Business Model Innovation

Keep on growing by reinventing your business

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Attractive and strongly-growing markets magically attract companies. Here, they see the chance to get the best return on investment. This inevitably leads to an increase in competition, often combined with falling prices and overcapacity. The mobile phone market is a good example. Twenty years ago, mobile phones were expensive luxury products, reserved for important decision-makers who had to be reached at any time. Today, mobile phones are mass products and producers are facing strong competition and price pressure.

How can a company react if its target market is becoming increasingly unattractive?

- The company can withdraw by selling the business unit with which it serves this market and use the proceeds to enter more attractive industries.

- The company can take over competitors and thereby neutralize them.

- The company can strengthen its competitive advantage through optimisation measures. These include re-designing processes, changing the organizational set-up, focusing on the most profitable products or widening the product portfolio to address new target groups.

Companies in tight markets embrace these strategies with various degrees of success. These strategies have one element in common: They are located within the current business model. Existing market conditions are taken as a given and companies try to adapt either by moving out, eliminating the competition or by doing the same thing as in the past, but better.

Business model innovation is a radically different approach. Here, companies are not satisfied with doing the same thing *better,* but they are looking for new ways to do things *differently*. The music industry is a good example: Triggered by the technological capabilities of the Internet, an increasing number of music titles is downloaded from the Web. This new business model has dramatic consequences for the producers of music CD´s, which have not yet found a convincing answer to this development.

What is a business model and how can it be changed?

A business model consists of four building blocks

1. Value proposition. The guiding question: Which benefit (or value) do we offer to which target group? The value not only lies in a specific product, but also in how it is provided. Returning to our music industry example: The music title remains the same, but downloading it from the Internet is completely different from purchasing a CD in a retail shop.

2. Resources. The guiding question: Which resources do we need to provide our value proposition? Resources include, e.g. people, resellers, channels, technology, information and brands.

3. Processes. The guiding question: Which processes do we need in order to market our value proposition profitably at a consistent quality level? Processes include, e.g., product development, purchasing, production, marketing and personnel recruiting.

4. Profit model. The guiding question: How do we generate profit? This includes, e.g., managing costs, exploiting economies of scale, inventory turnover and processing time.

How to find ideas for new business models
To find ideas for new business models, apply the above four guiding questions to your business and add the word ´other´. Example: ´In which *other* ways can we make our products available to our clients?

Examples

- Hilti, Liechtenstein, no longer *sells* its power tools, but *rents* them to its customers.

- Faced with economic difficulties, Danish Lan & Spar-Bank transformed itself into a direct bank at the end of the 1980´s – 6 years before the first internet-based online banks emerged! Instead of offering its services in the bank (the classic business model), Lan & Spar offered them over the telephone (and later over the Internet).

- Unlike the classic furniture shop, IKEA offers its products as an assembly kit, not as a finished product.

If your value proposition (building block No. 1 of the business model) is made available through other channels (online instead of physically) or in another form (assembly kit instead of finished product), this has far-reaching consequences for the other three building blocks of the business model (resources, processes, profit model). They must be adapted and, if required, radically changed so that the new value proposition can be marketed successfully.

Example Hilti

- Resources and processes: With the classic business model (sales of power tools) the focus was on channel management and production in low-cost countries. With the new model (renting power tools), the focus is on direct customer contact, managing rental contracts and on IT-based warehousing.

- Profit Model: With the classic model, Hilti could only realize low margins and the focus was on managing high inventory turnover. With the new model, margins are significantly higher and the focus is on inventory management, repair and on the exchange of rented power tools.

A step-by step approach to developing a new business model.
You can check whether a business model change is the right approach for your company based on the following steps,

1. How has your market developed over the past 3 years? How will it develop in the future? An increase in competitive intensity, falling prices and easily interchangeable products (´commodities´) are indicators of decreasing market attractiveness. If you are in such a situation, immediate action is required.

2. Start by asking how your existing business can be improved. Which processes can you optimise? Which products should be eliminated as they generate losses? The next question: How can you build new USP´s (unique selling propositions?) E.g. is there a possibility to improve existing products or to launch new products with strong competitive advantages? If you cannot improve your products at short notice, check whether you can build competitive advantage by offering product-enhancing services, e.g. maintenance contracts, customer consulting, training or remote monitoring.

3. The approaches introduced in 2. are still located within the boundaries of your current business model. Basically, you keep doing what you have done in the past, but you do it better or in a more cost-effective way. If the resulting competitive advantage is only marginal or if it can easily be copied by the competition, ask what you can do fundamentally differently. Now you start thinking about a possible change of your business model.

4. Ask the following questions:

   - What do our customers really want? Hilti discovered that its customers were not really interested in purchasing and maintaining expensive power tools. Rather, they needed the right tools at the right point of time in perfect condition to perform a given task (e.g. drilling a hole).

   - Which possibilities are there to provide our products in a different way? E.g. renting instead of selling (Hilti), via Internet instead of physically (Lahn & Spar-Bank), as an assembly kit rather than as a finished product (Ikea).

   - Is there a possibility to position our business as a service provider, not as a product seller? Example: In the beginning of the 1990´s IBM transformed itself from a producer of mainframe computers into an IT service provider which <u>also</u> sells computers, thereby escaping bankruptcy.

Summary

In markets with shrinking attractiveness, characterized by falling prices, strong competition, and easily interchangeable products, companies must act to defend their market position. First, they should find out whether new competitive advantage can be built by optimising processes, improving existing products, introducing new products with strong USP´s or by offering product-enhancing services.

If these approaches do not produce convincing results, decision-makers should ask what they can do to change their business model. Going through a systematic process, they can analyse the four building blocks of their business model (value proposition, resources, processes and profit model) and develop ideas for change.

The examples discussed above show that business model innovation is possible in every industry. The mindset of upper management is the most important success factor. Business leaders must be willing to shed traditional beliefs and to adopt radically new perspectives to remain competitive in the long term.