Some Thoughts on Business Models

A Report for Industry

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REINVENT
BUSINESS MODEL INNOVATION

A WORD FROM THE EDITOR

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This report for industry consists of a series of essays on business models and business model innovation. The first essay, by Karolina Rozmus, deals with one of the conditions necessary for business model innovation, namely a willingness to leave one's comfort zone behind. Michal Jasienski and Magdalena Rzeznik suggest frameworks that can be used to rethink business models. Anna Ujwary-Gil raises the issue of intellectual property in business models and, finally, Kjartan Sigurðsson discusses corporate social responsibility and the opportunities that might be found in this realm. Together, these essays are designed to spur reflection on business models and their reinvention.

THE GOAL OF STABILIZATION

KAROLINA ROZMUS

The recent financial crisis brought about drastic changes and uncertainty in companies. Many were forced to shut down their operations and people had to look for new job opportunities. More fortunate companies experienced only stagnation, which frequently resulted in the need for downsizing and layoffs as well as changes to other aspects doing business. Even today, a few years after the financial crisis, the economic and political situation is still somewhat unstable and many companies appear to have opted to enjoy the comfort zone rather than look for new market opportunities. These companies simply do not want to risk another "shock to the system" brought about by external forces. They rationalize that there is no reason to expand and target new customer segments, as this will bring about uncertainty. As a result, stability can easily become a prevailing objective and success if viewed as staying unchanged.

This quest for stability brings about fear of failure and taking risks. The people in a company, the organizational culture and internal communication can all fall into the trap of contributing to the quest for stability. A company striving for stability is likely to be full of people who are metaphorically hiding from new opportunities. Success and growth are not likely to happen in such a company.

A company's goals define where the company wants to be at some point in the future and what it wants to achieve. The goals can relate to any areas of the business that determine success. By their very definition, goals imply movement and change and, thus, do not sit well with the goal of stability. The stability goal is likely to lead to bypassing opportunities and the wish for risk-free work can be expected to hold companies back from exploring and finding new market opportunities.

Change in a company creates uncertainty and is frequently met by resistance, because it requires the whole company to leave the comfort zone, the everyday work routine. Fruitful change requires reaching beyond the safety net and routine behaviors. Managers and entrepreneurs need to look past entrenched business models, especially during difficult economic situations.

Companies can sit around and wait for that phone to ring or get out and reach out to new customers, improve their value proposition, strengthen channels of communication, look for new partners, change cost structures and look for new revenue streams. Companies should not settle for their current business models; they should constantly work towards improving them, by looking for new ways to create, deliver and capture value.

Behind every successful business model there is a team that works together towards creating, delivering and capturing value for the company and for its customers. Therefore, companies should encourage risk-taking and discourage the quest for stability. To quote Steve Jobs, they should „stay hungry, stay foolish."

RECIPROCITY IN BUSINESS MODELS

MICHAL JASIENSKI

Robert Axelrod's theory of cooperation may be used as a useful vantage point from which to assess business models aspects. The theory focuses on types of interactions between agents (i.e. individuals, organizations, countries) and explores what conditions must be fulfilled for sustained cooperation. The theory shows that cooperation based on reciprocity (the, so called, "tit-for-tat" strategy) generates benefits for both parties and minimizes costs of potential disputes.

Axelrod provides recommendations for how cooperation based on reciprocity can be started and maintained. First, emphasize the importance of and promote reciprocity as a valued and respected type of activity. Establish customs rewarding cooperative behavior (e.g. awards or any other forms of recognition) and introduce ways of discouraging individuals from abusing the system, i.e. by avoiding "giving back" in reciprocation. Teach business partners about the profound role reciprocity plays in business activities.

Second, increase the extent of what Axelrod calls "the shadow of the future", i.e. the expected length of time for cooperation to continue. An open-ended relationship is one without a foreseen end point. Reciprocity flourishes when both partners assume that their interactions (and, therefore, opportunity for retaliation) will continue forever.

Third, improve recognition abilities, i.e. use various forms of identification (labels, badges, uniforms, logos) through which business partners or customers will be easily recognized and acknowledged. Only then can the parties be sure that their acts of cooperative behavior will not go unnoticed or unrecorded, which would jeopardize reciprocity. In addition, create a system that records feedback, comments, outcomes of past interactions (analogous to eBay's system of points), based on which trustworthiness can be established. The higher the trustworthiness, the more likely it is that cooperation will be continued.

Below, the relevance of Axelrod's theory of cooperation relative to some key components of business models is considered.

KEY PARTNERS

The track record of interactions with business partners may be used as a criterion for determining which partners are more important for a company than others. The main features to take into account could be: the role played in business activities, the length of the relationship, the number and severity of disagreements, the ease with which the partner can be substituted, etc. Furthermore, strong reciprocity-based relationships maintained with suppliers and other business partners may have beneficial effects on the financial aspects of the business model. A cooperative climate may facilitate e.g. renegotiation of payment schedules, acceptance of better interest rates, etc.

CUSTOMER RELATIONSHIPS

Customer loyalty should be actively built and cultivated by the company. Loyalty arises from repeated interactions during which both parties show trust, honesty of intentions, and readiness to respect their business obligations.

COST STRUCTURE AND REVENUE STREAMS

Loyal customers may be willing to pay more for products or services based on the quality of past interactions. The trust built during repeated interactions can make higher costs much easier to justify by customers, based on the reciprocal beneficial relationships that competitors do not provide. Based on past experience, repeat customers are assured of higher quality services or products, and this relieves them from the necessity of paying for potential mediation or arbitration in the case of business conflicts.

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FRAMING THE BUSINESS MODEL INNOVATION PROCESS

MAGDALENA RZEZNIK

It is not easy to change an entrenched business model, especially for larger companies with long track records. However, remaining in the market and maintaining competitive advantage make business model innovation necessary. Business model innovation can be approached in a systematic fashion. One potentially useful heuristic method is SCAMPER, created in the world of advertising in the 1930s and also developed independently in the context of engineering. It is a mnemonic constructed from the first letters of each of the seven potentially useful procedures: Substitute, Combine, Adapt, Modify, Put to another use, Eliminate and Reverse. It consists of a set of simple questions aimed at stimulating creativity and, by suggesting counterintuitive ideas, at removing mental blocks, which can prevent solution finding. This tool can be useful for thinking about how existing business models can be improved by changing some or all of their components. Examples of how the SCAMPER method can be used are presented below.

VALUE PROPOSITION – MODIFY?

A value proposition can be modified through product range extension or by increased frequency of offerings. By changing inventory weekly, a particular product will not be available in a few days, so the client must buy it now or never. For example Tchibo, which produces and supplies coffee, has expanded its offering beyond coffee and related products, with a wide range of carefully selected products that make up its changing weekly offering of clothing, shoes, household and office articles, electronics, etc. Zara uses a similar approach in its stores.

CUSTOMER SEGMENTS – SUBSTITUTE?

When current customers do not show sufficient interest in a company's products, the customer segment can be substituted. Assumptions about a product and its uses can be changed. For example, Segway originally assumed that their product would revolutionize the way people move. However, its innovative solutions such as electric drive and control using gyroscope did not meet with interest from customers. The substitution of the target audience and offering the product to security companies and the police was successful and currently many shopping malls and exhibition halls are patrolled by people on Segways.

CHANNELS – COMBINE? REVERSE?

Channels can be combined and used together to reach customers in new ways. For example, Tchibo combined its traditional channels for reaching customers, i.e. brand stores, with an on-line store offering the same products. Some package-delivery companies offer automated package pick-up locations, where the customers themselves can go to pick up their mail, i.e. the traditional roles have been reversed: the customer becomes active and the delivery service company becomes passive during the final stage of delivery.

REVENUE STREAMS – MODIFY? ELIMINATE?

Reducing prices or promotional pricing are potential ways to espouse to the philosophy of "less is more". In the long term this can lead to increased profits since the increased appeal of lower prices and resultant higher sales could more than compensate for lower revenue per item. For example, a complex of geothermal pools in southern Poland attracts visitors by offering, in addition to traditional family discounts, free use of the swimming pools on selected days for every fifth visitor.

KEY PARTNERS - SUBSTITUTE? ELIMINATE?

Substituting key partners can lead to an improvement of the entire business model. The key questions here are whether someone else could do things better and even whether some partners are simply redundant. For instance, a consulting company could substitute cooperation with a partner in the field of information technology services by its own team of software developers. As a consequence, software development can further enhance the company's value proposition and enrich its range of services.

COST STRUCTURE – MODIFY? ELIMINATE?

One way to reduce costs is to replace traditional forms of employment with outsourcing. This is an attractive option for companies to not do everything by themselves and can expand the scope of business and at the same time reduce employment costs.

KEY ACTIVITIES – COMBINE?

Apart from traditional activities, a company could offer more to its customers by combining a product with a service. For example, the Polish brand Irena Eris, in addition to producing a wide range of cosmetics, offers its customers a network of spas that provide wellness services based on its own products.

KEY RESOURCES – SUBSTITUTE?

Enhancing diversity in the employee group can be an effective way to introduce a new spirit. Heterogeneity in the team may have a positive impact on its creative potential: to build a creative team, its composition could be diversified to consist of people with a broad array of personalities and talents (even including employees not trained in a given area), which complement each other, leading to new opportunities.

CUSTOMER RELATIONSHIPS – COMBINE? ADAPT? PUT TO ANOTHER USE?

Customer relationships may be strengthened by multiplying the benefits delivered to customers. A strong message that the company cares for customers and that it will try to meet its needs and be available when convenient for them can work wonders. The club-cafeteria Rodzinka in Nowy Sacz is a good example of such a company. This is a cozy and friendly place for both seniors and for parents with children where the owners combine professionalism with passion and commitment. They support comprehensive development of children aged 0-12 years through creative and constructive play and workshops under the supervision of specialists. The cafeteria is adapted to support the building of social bonds, assists in establishing contacts with peers, integrates generations and gives parents a meeting place to exchange their parenting experiences. At the same time it helps the company to maintain and strengthen the relationships with clients.

BUSINESS MODELS AND INTELLECTUAL CAPITAL

ANNA UJWARY-GIL

Each business model has a value proposition at its heart. The value proposition defines how a set of products or services can create value for specific groups of customers. Intellectual capital has been found to be positively related with value creation as well as financial performance. Hence, intellectual capital should be considered when developing business models. Intellectual capital can be viewed as the result of interactions between three main components, namely: *human*, *structural* and *relational* capital.

Bearing this in mind, the components of intellectual capital can be mapped onto components of business models. Among key resources of a business model are the establishment of a brand name, customer base, and know-how, which together form the *structural* capital of an enterprise. The key activities of a business model, viewed from the context of *human* capital, comprise the knowledge and skills required to resolve problems and develop solutions. *Relational* capital encompasses business relationships with customers, partners and competitors.

From the perspectives of both business models and intellectual capital, the value created by an organization changes over time due to the emergence of innovations and improvements and modifications of products or services. This value increases when a customer decides to purchase. Pricing does not affect the creation of value, but determines how the value is shared between the organization and the customer. Customer surplus increases if the price of the product is reduced, or if its quality is improved without an increase in price.

The Business Model, Intellectual Capital and their Measured Outcomes

Although not used much, established methods and tools for evaluating business models do exist. One such tool is the Intellectual Capital Accounting Model, in which the following questions are posed:

What is the composition of resources (assets) that creates value?

What steps have been taken to upgrade skills and further develop resources (what investments have been made)?

What are the consequences of applying knowledge, innovation and strategic choices in the functioning of the organization (what is profitable)?

Another good example is the method for measuring intellectual capital called The Intellectual Capital Statement (ICS). In this approach, the focus is on an organization's business model including value creation and a business strategy. The basic issues concerned with value creation of a business model include a determination of what the organization sells (products, services or product-service combinations) since the generated value is determined by what the enterprise offers to its customers. Furthermore, how value is determined basically concerns major business processes. Other issues relate to the benefits customers gain through services and products, market segments, key customer groups, key suppliers, method of customer payment, as well as how prices for products and services are viewed in the marketplace by customers (see Figure 1).

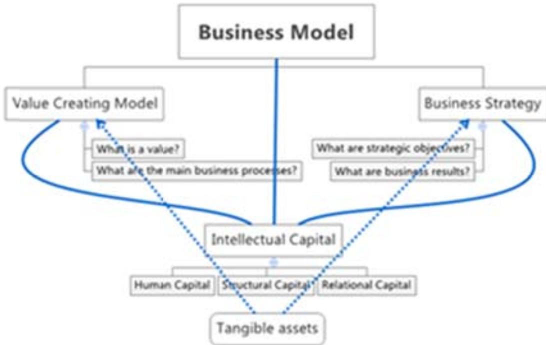

Figure 1: The Trajectory of the Business Model

It is worth emphasizing that measurement and operationalization of business models poses a challenge when it comes to a decision as to what should be the subject of these measurements (resources and tangible assets while being important, are not the only areas of the business model).

The methods of measurement and operationalization of intellectual capital are focused mainly on the recognition of so-called status quo of organizational (intangible) resources. Similarly, in the case of business models, the presentation of their components is carried out without a broader discussion, which would allow deeper interpretations of the dynamics of change, links and relationships between them.

Basically the dynamic approach to intellectual capital is connected to obtaining resources from inside or outside of an enterprise. These resources offer the potential for creating value. Such value is created when resources are utilized, while it is wasted when they are left unused. The static nature of intellectual capital (like a status quo of intangible resources) indicates just a potential to something more dynamic (resources that can be used or implemented). The dynamic nature of intellectual capital indicates his actual or possible use. Thus, the dynamic approach for the measurement of a business model and its components should include an analysis of the changes, processes, and flow of resources where potential value could be created or wasted. The challenge is to measure and manage the dynamics of resources (assets), examine how resources are interrelated and how a change in one resource results in changes in another and thereby leads to changes in the business model.

The Opportunities of Corporate Social Responsibility

Kjartan Sigurðsson

There are indications that the implementation of a strategy for corporate social responsibility (CSR) can raise competitiveness. There are a number of important issues that need to be taken into consideration when businesses deliberately consider their ethical position and attitude toward socially responsible behavior.

First, it often happens in organizations that instead of examining the company's resources in order to develop a CSR strategy, they try to take a shortcut and only develop some aspects of sustainability through established standards, such as ISO standards. This is done to gain a level of acceptance from the economic environment. However, this kind of piecemeal approach is likely to lead to problems and compromised credibility. If ISO standards for environmental sustainability are implemented only in some departments of a company or for some activities, the positive message will be confused when looking at other departments or activities.

It is important to recognize that a holistic CSR strategy spreads vertically and horizontally across all departments and functions. Although implementing a holistic company-wide CSR strategy may seem daunting, it is in fact likely to save work down the road since the need to bring previously ignored departments and functions in line with the CSR strategy can be expensive and time-consuming.

The implementation process for CSR strategy starts with researching what might be done better and what is already being done appropriately with regards to three dimensions: the environment, employees and society.

The process involves reviewing the company's infrastructure and organization to create a good working environment for employees resulting in positive internal and external views of the organization. Most important is to understand what kind of strategy fits with the organization and questions should be asked about why the organization should change, how it should change and what should be implemented to gain further competitiveness and attractiveness on the market.

A CSR strategy needs to be formalized in writing so that it can serve as a guide for all activities. Furthermore, a written CSR strategy will prove its usefulness when an organization wants to report on its achievements, for example how it works to improve the environment, how employees are treated, and how it contributes to the benefit of society. At the same time, it is worth noting that adopting standards, such as ISO standards, or GRI can involve high administrative costs, which may not be necessary, particularly if the CSR strategy is transparent to employees, customers, shareholders, stakeholders, etc.

There are always costs involved when an organization decides to implement new strategies and processes. Implementing a CSR strategy may be driven by the opportunities foreseen, such as potential growth, or it can stem from customers or other stakeholders that put pressure on the company to change and commit to, for example, ethical standards.

The CSR strategy implementation process in an organization should aim to create a better working environment, to become known for being helpful in the society by giving something back in return for what they earn and to respect the environment by doing everything possible to minimize negative environmental impacts. This can include innovating to change from old production methods to environmentally friendly production.

It is dangerous to box in regulations for CSR in order to set limits and build a standardized environment around CSR because opportunities for an organization to differentiate through its CSR strategy may lead to the creation of uniqueness that cannot be copied by competitors. The opportunities are to be found in a free market environment where organizations develop their own limits of morality that go beyond what laws and regulations stipulate.

So why should organizations not implement the ISO or GRI standards as mentioned above? It is not that the standards are seen as something negative, on the contrary, they can serve an organization quite well. It is more about what should come first (prioritization) in the implementation process to reach corporate social responsibility and how organizations can make sure they are not spending time and resources just to follow some track that competitors are stuck in and does not differentiate them from others.

It should be kept in mind that implementing a CSR strategy as a core business strategy or an umbrella that guides all functions can be used as a tool for differentiation. Moreover, such a strategy can help organizations to rethink their working environments to appeal to employees, spur innovation, and raise environmental issues and contributions to society to the forefront.

About the Reinvent Project

Business model innovation has to do with inventing and implementing new models for doing business and creating value. As such, business model innovation can be viewed as a process of transformation and reinvention (hence, the acronym for the project).

Because of the unique importance of small and medium-sized enterprises (SMEs) and the creative sectors for Europe, Reinvent has SMEs in creative sectors as its focus.

The aim of the Reinvent project is to develop and share knowledge about how SMEs in creative sectors – SMEs operating in both digital and non-digital markets – can implement business model innovation as a means to enhance competitive advantage. Reinvent creates opportunities to evaluate and validate business model innovation as a competitive tool for European SMEs through empirical research among SMEs in the three partner countries: Iceland, Poland and Denmark.

The Reinvent project is funded by the Marie Curie Industry-Academia Partnerships and Pathways Program (IAPP). Project number 324448.

The Reinvent Project can be followed here: http://reinventproject.wordpress.com/