as manufacturing companies, are characterized by a high proportion of fixed costs.

## **Variable costs**

Costs that vary proportionally with the volume of goods or services produced. Some businesses, such as music festivals, are characterized by a high proportion of variable costs.

## **Economies of scale**

Cost advantages that a business enjoys as its output expands. Larger companies, for instance, benefit from lower bulk purchase rates. This and other factors cause average cost per unit to fall as output rises.

## **Economies of scope**

Cost advantages that a business enjoys due to a larger scope of operations. In a large enterprise, for example, the same marketing activities or Distribution Channels may support multiple products.