

Business model innovation

Game-changing the future

Part 2 – Understanding innovation

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What is business model innovation? In order to answer this question, we need a framework to identify the key drivers of value within a business.

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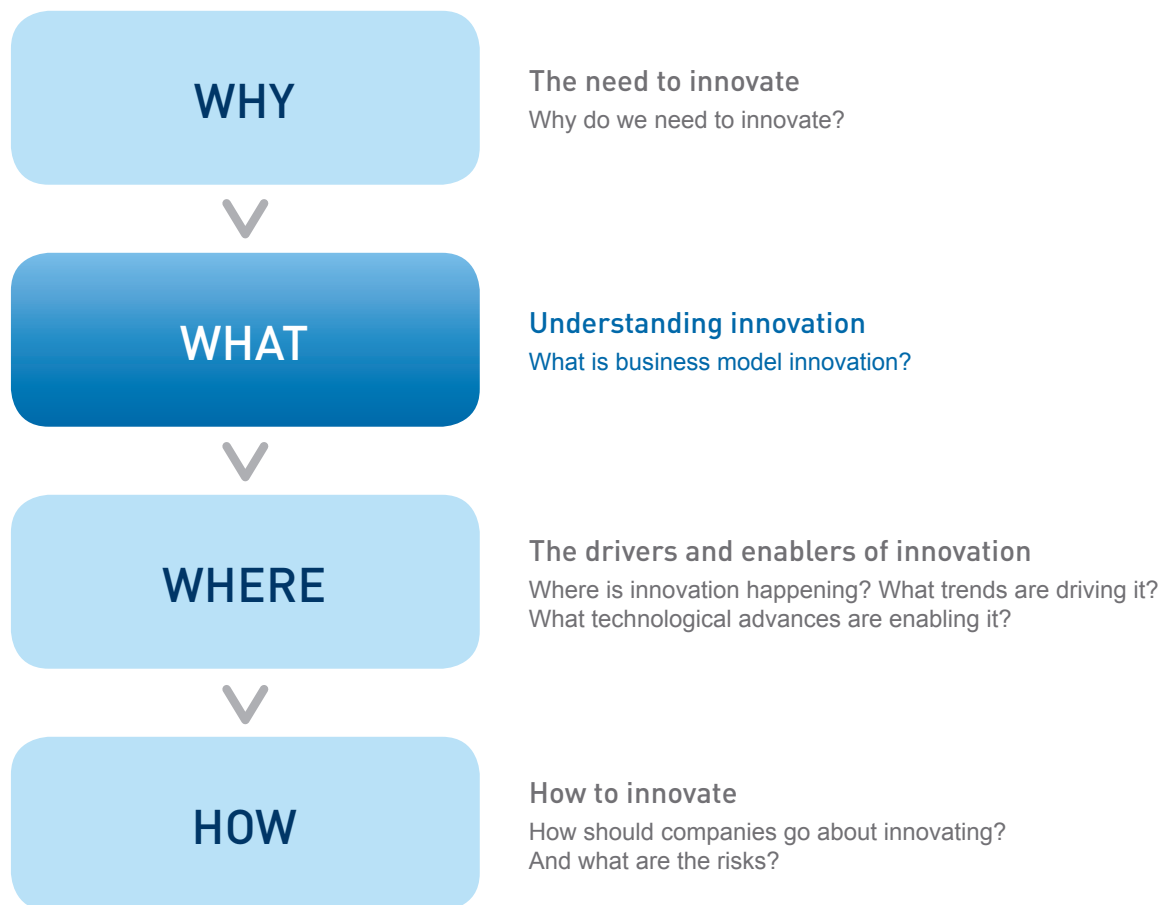
1

Overview

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Understanding innovation

What is business model innovation? In order to answer this question, we need a framework to identify the key drivers of value within a business.



Introducing the Business Model Canvas

If business models are the recipe for creating value, what are the ingredients? The Business Model Canvas is a visual framework comprising nine segments, or building blocks, that enable us to identify the key drivers of innovation within an organisation.

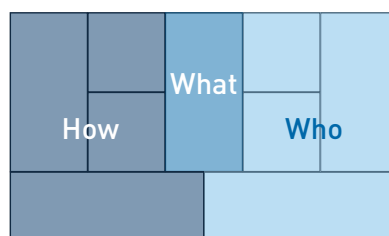
The Business Model Canvas



Source: Business Model Generation, Alexander Osterwalder and Yves Pigneur, 2010, businessmodelgeneration.com

The nine building blocks represent three distinct segments of a business model.

The left segment comprises Key Partners, Key Activities, Key Resources, and Cost structure and represent the resources a company uses to deliver its services and products. It identifies **how** services and products are produced and the costs involved.



The central building block, Value Proposition, describes the bundle of services and products that are offered by a business. It identifies **what** is offered to customers.

The right segment comprises Customer Relationships, Customers Segments, Channels and Revenue streams and represents **who** the business sells its services and products to, and **how** these are delivered to market.



The Value Proposition

The Value Proposition describes the bundle of services and products that creates value for a Customer Segment. It is the reason customers choose one company over another. It solves a problem or satisfies a need. It may be quantitative (price, speed) or qualitative (design, customer experience).

Newness

Satisfy an entirely new set of needs that customers previously did not perceive because there were no similar offerings (mobile phones)

Performance

Improving product or service performance has been a traditional way of creating value but it is difficult to defend against competitors

Customisation

Tailoring products and service to individual customer needs. Mass customisation and customer co-creating are becoming increasing evident in new and innovative business models (Lego)

'Getting the job done'

Value can be created by simply helping a customer to get certain jobs done, (airline manufacturers rely on Rolls Royce to manufacture and service their jet engines)

Design

Design plays a critical role in fashion and consumer electronics industries (Apple)

Brand/status

Brand plays a critical role in fashion and consumer electronics industries (Nike)

Cost reduction

Customers value products and services that help them lower their costs (Salesforce.com sells a hosted Customer Relationship management application that means their customers do not have to buy, install and manage CRM software themselves)

Price

Offering similar value at a lower price is a common Value Proposition, but is difficult to defend against competitors

Risk reduction

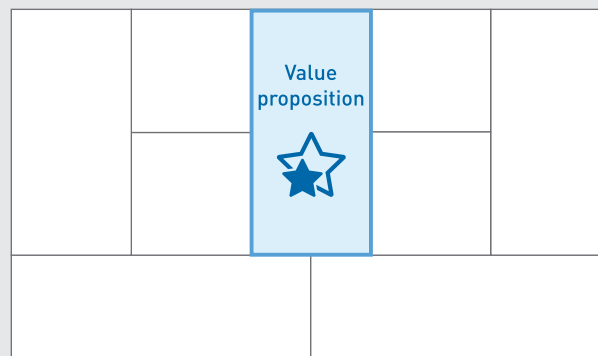
Customers value reducing the risks they incur when purchasing products or services (three year warranty)

Convenience/ usability

Making things more convenient or easier to use can create substantial value (iTunes offers Apple customers convenient searching, buying, downloading and listening to digital music)

Accessibility

New technologies and business model innovation can allow products and services to be made available to Customer Segments which previously did not have access to them (NetJets popularised the concept of fractional private jet ownership)



Source: Business Model Generation, Alexander Osterwalder and Yves Pigneur, 2010, businessmodelgeneration.com



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Creating value

Businesses create value (and create their Value Proposition) by leveraging Key Partnerships and Key Resources to perform Key Activities.

Key Partnerships

Key Partnerships are the network of suppliers and partners that make the business model work. There are three main motivations for creating partnerships.

Optimisation and economy of scale

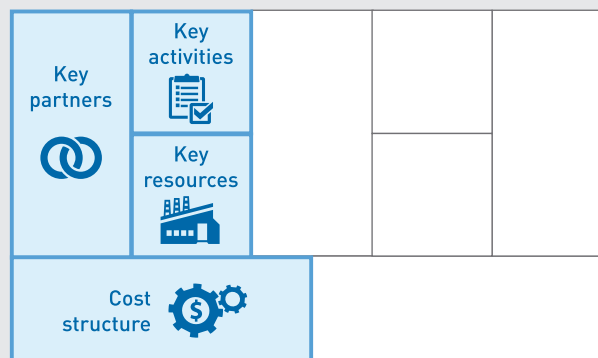
Partnerships focused on reducing costs, and typically involve outsourcing or sharing infrastructure.

Reduction of risk and uncertainty

It is not unusual for competitors to form strategic alliances (Blu-ray was developed by a number of consumer electronic manufacturers acting cooperatively, but they still compete against each other in selling their own Blu-ray products).

Acquisition of particular resources and activities

Few companies own all the resources required by their business model. Rather than increasing their own resources and activities, they can outsource. Such partnerships can be motivated by the need to acquire knowledge, licenses or access customers (an insurer may rely on a network of independent brokers rather than an in house sales and marketing division).



Cost Structure

Cost Structure identifies the most important costs incurred by a particular business model. Creating and delivering a Value Proposition incurs costs. These costs can be readily identified and are driven by Key Partnerships, Key Activities and Key Resources.

Whilst costs are important for all businesses, they are critical for cost-driven business models such as low-cost airlines. These business models typically feature low price Value Propositions, high levels of automation and extensive outsourcing.

Economies of scale (cost advantages derived through volume) and economies of scope (costs advantages derived through multiple products or services being supported by a common infrastructure such as a marketing or distribution division) are a well known feature of many business models.

Source: Business Model Generation, Alexander Osterwalder and Yves Pigneur, 2010, businessmodelgeneration.com



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Creating value

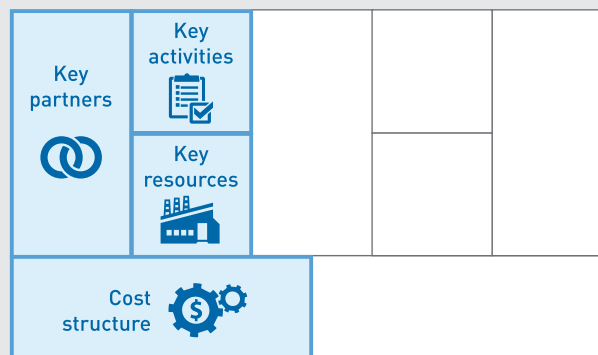
Businesses create value (and create their Value Proposition) by leveraging Key Partnerships and Key Resources to perform Key Activities.

Key Activities

Key Activities represent the most important things a company must do to create and deliver its Value Proposition. Depending on the nature of the business, key activities could be:

- Production
Relates to designing, making and delivering a product (typical of manufacturing businesses)
- Problem solving
Business models for consultancy and service businesses require new solutions for customer problems and require activities such as knowledge management and continuous training

- Platform/network
Many technology businesses build their business model around a platform. (eBay is required to continually develop and maintain its website platform. This involves platform management, service provisioning and platform promotion)



Key Resources

Key Resources are the assets required to allow a business to create and deliver its Value Proposition. Key Resources can be owned, leased or acquired through Key Partners and typically comprise:

- Physical
Retailers such as Coles and Amazon.com rely heavily on physical resources such as buildings, point-of-sales systems and distribution networks.
- Intellectual
Intellectual resources include brands, proprietary knowledge, patents and copyrights, partnerships and customer databases. Consumer goods businesses such as Nike and Sony rely heavily on brand as a Key Resource. Apple and MYOB depend on software and intellectual property developed over many years.

- Human
All businesses require human resources, but these are particularly critical in knowledge-intensive and creative industries. (consultancies)
- Financial
Financial resources can be used by non-financial businesses to support their Value Proposition. (Xerox financing)

Delivering value

Businesses deliver value (and deliver their Value Proposition) to Customer Segments through Customer Relationships and Channels.

Customer Relationships

Customer Relationships describes the type of relationship a company has with each of its Customer Segments. Relationships are critical for customer acquisitions, customer retention and upselling.

Customer Relationship can range from automated to personal:

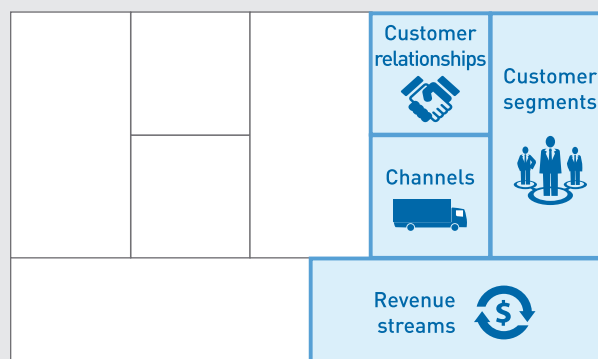
- dedicated personal assistance
- personal assistance
- self-service
- automated services

Customer Segments

Customer Segments are the different customer groups a Value Proposition is directed towards. A customer group should be treated as an individual Customer Segment if:

- their needs require and justify a distinct offer
- they are reached through different Channels
- they require different types of Customer Relationships
- they have substantially different profitabilities
- they are willing to pay for different aspects of the Value Proposition

Customer segments include: mass market, niche, segmented, diversified and multi-sided



Channels

Channels are the routes through which a company delivers its Value Proposition. Channels are used as touch points with customers to:

- raise awareness about products and services
- help customers evaluate the Value Proposition
- facilitate the purchase of products and services
- deliver the Value Proposition to customers
- provide after-sales support

Companies can use their own channels or those of their partners. Owned channels include websites and retail networks. Partner channels include wholesale distribution, retail or partner-owned websites. Partner channels tend to have lower margins, but allow a company to expand its reach and benefit beyond its own infrastructure.

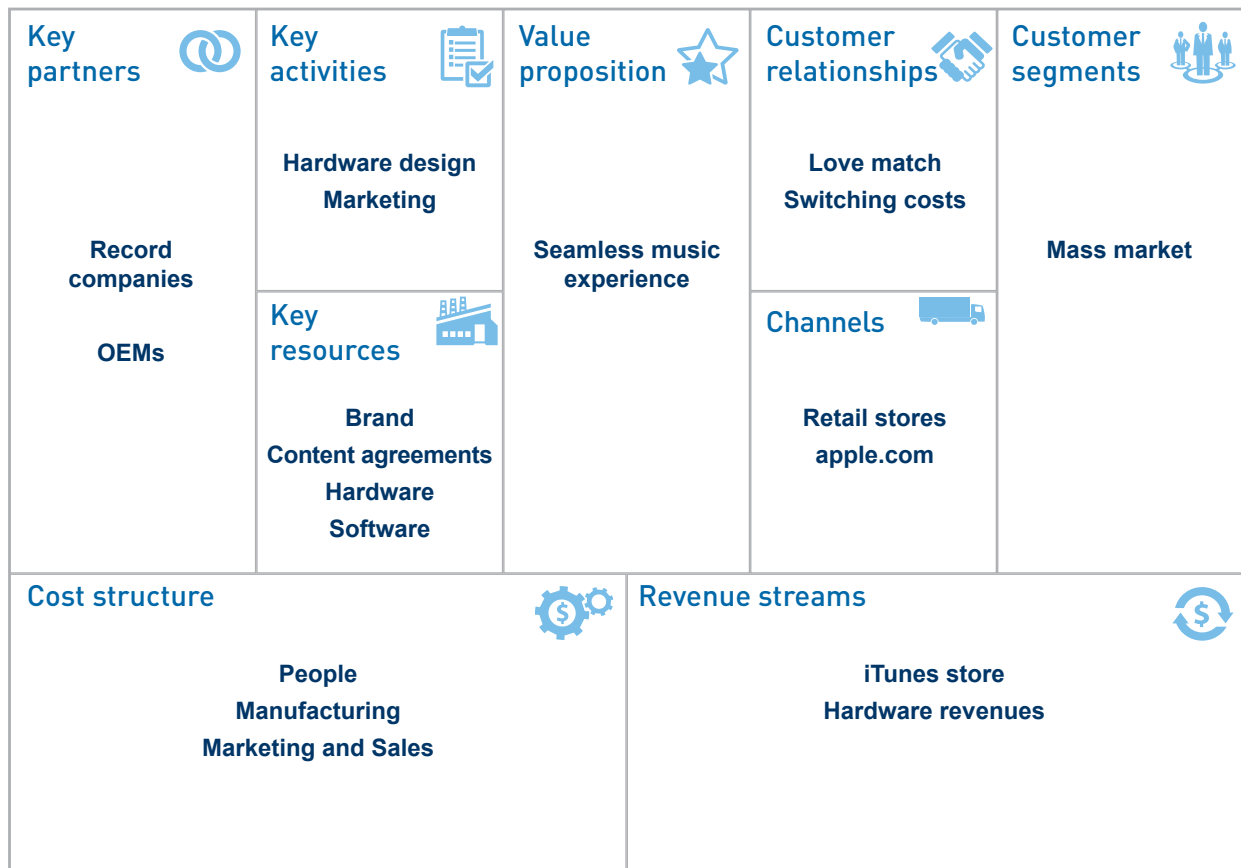
Revenue Streams

Revenue Streams represent the income generated from each Customer Segment. Each Revenue Stream may have a different pricing mechanism. Pricing mechanisms include Fixed 'Menu' Pricing (list price, product feature dependent, customer segment dependent, volume dependent) or Dynamic Pricing (negotiation, yield management, real time market and auctions).

The Business Model Canvas in action

Apple's iTunes store (in combination with its iconic iPod product) disrupted the music industry and quickly gave Apple a dominant position. Apple was not the first entrant into this market, but it was by far the most successful. We can apply the Business Model Canvas to identify the drivers of Apple's success.

iTunes business model canvas



Source: Business Model Generation, Alexander Osterwalder and Yves Pigneur, 2010, businessmodelgeneration.com

Unlike earlier market entrants such as Diamond Multimedia (Rio portable media players), Apple's Value Proposition offered a seamless music experience that combined well designed iPod hardware with a curated music purchasing experience via iTunes software and an online store. To deliver this Value Proposition, Apple had to negotiate content sharing agreements with the major record companies. In doing so it created a valuable asset – the world's largest online music library.

To cement its position, Digital Rights Management restrictions made it difficult for existing customers to switch to competitors who tried to subsequently emulate its business model.¹



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Applying the Business Model Canvas

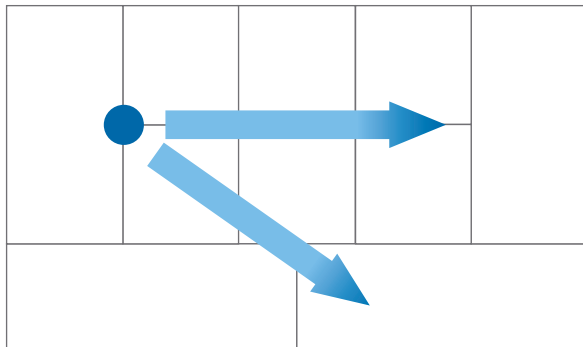
Once we understand how to identify the core components of business model innovation, we can apply this to understand and evaluate real life business models.



Epicentres of business model innovation

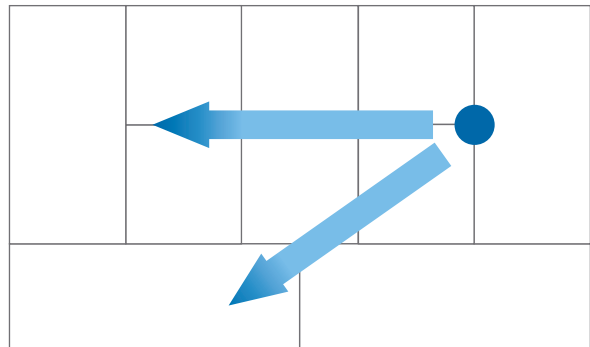
Business model innovations can arise from one or more epicentres. Whatever the starting point, they tend to have a transformative impact on most, if not all, aspects of a business.²

Originate from existing infrastructure or partnerships



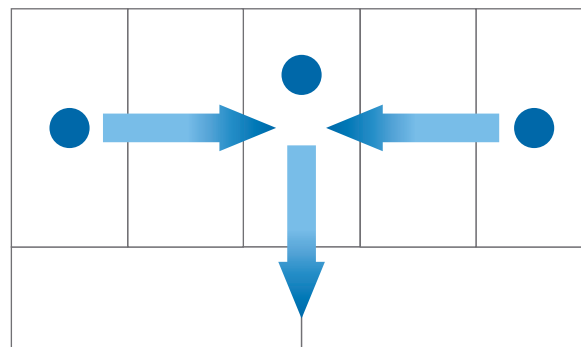
Amazon Web Services built on top of Amazon.com's retail infrastructure to offer cloud services to other companies

Originate from customer needs



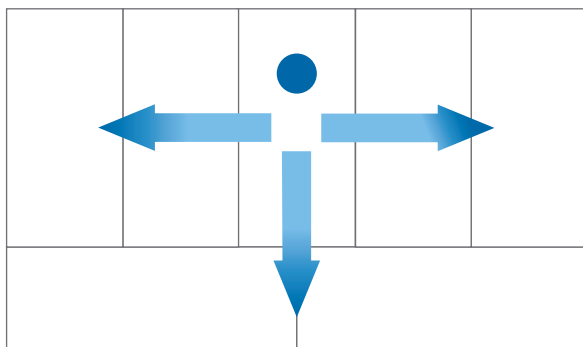
23andMe brought personalized DNA testing to individual clients – an offer previously available exclusively to health professionals and researchers.

Innovations driven by multiple epicentres can transform a business



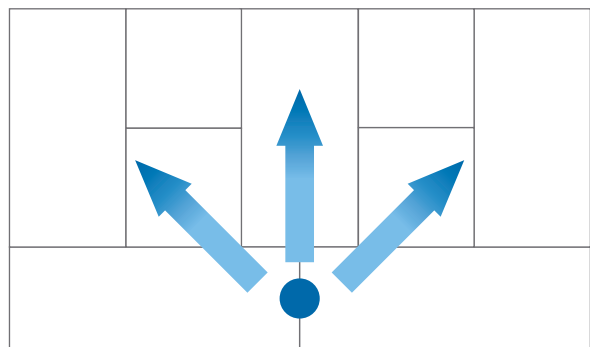
Hilti, a manufacturer of professional construction tools, moved away from selling tools toward renting sets of tools to customers, shifting revenue streams from one-time product revenues to recurring service revenues.

Create new value propositions



Cemex, a Mexican cement maker, promised to deliver poured concrete to construction sites within four hours rather than the 48 hour industry standard.

Innovations driven by new revenue streams, pricing mechanisms or reduced cost structures



When Xerox invented the Xerox 914 in 1958 it was priced too high for the market. So Xerox leased, rather than sold, the machines to customers and charged customers for all copies over 2,000 per month.

Source: Business Model Generation, Alexander Osterwalder and Yves Pigneur, 2010, businessmodelgeneration.com



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Case Study: Tata Motors – Building a new market place with a disruptive Value Proposition

In a country where the cheapest car was out of the reach of the vast majority of the population, India's Tata Motors democratised an iconic Western consumer product by building a car for USD \$2,500. Tata Motors was only able to deliver this radical Value Proposition by re-inventing the traditional business model for automobile design, manufacture and distribution.^{3 4}

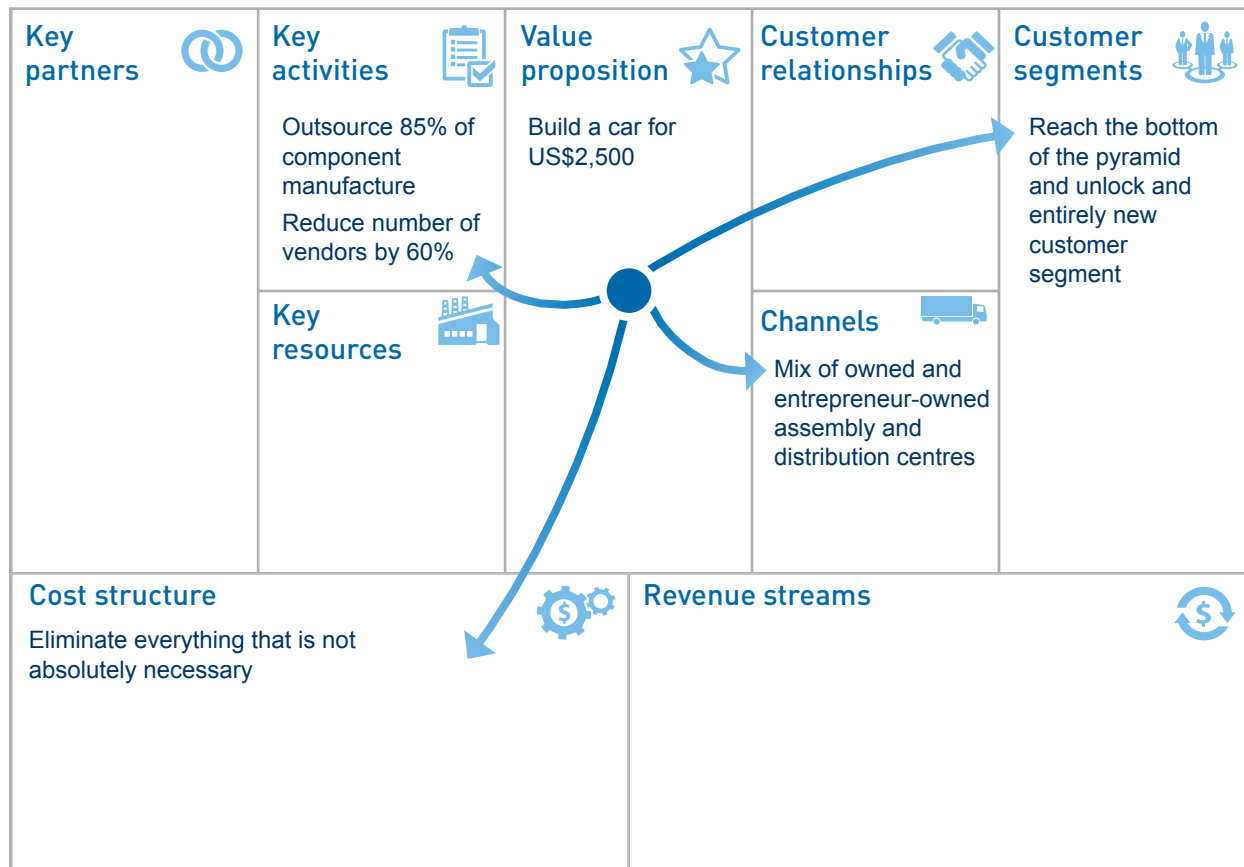
Tata reconceived how a car is designed, manufactured and distributed.

Young team of engineers	Tata built a small team of fairly young engineers who would not, like the company's more-experienced designers, be influenced and constrained in their thinking by the automaker's existing profit formulas.
Eliminate the unnecessary	Tata refined the manufacturing process breaking down every component of the car into its smallest pieces eliminating everything that is not absolutely necessary. The result is one windscreen wiper instead of two, no power steering, three lug nuts on the wheel instead of four, no tubes in the tires, only one side mirror and the basic version has no air conditioning, no power windows, no fabric seats, radio or central locking. Body panels are glued instead of welded.
Streamlined supplier strategy	Tata redefined its supplier strategy, choosing to outsource a remarkable 85% of components and to use nearly 60% fewer vendors than normal to reduce transaction and logistic costs.
Innovative assembly and distribution	At the other end of the manufacturing line, Tata envisioned an entirely new way of assembling and distributing cars. Modular components of the cars are shipped to a combined network of company-owned and independent entrepreneur-owned assembly plants, which build them to order. This model reduces transportation costs when moving product from the manufacturing site to distributors and increases customisation to meet the needs to customers in rural and semi-rural India. This distribution model can create barriers for other automobile companies because it will be difficult for them to replicate this volume and market penetration.

Source: Business model example: Tata Motors – Inexpensive cars for modular distribution, The Business Model Database, tbmdb.com

Reinventing your business model, Mark Johnson, Clayton Christensen and Henning Kagerman, Harvard Business Review.





Source: KordaMentha businessmodelgeneration.com

“‘What if I can change the game and make a car for one lakh?’ wondered Tata (ex-Chairman, Tata Group), envisioning a price point of around US \$2,500, less than half the price of the cheapest car available. This, of course, had dramatic ramifications for the profit formula. It required both a significant drop in gross margins and a radical reduction in many elements of the cost structure.”

Harvard Business Review on Business Model Innovation, 2010

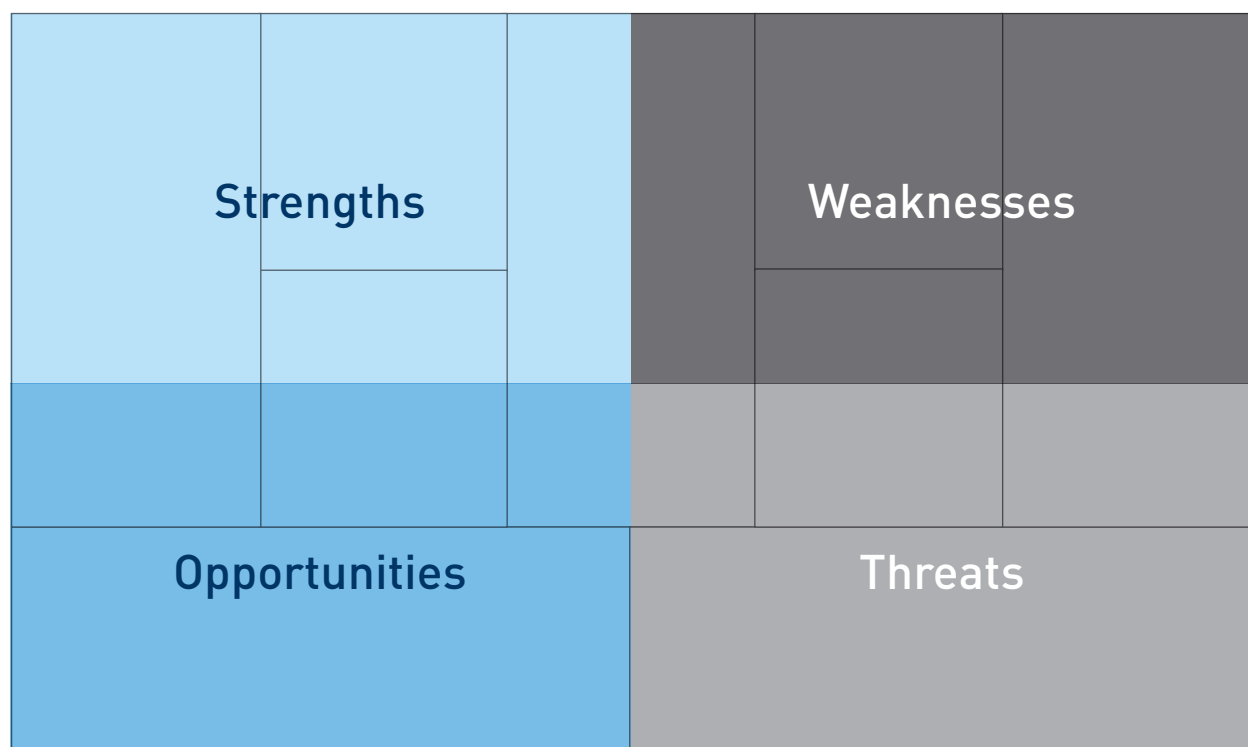


Evaluating and improving business models – SWOT analysis

How do you assess a business model? How can you identify areas for improvement and innovation? Traditional SWOT analysis can be applied to the Business Model Canvas to reveal interesting paths to innovation and renewal.⁵

SWOT analysis is a familiar and well-used strategic assessment tool. It asks four primary questions. What are your strengths and weaknesses? These prompt an evaluation of internal capabilities. And where are the opportunities and threats? These questions require us to consider an organisation's position within the external environment.

Applying SWOT analysis to the Business Model Canvas



Source: Business Model Generation, Alexander Osterwalder and Yves Pigneur, 2010, businessmodelgeneration.com

These questions can be applied to each segment of the Business Model Canvas. By doing so, they provide an avenue for a structured consideration of an existing business model and may, in turn, provide the foundation for business model change and innovation.⁶



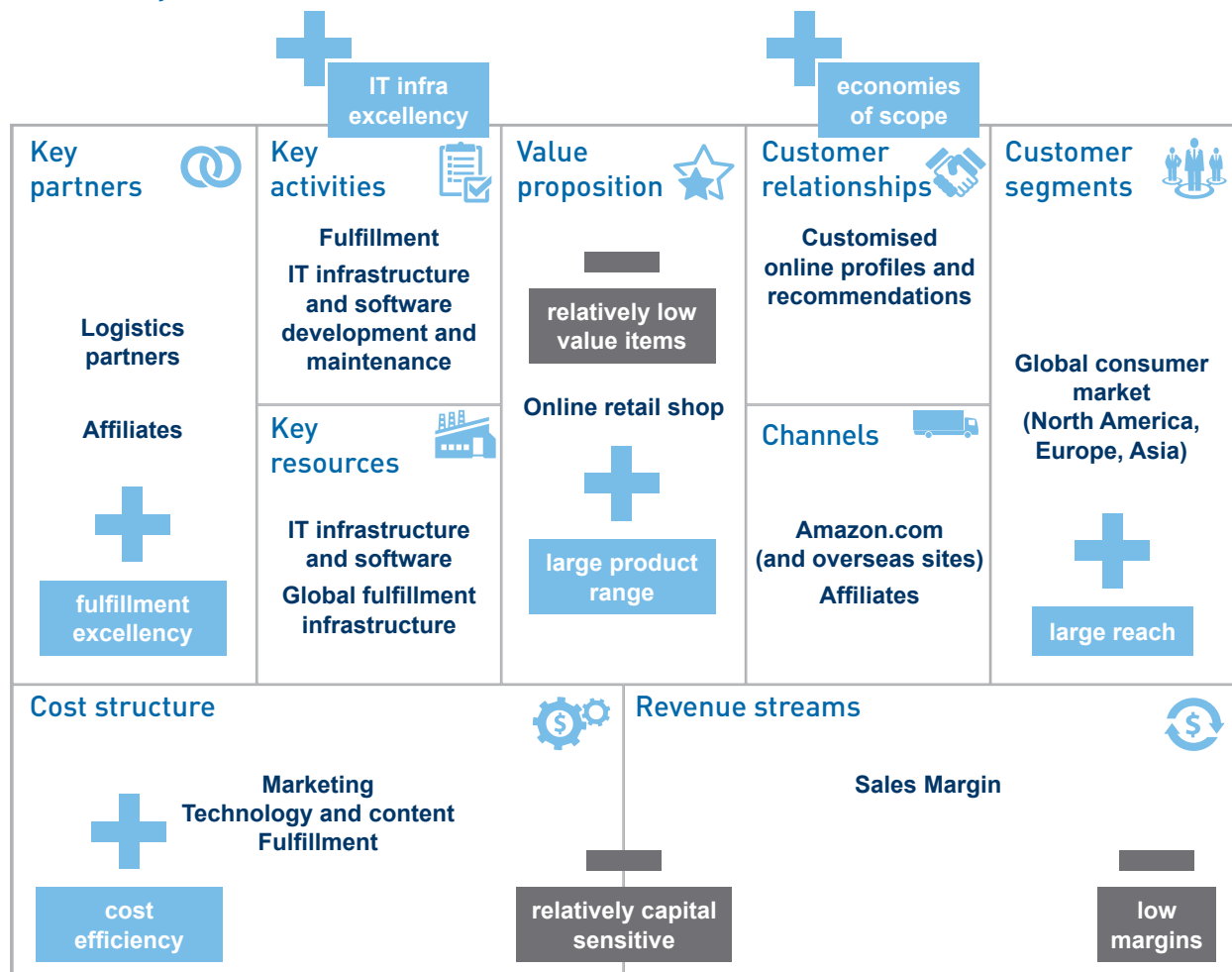
Amazon.com

Applying SWOT analysis to Amazon.com's Business Model Canvas in 2005 reveals both significant strengths and concerning weaknesses.



In 2005 Amazon.com recorded sales of US\$8.5 billion as an online retailer. It had established itself as a pre-eminent retailer of books, music CDs and DVDs. In doing so, it had built significant strength in fulfillment excellence and, through economies of scale and investment in IT infrastructure, was able to reach a very large customer market in a cost efficient way.

Case study: Amazon.com



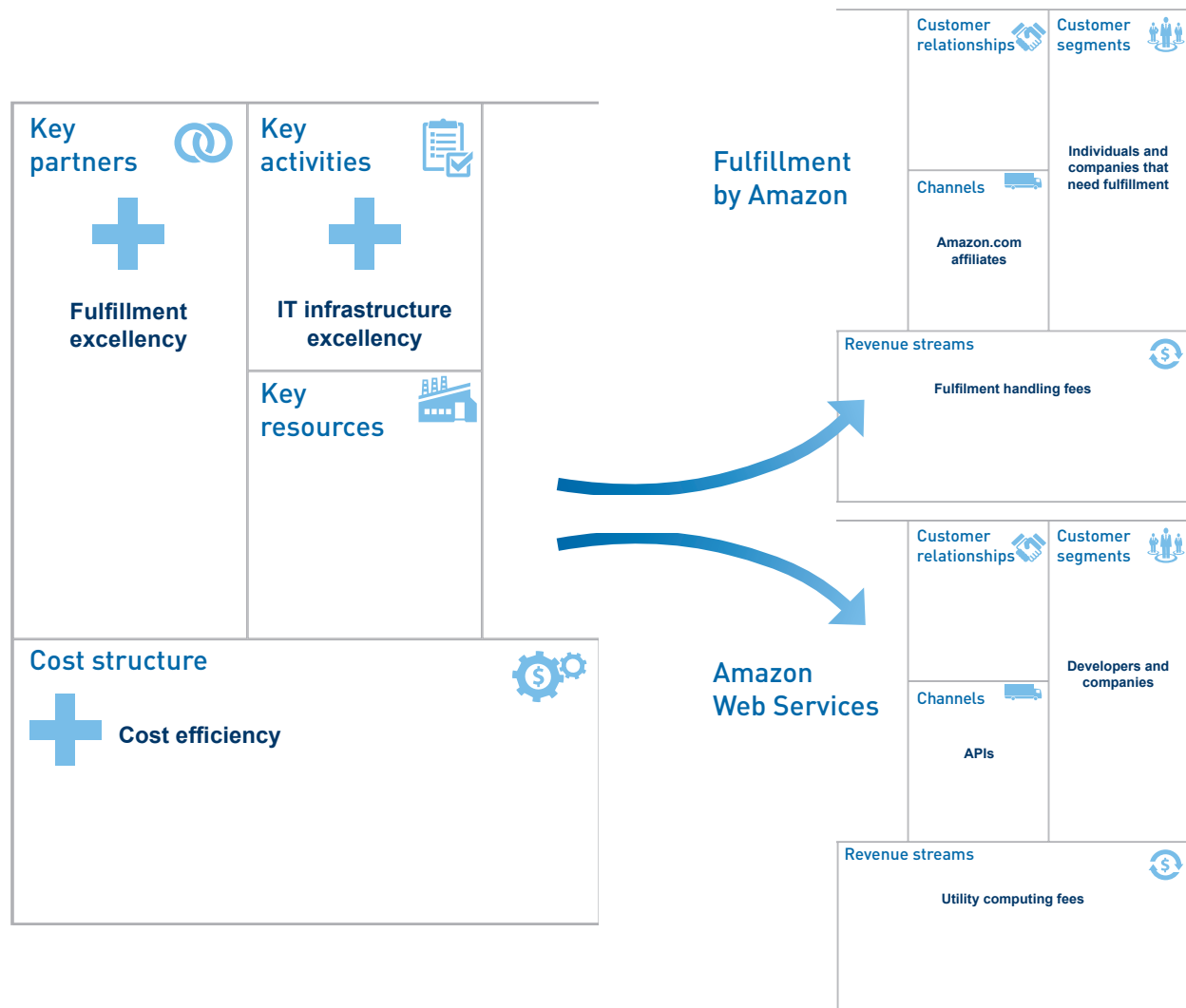
Source: Business Model Generation, Alexander Osterwalder and Yves Pigneur, 2010, businessmodelgeneration.com



But margins were weak. By focusing on the sale of low-value, low-margin products such as books, CDs and DVDs, Amazon.com only achieved a net margin of 4.2% in 2005 from its sales of US \$8.5 billion. By contrast, both Google and eBay achieved net margins of around 24% in that same year.⁷



SWOT analysis revealed Amazon.com needed to lift its net margin. But how? The same analysis provided the answer. Amazon.com began to look for growth initiatives in higher-margin areas, and leveraged its key strengths in fulfillment excellence and IT infrastructure to identify these new opportunities.



Fulfillment by Amazon

Fulfillment by Amazon allows individuals and companies to use Amazon.com's fulfillment infrastructure for their own businesses in exchange for a fee. Amazon.com stores a seller's inventory in its warehouses, then picks, packs, and ships on the seller's behalf when an order is received. Sellers can sell through Amazon.com, their own channels, or a combination of both.

Amazon Web Services

Amazon Web Services targets software developers and any party requiring high performance server capability by offering on-demand storage and computing capacity.

Source: Business Model Generation, Alexander Osterwalder and Yves Pigneur, 2010, businessmodelgeneration.com

Both initiatives leveraged Amazon's existing strengths and allowed further synergies to be achieved through the use of existing Key Activities and Key Resources to deliver two new Value Propositions to two new (and higher margin) Customer Segments.⁸

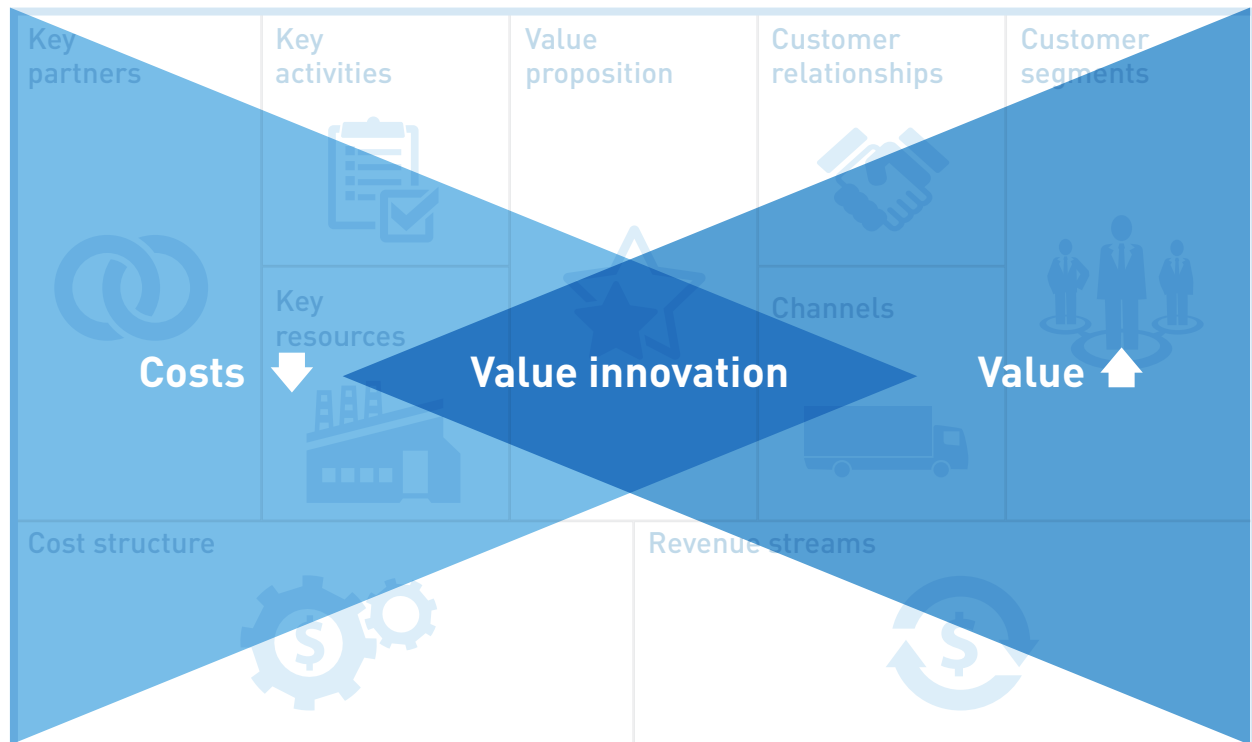


Evaluating and improving business models – Blue Ocean Strategy

The old dichotomy of competing on either price or value is being dismantled. True innovation is not about competing on traditional performance metrics, but about creating new, uncontested markets.⁹

Blue Ocean strategy is about simultaneously increasing value while reducing costs. This is achieved by identifying which elements of the Value Proposition can be eliminated, reduced, raised or newly created.

1. Lower costs by reducing or eliminating less valued features or services.
2. Enhance or create high-value features or services that do not significantly increase the cost base.



Eliminate

Which factors can be eliminated that the industry has long competed on?

Reduce

Which factors should be reduced well below the industry's standard?

Raise

Which factors should be raised well above the industry's standard?

Create

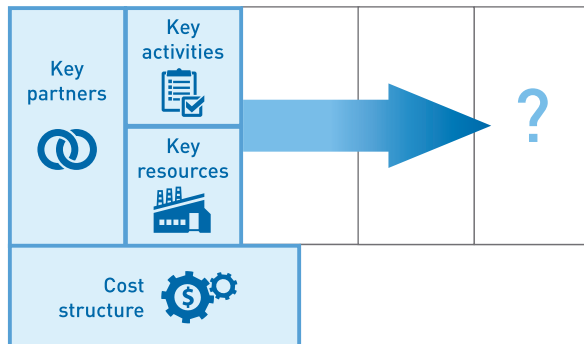
Which factors should be created that the industry has never offered?

Source: Business Model Generation, Alexander Osterwalder and Yves Pigneur, 2010, businessmodelgeneration.com

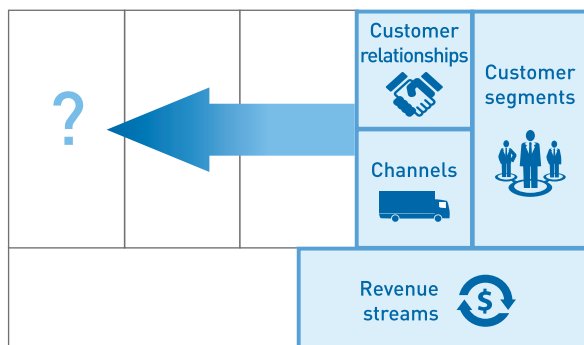


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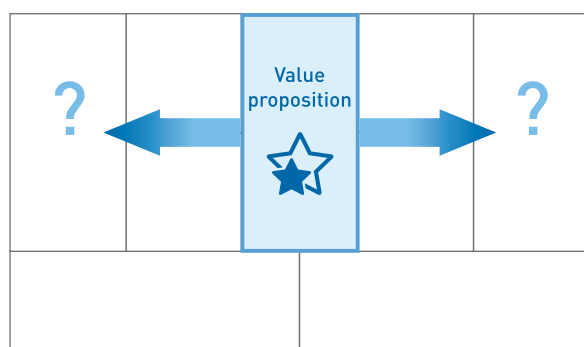
The Business Model Canvas can be used to identify Blue Ocean Strategy opportunities by considering opportunities for elimination, reduction, increase and creation) in each of the nine building blocks.



- What activities, resources and partnerships have the highest costs?
- What happens if you reduce or eliminate some of these cost factors?
- How could you replace, using less costly elements, the value lost by reducing or eliminating these cost factors?



- Which new Customer Segments could you focus on, and which segments could you possibly reduce or eliminate?
- What jobs do new Customer Segments really want to have done?
- How do these customers prefer to be reached and what kind of relationship do they expect?



- What less-valued features or services could be eliminated or reduced?
- What features or services could be enhanced or newly created to produce a valuable new customer experience?

Source: Business Model Generation, Alexander Osterwalder and Yves Pigneur, 2010, businessmodelgeneration.com



Case Study: Nintendo Wii

A combination of Blue Ocean Strategy and the Business Model Canvas highlights the fundamentally different business model Nintendo adopted to allow Wii to compete effectively against more powerful games consoles such as Sony's Playstation 3 and Microsoft's Xbox 360.

Existing focus

Technological performance

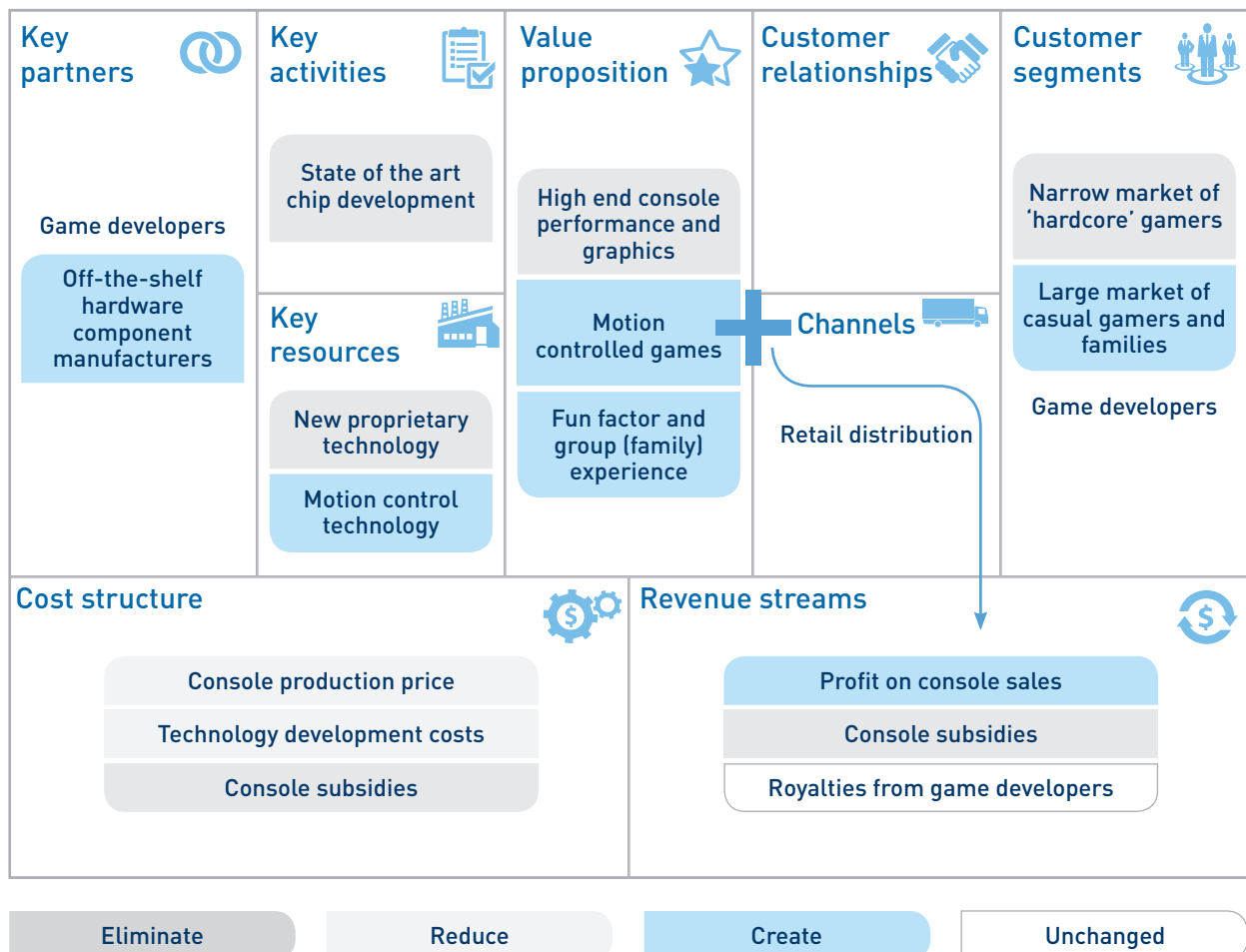
Die hard gamers

Blue Ocean focus

new form or player interaction

casual gamer

“The heart of Nintendo’s strategy was the assumption that consoles do not necessarily require leading-edge power and performance”¹⁰



Source: Business Model Generation, Alexander Osterwalder and Yves Pigneur, businessmodelgeneration.com



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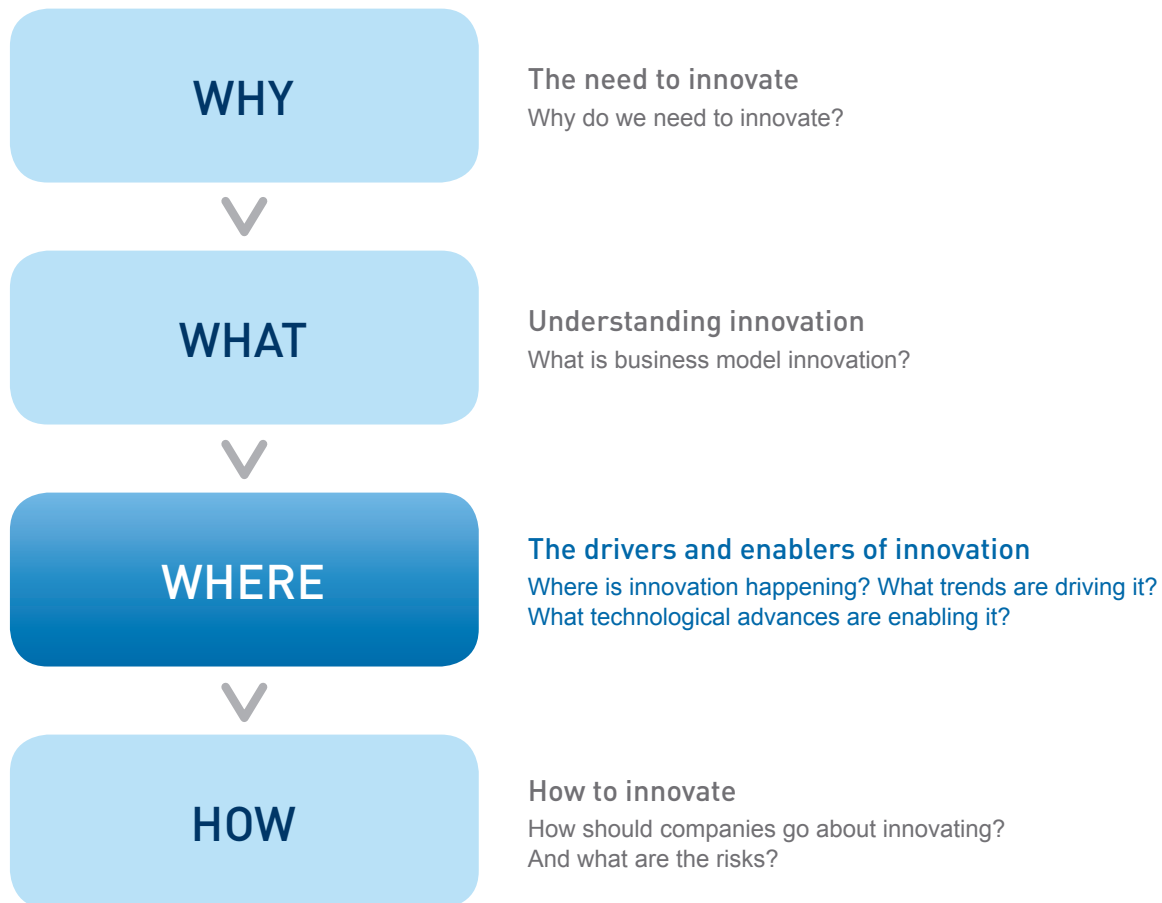
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1. *Business Model Generation*, Alexander Osterwalder & Yves Pigneur, 2010.
businessmodelgeneration.com
2. Ibid
3. Business model example: Tata Motors – Inexpensive cars for modular distribution,
The Business Model Database. Web 17 April 2014
<http://tbmdb.blogspot.com/2009/12/business-model-example-tata-motors.html>
4. *Reinventing your business model*, Mark Johnson, Clayton Christensen and Henning Kagerman,
Harvard Business Review
5. *Business Model Generation*, Alexander Osterwalder & Yves Pigneur, 2010.
businessmodelgeneration.com
6. Ibid
7. Ibid
8. Ibid
9. Ibid
10. Ibid

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