PALLADIUM WHITE PAPER

Business Model Innovation

Innovating Your Business in a Changing World

Palladium
Executing Strategy

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Article in Brief

Many executives find their organizations in a rapidly changing environment threatening the core profit engine. In every economic sector, both private and public, disruptive changes are underway and accelerating, driven by market volatility, technological advances, shifting demographics, regulatory changes, new competitors, and other factors testing the limits of the existing business models. Today, most organizations rely too heavily on new product development and process improvements, both incremental innovation approaches that offer little respite to counter these disruptive forces and therefore lead to diminishing returns over time.

Few organizations have the know-how nor the executive commitment to reinvent their business model (or value creation formula). Those that do, however, are rewarded with sustained margin growth and superior shareholder return.

The Palladium white paper gives an overview of Business Model Innovation (BMI), a new innovation discipline designed to help organizations change the way they create, capture, and deliver value. This white paper will:

- Introduce BMI and summarize the findings from several research studies that demonstrate the benefits of investing in BMI over other forms of innovation;
- Examine the key drivers of disruptive change;
- Present the BMI process and several frameworks and tools to characterize, deconstruct, and reconstruct business models (or develop new business models altogether);
- Discuss the lessons learned for implementing business model innovation and postulate a few issues for executive consideration.

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WHAT IS BUSINESS MODEL INNOVATION (BMI)?

There are many definitions of the term "business model," each with a specific nuance. For the most part, these definitions converge on the notion of a particular organization's unique recipe to create value. The definition that we find most helpful is that a business model describes the formula of how an organization creates, delivers, and captures value. The business model consists of four main components (Figure 1):

- *Target customer(s):* Which customer segments we are targeting and what needs we are intending to address
- *Value proposition:* What types or combination of products and services we are offering to satisfy the needs of the target customers
- *Value network:* How we will configure and sustain our organization, assets, and capabilities to capture value and deliver the stated proposition
- *Financial model:* What the underlying revenue and cost models are – how we will be compensated and how we will optimize our costs to deliver the above

Innovation is about creating and delivering value to customers in new ways. Innovating the business model typically involves renewing two or more of the above components. (All things equal, targeting another customer segment is usually referred to as *market expansion*, while delivering new solutions to the same customers is *market penetration*.)

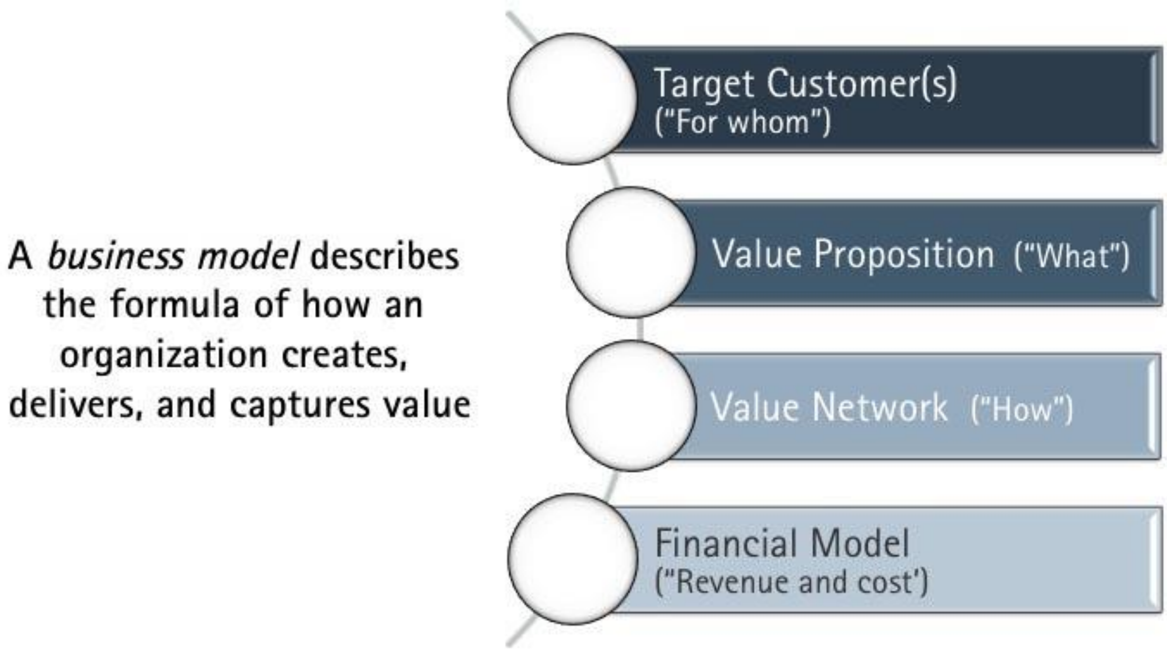

Figure 1: What is a Business Model?

As far back as 1934, Joseph Schumpeter (the same economist who famously coined the term “creative destruction”) distinguished between five types of innovation: new products, new methods of production, new sources of supply, exploitation of new markets, and new ways to organize business. CEO surveys perennially cite innovation as one of the top issues on the executive agenda. Typically, organizations focus the majority of their energy and resources on the first two types of innovation – in fact these account for most if not all of their “R&D spend.” However, multiple studies have been unable to establish a definitive link between the level of R&D spend and key shareholder metrics such as sales growth and total return. In other words, product and process innovation alone are not sufficient to drive a sustainable competitive advantage.

BMI focuses on the last two types of innovation – exploiting new markets (the components of *target customers* and *value proposition*) and new business organization (*value network* and *financial model*). In recent years, three studies examining the benefits of BMI compare company performance over a period of three to five years against average total shareholder return, enterprise value-to-sales versus R&D spend, and margin growth. The independent studies are aligned in their conclusion that those that invest disproportionately in BMI outperform their product- and process-innovating rivals by at least doubling the benchmark metric.

> *“Business model innovations have reshaped entire industries and redistributed billions of dollars of value.”*
>
> *Clayton Christensen*
> *Harvard Business School Professor*

What accounts for the superiority of BMI as an innovation discipline? As is most evident in the high tech and consumer product sectors, adjacencies and product line extensions are the easiest opportunities to pursue but by themselves provide limited or diminishing returns over time. On the other hand, BMI can be much harder to replicate, fuel longer-lasting differentiation, and provide a way to disrupt the industry status quo where the disruptor can capture value for a more sustained period of time. BMI can help new entrants challenge the prevalent business model in an industry, as in the case of low-cost carriers (“budget airlines”). For incumbents, BMI can help replace maturing revenue streams, extend the existing business model, and address disruptive changes in the marketplace.

Case Example:
Netflix – the Threequel

The opening scene of Netflix began in a similar fashion as that of several famous startups – an entrepreneur who turned his agitation into a venture. In 1997, Reed Hastings, founder of a Silicon Valley software firm, was perturbed that he had to pay a $40 late fee to Blockbuster, the dominant video rental chain in the U.S. Hastings discerned the emergence of DVDs and a web interface as key planks of a business model that evolved to offer subscribers unlimited rentals for a flat monthly fee, one DVD at a time delivered and returned by mail. Netflix featured a vast library from its central hub and no late fees, a common consumer gripe but a lucrative profit source for rental chains. In 2000, soon after the first Internet bubble burst, Hastings offered to sell the still unprofitable Netflix and its 300,000 subscribers to Blockbuster. The behemoth with 7,700 stores turned him down. As reported a few years later by trade publication *Variety*, Blockbuster's executives lacked the vision to anticipate where the home video market was heading and the shifting forces at work, nor were they willing to cannibalize their sales to what was considered a niche business. By 2005, Blockbuster capitulated with its own foray into online subscription service and even cancelled late fees at the stores, but it was too late. At 6.3 million, Netflix in 2006 had more than thrice the number of subscribers. Also strained by rental kiosk operators such as Redbox, Blockbuster filed for bankruptcy in 2010 and closed its final 300 stores in early 2014.

In Hollywood, every blockbuster spawns a sequel. During Netflix's early years, most consumers accessed the Internet via slow dial-up and video streaming seemed more science fiction than reality entertainment. In 2007, despite the still-growing subscriber base for its traditional model, Netflix launched Internet video streaming as a supplemental service for subscribers. This enhanced customer convenience, lowered DVD mailing costs, and served as the beachhead for a new business model. By 2010, Netflix had become the biggest source of evening Internet traffic in North America. Netflix has had a few blemishes – due to huge subscriber backlash it had to backtrack on its plan in 2011 to split the DVD-by-mail and video streaming businesses. The new model puts a spotlight on Netflix as a purveyor of other studios' content, the rise of streaming rivals such as Hulu and Amazon Instant Video, sustainability of the net neutrality government policy, and disruption triggered by consolidation in the industry (e.g., leading cable television provider Comcast's acquisition of majority and later full ownership of NBC Universal, the television and movie studio). In early 2011, Netflix announced an original content strategy to bolster its streaming subscription model. Netflix programming debuted with the political drama *House of Cards* in 2013, followed by other original content and exclusive distribution deals. These shows have netted Netflix a total of 14 Emmy nominations and three wins and have contributed to subscriber growth to 30 million in the U.S. (eclipsing even the premium channel HBO). It is too early to declare this latest move an unqualified success, but Netflix has now starred in the leading role in three BMI episodes as an entrant, a maturing act, and an entertainment industry veteran.

Case Example:

The Kodak Moment – a Monumental Failure

Founded by George Eastman in 1888, Kodak was an imaging solutions company that still has one of the most recognizable brand names worldwide. Kodak followed the razor and blades strategy of selling inexpensive cameras and making large margins from consumables (film, chemicals, and paper). As late as 1976, Kodak commanded 90% of film sales and 85% of camera sales in the U.S. It invested heavily in vertical integration, once even owning silver mines, and regarded its global distribution network to sell film and develop photos as its ultimate competitive advantage. It ploughed much of its profits into product innovation on the core business model – the Advanced Photo System (under the brand name Advantix) was an upgrade over traditional film but essentially still the same business model based on film and processing fees through its channels. While Kodak had to deal with competitive threats from Polaroid's instant photography and cutthroat rival Fuji, the fatal blow to its business model and ultimately the company was the advent of digital photography and inexpensive home printers. Kodak could not compete in the digital space against consumer electronic giants Canon and Sony (no consumables) or Hewlett-Packard (different/superior value proposition). Despite the fact that Kodak had invented the core technology used in digital cameras, it was hampered by the management mindset to protect and prolong the core film and development business. After a long and painful decline with multiple rounds of restructuring, Kodak filed for bankruptcy in 2012.

Kodak made three principal mistakes. The first was to underestimate the potential impact of emergent digital technology to the core business model. The second was assuming that consumers would consume digital imaging in the same way as traditional post-processed film. The final and perhaps most costly mistake was the failure to "self-disrupt" the existing business model for fear of cannibalization of the core film business. This last blow is as much organizational as anything else. After all, what CEO would put 85% plus gross margins at risk in favor of low-margin alternatives?

Key Drivers for Business Model Disruptions

The greater frequency of disruption and dislocation in many industries is rapidly shrinking the lifecycle of business models. Rita Gunther McGrath, a professor at Columbia Business School and author of the bestseller *The End of Competitive Advantage*, asserts that the notion for firms to establish a unique competitive position to be sustained for long periods of time is no longer relevant. Competitors and customers have become too unpredictable and industries too amorphous. Some of the forces at work are briefly examined below. Instead, organizations need to embrace the new paradigm of building and exploiting transient advantages. McGrath's thesis lends weight to BMI – that companies much be vigilant at monitoring potential disruptive forces, continuously refresh their existing business models, and explore multiple alternatives as part of their innovation efforts.

> *"Constant reinvention is the central necessity at GE. We're all just a moment away from commodity hell."*
>
> *Jeff Immelt*
> *Chairman and CEO of GE*

- Digital revolution and other technological advances. The first wave of the digital revolution disruptions crested in the late 1990s and early 2000s, when most of today's Internet giants (e.g. Amazon, eBay, Expedia, Google) emerged. Many traditional brick-and-mortar businesses, such as retail and traditional media (and the two cases profiled), were impacted as disintermediation became rampant. The second wave beginning around 2010 has been driven by mobile phone ubiquity and more specifically the broad adoption of smartphones and other mobility solutions. According to the International Telecommunication Union, mobile phone penetration reached 96% globally by the end of 2013 (89% in the developing world) and smartphones are at 30% and growing dramatically. This proliferation of enormous communication and computing capability at the hands of consumers may lead to far greater disruptions than the first wave. Other disruptive technologies to watch for in the next three to five years include the Internet of Things, advanced robotics, next-generation genomics, digital currency, and 3-D printing.

- Regulatory and policy changes. Two lasting influences of the recent global financial crisis are the tightening of government regulations and greater scrutiny of public sector outlays. While the financial services sector may have received the most attention, the overall regulatory environment in many countries has become stricter and more interventionist. The massive debts accumulated by various governments have also imposed deeper budgetary austerity in such sectors as healthcare, care for the elderly, welfare, education, and continued government subsidies for protected industries. The financial crisis may have led to more protectionist trade policies in a few countries, but others are still pursuing cross-border liberalization such as the Trans-Pacific Partnership, the ASEAN Economic Community, and various bilateral trade agreements. Government administrators at all levels are striving ever harder at value for money, reallocating their public sector balance sheets, experimenting with if not fully pursuing asset privatization, and outsourcing essential services. In aggregate, regulatory and policy changes will continue to be a crucial source of disruptions and opportunities.
- Shifting consumer demographics and preferences. In developed countries, the Baby Boomer generation is edging toward retirement age. Their exodus from the workforce will create enormous macroeconomic pressures in terms of labor shortages, lower government tax intake, and high public sector spending (e.g., healthcare, pensions, etc.). The global financial crisis has arguably permanently shifted consumer behavior to a more conservative and value-hunting mindset. Consumers, enabled or spoiled by technology, are also becoming savvier in comparing prices and offers and demanding superior experiences beyond just better products and services. In developing countries, an expanding middle class with higher disposable incomes fuels spending on non-necessities, premiumization, and asset preservation.

"The global financial crisis has arguably permanently shifted consumer behavior to a more conservative and value-hunting mindset."

- New business model and competitive paradigms become mainstream. The mainstreaming of new business model paradigms for consumers, startups, established organizations, and investors will only further accelerate disruptions. These paradigms and examples include:
  - Open sourcing/crowdsourcing/crowd funding: InnoCentive, Freelancer, Kickstarter, Kiva
  - Community-based models: Facebook, LinkedIn, Sermo (online community for doctors)
  - Share/peer economy: Airbnb, Getaround, LendingClub, SnapGoods

One may ask which organizations are industries are under the most severe disruptive threats and therefore have the greatest need for BMI. While a few industries such as retail, traditional media, and transport and logistics (e.g., airlines, postal services) have already undergone significant transformations that are bound to continue, the above disruptive forces are remarkably broad in impact and leave hardly any industry untouched. Traditional entry barriers are breaking down, blurring industry boundaries. Even previously static and seemingly less exposed industries such as taxis and hotels are facing threats from the likes of Uber and Airbnb, respectively. Certain sector characteristics suggest greater potential of disruption and therefore a more critical need for BMI:

- High competitive intensity focusing largely on one dimension, usually price or availability
- A high degree of customer dissatisfaction in predominant value delivery model, e.g., government services, healthcare
- A minimally differentiated customer value proposition
- Industries with abnormal profits – often correlated with previously high entry barriers – that serve as a magnet for entrepreneurs and venture capitalists
- Industries with artificial constraints such as a limited overall supply and therefore inflated prices, e.g. taxi services now being disrupted by Uber, traditional learning institutions being disrupted by Massive Open Online Courses (MOOCs) such as Coursera and edX

The counterargument to the original question may be – can any organization afford not to innovate their business model?

“Traditional entry barriers are breaking down, blurring industry boundaries. Even previously static and seemingly less exposed industries such as taxis and hotels are facing threats from the likes of Uber and Airbnb, respectively.”

BMI PROCESS, FRAMEWORKS, AND TOOLS

The BMI process architecture consists of three phases – Ideate, Design and Develop, and Scale and Transform. Refer to Figure 2 below.

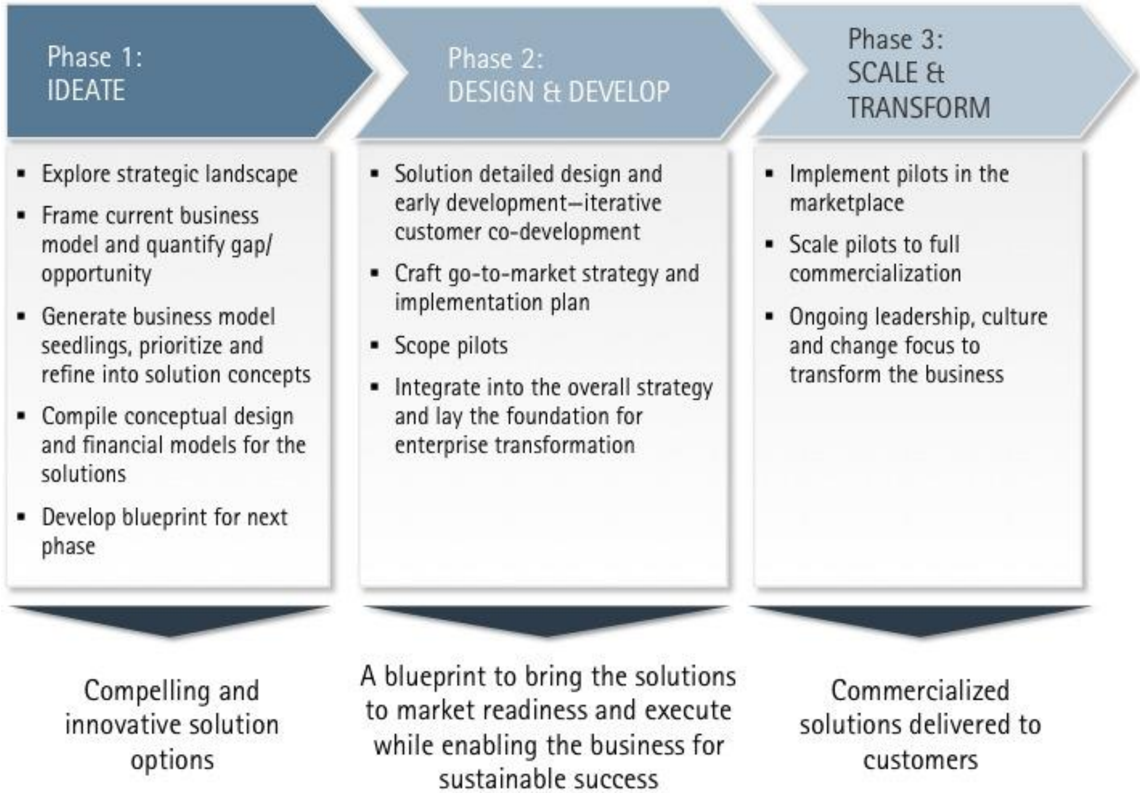

Figure 2: Business Model Innovation Process Phases

Ideate kicks off the BMI process and strives to capture the organization's strategic landscape, e.g., current business model, barriers, and capabilities. An evaluation of emerging trends, potential disruptive forces, strategic growth opportunities, and collation of case profiles and relevant analogs are also undertaken during this phase. The existing business model will be critically scrutinized for embedded assumptions and risks to the financial model. A set of business model hypotheses is typically compiled at this time. Building on the foundational analysis, a series of internal and external sessions will be held where various business models and hypotheses are proposed, deconstructed, and reconstructed. The external sessions allow a mix of internal and external stakeholders to co-create, iterate, and challenge the existing and hypothetical business models. The resulting learnings will be drawn and packaged to validate insights on customer needs and market trends and to formulate (or reformulate) business model seedlings (i.e., early stage business model concepts). A prioritized set of seedlings are integrated, co-created, shaped, and validated again with internal and external stakeholders. A screening and culling of the business model concepts takes place and various financial modeling scenarios will be presented, advancing the concepts into business model solutions.

The second phase, *Design and Develop*, steers the solutions through detailed design and early development (iterative customer co-development and rapid prototyping). The critical deliverables for this phase are the go-to-market strategy, implementation plan, and pilot scoping for each solution. Additionally, these solutions need to be integrated into the organization's overall strategy and the foundation for enterprise transformation (e.g., organizational design, leadership, and change management) will be articulated as needed.

Last, the *Scale and Transform* phase strives to deliver the commercialized solutions to customers. One or more pilots will be taken into the market during this phase – the resulting learnings, refinement, and validation will drive the eventual scaling of the solution into full commercialization.

> *"To turn really interesting ideas into a company that can continue to innovate for years requires a lot of discipline."*
>
> *Steve Jobs*
> *Co-Founder and Former CEO of Apple*

The overall BMI process architecture embeds an agile and customer co-development approach – many of the steps described earlier are carried out iteratively rather than in a linear fashion – and is well aligned with the "lean startup" principles advocated by Eric Ries and Steve Blank. A BMI project will be supported by a number of frameworks and tools through each phase to analyze, ideate, deconstruct, and reconstruct the business model effectively and efficiently.

We will highlight several of the more notable frameworks and tools here:

Business Model Canvas

Initially proposed by Alexander Osterwalder, the Business Model Canvas is a tool that helps characterize a business model along nine building blocks: Key Activities, Key Resources, Partner Network, Value Proposition, Customer Segments, Channels, Customer Relationship, Cost Structure, and Revenue Streams. (Note: These building blocks are consistent with the next-level decomposition of the four components of a business model we defined earlier). Since its introduction in 2008, the Business Model Canvas has garnered popular usage, as the easy-to-understand template can proficiently capture and compare existing and alternative business models. However, it is primarily a descriptive (used during the *Ideate* phase) rather than prescriptive tool, meaning that by itself the Business Model Canvas is less effective for the purpose of formulating new models for consideration.

Ten Business Model Innovation Levers

Based on our research and work with hundreds of clients, Palladium's proprietary framework of ten innovation levers has been designed to help ideate new business models. These levers are mapped to the four components of a business model (see definition above). Refer to Figure 3.

Target Customers	1. Pursue new markets/customers: Explore non-customers or those who are currently poorly served by the organization (and possibly the whole industry)
Value Proposition	2. Harness disruptive technology: Leverage technology to fundamentally alter the value proposition
	3. Re-define the solution: Devise options such as bundling or unbundling products and services, free solution (by finding alternative payers), and exploiting the brand
	4. Transform the customer experience: Employ frameworks such as Experience Co-Creation to deliver a holistic and compelling customer experience rather than just products and services
Value Network	5. Re-configure the value network: consider upstream/downstream integration, deconstructing the network, and partnering; leverage technology to enlarge the span of the value network
	6. Re-align network resources: Closely related to Lever 5, modify the mix or control of the resources within the value network
	7. Foster new capabilities: Acquire or develop new capabilities to enable a step change in the value network
Financial Model	8. Monetize information and networks: Capture the inherent value embedded in the network of member customers, stakeholders, and/or the information generated by related business transactions
	9. Reset payer or balance sheet equation: Explore alternative to the revenue and cost model, e.g., ad-supported rather than user pays, service or pay-per-use rather than capital purchase
Overall	10. Recast assumptions and remove boundary conditions: Identify and relax/challenge the set of embedded assumptions and boundary conditions underlying the current industry norms or business model

Figure 3: Ten Business Model Innovation Levers

The levers are not mutually exclusive – many business model concepts may involve pulling more than one lever at a time. The Ten Levers are typically employed during the *Ideate* phase.

Case Example:

Lego – Innovating the Business Model Brick by Brick

The Lego Group began producing their colorful interlocking plastic brick construction toys in 1949. While it is one of the most successful toy and family products companies today, Lego endured a difficult stretch between the late 1990s and early 2000s, when it had to battle the shift to video games and low-price direct competitors such as Mega Brands. However, in recent years Lego has managed to revive its fortune by launching several new business models:

- Mindstorm, a series of kits containing software and hardware to create customizable, programmable robots, appeals to both hobbyists and children older than the target Lego customers (Levers 1 and 4). The kits contained a number of low-cost servo motors, light and touch sensors, and software platforms developed at MIT and Tufts University. For Lego, the technologies represent new capabilities and partners in the value network (Levers 2, 5, and 7).
- Cuusoo is a crowdsourcing platform where any user can submit a product design to be voted on by other users. When a submission gets enough votes, the design goes into production and the originator receives 1% royalty on net revenue. The Shinkai 6500 submarine was the first concept that came out of Cuusoo; every product thus launched as received tremendous marketing buzz. This builds on the now-discontinued Lego Design byME initiative, which allowed any user to use Lego Digital Designer to build models using virtual bricks and order the model for delivery as a real package set (Levers 4, 5, 6, 7, and 10).
- Ninjago is a current line of Legos featuring a ninja theme. Ninjago is being cross-promoted via a television cartoon series and soon a movie. Lego has become much more aggressive at partnering (licensing) with others for content (e.g., LucasFilm for the *Star Wars* characters, Warner Bros. for *Lord of the Rings*, DC Comics, and Marvel) as well as exploiting its own intellectual property across multiple media platforms (e.g. the recently released blockbuster *The Lego Movie* and its spinoff video game) (Levers 1, 3, 5, and 10).
- Novel business models can often emerge to compete with or even complement successful models. Pleygo, an independent startup launched in mid-2013, seeks to apply the Netflix monthly subscription model to Lego. Instead of buying new Lego sets, parents can affordably choose from thousands of sets and swap for a new set as often as they choose (Levers 1, 3, 5, and 10). Pleygo won over 7,000 users during its first quarter in operation and was seeing membership doubling every month. Lego's response remains open.

Customer Experience Innovation and Co-Creation

"Transform the customer experience" is one of the ten innovation levers identified earlier. There are a number of common methodologies such as customer journey mapping and Lean Six Sigma that may help improve the customer experience. However, the way these tools are usually applied often result in only incremental process enhancements. To innovate the business model via customer experience transformation requires a more holistic approach than automating an existing process, standardizing the current customer interface, or reducing process inefficiencies. No longer are customers satisfied with merely the highest quality product or service or the lowest price, but they increasingly demand and expect the best experience across all of the interactions they have with an organization. The "new" customers yearn for more participation and may willingly share the rewards and risks of value creation if they could gain more information, dialog, transparency, and access in the engagement. The thought leader in this emerging discipline is Venkat Ramaswamy at the Ross School of Business at the University of Michigan. First advocating for co-creation in *The Future of Competition* (with co-author C.K. Pahalad) and further championing it in *The Power of Co-Creation* (with co-author Francis Gouillart), Professor Ramaswamy has framed the co-creation paradigm as the joint creation and evolution of value with stakeholding individuals, intensified and enacted through platforms of engagements.

Crushpad, a custom winemaking company, espoused the co-creation paradigm. It broke down the winemaking process into five steps: creating a plan, growing and monitoring the grapes, picking and processing the grapes, aging the wine, and labeling the bottles. Clients, typically wine enthusiasts and restaurateurs, can engage as much or as little as they wish along these steps to customize their wine, guided by virtual tutorials. The Crushpad value network consists of various growers, vineyards, and the logistics network to distribute wine to different locations. The firm did not just sell wine, but rather co-created the winemaking experience with stakeholders. Additionally, some of its more entrepreneurial clients could leverage the Crushpad commerce platform, a fulfillment infrastructure that manages the regulatory paperwork and shipping for a one-stop shop to produce and sell wine without every owning or managing any physical assets (essentially monetizing their winemaking intellectual property). At its peak, the company had more than 5,000 clients producing 35,000 cases of 650 wines annually. Unfortunately, Crushpad was a victim of over-aggressive expansion during the recent economic downturn, but the company lives on with the Wine Foundry and VINIV as successor firms. More than that, Crushpad has inspired trail-blazing business models in other industries and continues to serve as a remarkable case profile for Experience Co-Creation.

Breakthrough customer experience innovation inevitably demands reinventing an organization's current business model. As demonstrated by Crushpad, Lego, and other notable successes such as Nike (Nike+), Toyota (Scion), Wacoal (Ouchi wear), and Crédit Agricole (Predica's Cap Découverte low-cost life insurance product targeting the youth market), BMI and customer experience innovation are fundamentally two sides of the same coin.

Additional BMI Tools

The BMI Process can be further facilitated by several other tools and techniques. During the *Ideate* phase, we typically leverage archetypes and analogs from other industries or geographies. For example, while formulating a new business model for a large healthcare provider, we reviewed as analogs the ubiquitous convenience store chains in Japan for utmost flexibility and a village exchange approach from rural India to attain affordability and self-service goals.

Concept visualization – sketching and/or staging props to illustrate how the business model may take shape – is an effective technique to test, validate, and refine the concepts. This tactile approach allows for greater understanding and elicits more powerful feedback/co-creation with internal and external stakeholders. Another technique is the Business War Game. We can stage war games during the *Design and Develop* and possible the *Scale and Transform* phases to more systematically assess the multi-stakeholder dynamics as we launch and operate the new business model in the marketplace, as well as test emerging models in the theoretical "market" at zero risk to the organization. This process in turn helps polish the tactical rollout (e.g., communication plan, staff training, etc.), identify and mitigate risks, and build the internal team's confidence during execution.

Lessons Learned from Business Model Innovation

An *a posteriori* review of notable organizations that have failed to innovate their business models suggests a number of arduous but surmountable barriers:

> *"Those who cannot learn from history are doomed to repeat it."*
>
> *George Santayana*
> *Noted philosopher and essayist*

- The incumbent business model is too successful. Kodak's long years of past success and continual re-investment in its established competitive advantages, while logical in the short term, turned out to be a curse for the long term. Management's unwillingness to cannibalize its own business proved to be its ultimate undoing. As McGrath argued in *The End of Competitive Advantage*, management must not be complacent and instead embrace the transient advantage paradigm.

- Organizations overlook the need to test the existing model. According to one of our recent surveys, when organizations undertake their annual strategy refresh and planning activities, fewer than 15% apply a rigorous assessment of potential disruptive forces and an unbiased critical review of the existing business model. Most adopt an incremental approach to the current year's strategic plan, whereas business model innovation requires a more sweeping perspective, one that entails looks beyond present industry boundaries. Given the accelerating change velocity for more industries, management may well expect business model disruptions to arise and focus on cultivating readiness to meet the challenges.
- Internal performance incentives reward maintaining the status quo. Most organizations have designed executive incentives in a way that does not encourage longer-term investments and sensible risk-taking. In traditional industries, financial markets obsessed with quarterly results often punish innovators. It is a Board imperative to ensure that management devotes sufficient attention to proactively managing business model disruptions and innovations.
- Deeply held beliefs about what creates value are difficult to overcome. Identifying and challenging embedded assumptions is not only an effective way to ideate new business model concepts, but the exercise can also validate if the original rationale behind the "sacred cows" still holds true. Assuming change is required, management must lead the organization forward. The first four steps of John Kotter's Eight-Step Process for Leading Change (Establish a Sense of Urgency, Create the Guiding Coalition, Develop a Change Vision, and Communicate the Vision for Buy-In) provide a sound blueprint.
- Once the business model is recognized to be in decline, organizations are slow to adapt. We know from years of research that 70% of organizations fail to execute their strategy. Palladium has been a pioneer in the discipline of strategy execution and has developed a number of best practice strategy execution tools and frameworks that can help in this regard.

"Chance favors the prepared mind."

Louis Pasteur
French microbiologist

As highlighted earlier, a survey of the forces of business model disruptions reveals that few industries and organizations, even government and not-for-profit agencies, will be unscathed in this latest stage of industry disruption. The best defense (or offense) is to foster and manage Business Model Innovation as a critical capability.

Start by deepening the organization's knowledge of customers, non-customers, and disruptive trends in the immediate and adjacent industries. The perspective should be longer term than what is typically applied in new product or process innovation. Next, create and maintain a corporate entrepreneurial platform where the allocated staff is allowed to ideate, experiment, learn, and iterate, ideally while engaging and collaborating with external stakeholders. Managing this platform would require a different discipline than operating more established businesses, so the metrics and performance incentives must be realigned. Last, readiness, timeliness, and agility are key: the organization must invest in not just a single discrete model concept but rather a portfolio of business models. Not all models are expected to survive the development pipeline. A balanced portfolio approach, if soundly managed, will help the organization seed its future, capitalize on strategic opportunities, and mitigate the risks and timing of various disruptive forces. The principle of "strategic resilience" becomes more nuanced – less directed at upholding the existing business model at all cost and more about boosting enterprise readiness to augment or supplant it with potential alternatives.*

NEXT STEPS

The *Tyrannosaurus rex* lived during the Cretaceous Period and was one of the largest and most fearsome creatures to ever roam the Earth. Its combination of mass, height, awesome bite, and speed meant it was an apex predator perfectly tuned for its ecosystem. However, the end of the Cretaceous Period was marked by massive volcanic eruptions, a catastrophic asteroid impact bringing on a lingering winter, and mass dying of plant species and herbivore preys. Unable to adapt to the new environment, T-rex's "competitive advantages" were of little use. Like all non-avian dinosaurs, it became extinct. Scientists believe this opened up niches for early mammals whose "life formula" was better able to accommodate the new world.

> *"It is not the strongest of the species that survives nor the most intelligent…it is the one that is most adaptable to change."*
>
> *Charles Darwin*

65 million years later, the quest for organizational survival and success does not seem to have changed much. The stability of every industry and sector will be punctuated by disruptive forces. Those most ready in planning and executing their business model innovations will not only survive but flourish.

* For further information on fostering innovation, the Palladium white paper *How to Imbed Innovation into Your Organizational Culture* is available for download at www.thepalladiumgroup.com/thoughtleadership.

We offer the following questions for executives to reflect upon in consideration for next steps:

- How does your organization currently allocate its budget across innovating in new products/services, process improvements, and business model(s)? Who in your organization, if anyone, champions BMI?
- What disruptive trends are pertinent to your industry? Have you evaluated their likelihood and impact? Has the evaluation informed your current strategy?
- What disruptions and new business models are emerging in adjacent industries or other geographies? Can your organization emulate aspects of these new business models to refresh or replace your current one?
- How well is your organization (or the industry overall) delivering on its value proposition to customers? Who are the non-customers and what existing or nascent alternatives might they have?
- If your organization were a greenfield market entrant with no legacy business model, how might you configure a business model to best compete in the industry? How might this hypothetical entrant capitalize on any vulnerability in your current model? Similarly, how might a brand champion or a low-cost leader from another industry exploit the dynamics and norms of your industry?
- How robust is your BMI capability? How well can you identify and evaluate potential disruptive trends? How well can you foster a platform for assigned staff to ideate, experiment, learn, and iterate business models with customers and stakeholders? Are you managing a portfolio of business models with a lifecycle approach?
- How readily can you transition the existing business model and implement a new one? What might the key internal and external barriers be?

Palladium has helped clients across a diverse range of industries, geographies, and corporate lifecycles rigorously think through and successfully tackle these issues. Let us help you employ Business Model Innovation for your ultimate and enduring competitive advantage.

Palladium
Executing Strategy

Palladium Group, Inc. is the global leader in helping organizations solve pressing strategy execution challenges. We are dedicated to understanding and addressing the strategic issues that drive successful results. Founded by Dr. Robert S. Kaplan and Dr. David P. Norton, we help clients achieve superior performance through a set of integrated consulting services. We deliver tangible results, building enduring internal capabilities with supporting technologies and education programs. Our approach combines expertise in proven strategy execution with integrated change management and leadership development programs. Our methods include the Execution Premium Process™ (XPP™), the Kaplan-Norton Balanced Scorecard™, and other best-practice frameworks that translate concepts into programs that deliver measurable results. The benefits of our approach are demonstrated in the *Balanced Scorecard Hall of Fame for Executing Strategy*®, which recognizes organizations that improve performance through outstanding execution. Our offices located throughout the Americas, Europe, the Middle East, Africa, and Asia-Pacific enjoy a successful track record with over 700 clients.
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