

Business Model Innovation



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**RESPONDING TO CHANGE AND
PURSUING GROWTH:
EXPLORING THE POTENTIAL OF BUSINESS
MODEL INNOVATION IN AUSTRALIA**

**REPORT OF A STUDY SUPPORTED BY THE
AUSTRALIAN BUSINESS FOUNDATION**

DON SCOTT-KEMMIS

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I particularly thank Peter Roberts, of the Australian Financial Review, who has provided extensive advice on examples of business models in Australia. Ian Buchanan and Peter Burns of Booz and Company have also provided suggestions for examples of significant business model innovators in Australia.

Don Scott-Kemmis

Executive Summary

A business model is how a firm creates value for customers, partners and itself. It is the firm's answer to the questions: what to produce, for whom and how to make money doing so. Some people call this the business recipe, and in the past it was often the case that most firms in an industry followed more or less the 'industry recipe'.

Following the industry recipe is less and less a viable strategy. There are more options for how to organise value creation – what is done in-house, what is outsourced, what sort of relationships to have with suppliers and partners. Markets are more segmented and competition punishes firms that are not focused. Firms must increasingly let go of the old recipe and develop a unique business model – i.e. innovate their business model.

There are many examples of new entrants rapidly gaining ground against long-established industry titans on the basis of a new business model. Think of Amazon in book retailing, Apple in mobile phones and MP3 players, Wikipedia and encyclopaedias. But many established firms have regenerated growth and competitiveness through business model innovation. Think Qantas with Jetstar. For new firms the challenge is building an organisation around an effective strategy. But for established firms it is to establish new insights and engineer change where a great deal is invested in the 'old' strategy, structure and approach to business.

There are now many examples of Australian firms of all sizes, both new and established, that have successfully introduced new business models. Some have then expanded their operations globally based on their new business model.

This report aims to raise awareness of the diversity and significance of business model innovation. It illustrates these issues through examples of business model innovation in Australia. It also provides a guide to assessing the viability of an established business model, and designing and implementing business model innovations.

WHAT IS A BUSINESS MODEL?

A business model defines the **who**, **what** and **how** of the business architecture:

- Who are the targeted customers?
- What is the value proposition offered to the target customers?
- How is the offering generated and provided and how does the firm capture value from the business?

The 'how' dimension covers a number of distinct components: the value chain or more often today the value network; the relationships with partners; the distribution channels; customer relationships; and the underlying revenue model.

There are often many options in each of these dimensions. The feasibility and attractiveness of those options is continuously changing due to technological, market, regulatory and industry evolution, and to the strategies of suppliers, partners, customers and competitors.

What is vital is focus, and alignment - each element reinforcing the others and combining to form a well-integrated business model.

To illustrate the diversity and competitive significance of business models, the business models of six Australian businesses are described:

- Webjet
- Sumo Salad
- Xpresso Delight
- J.B. Hi Fi
- Kitchener Kitchens
- Revive Clinics

WHAT IS BUSINESS MODEL INNOVATION?

A major change in one dimension of a business model often leads to a need to change other components – and hence to creating a new innovative business model. This is because alignment and synergy among the elements is vital. Business model innovation may be radical, involving a complete transformation of the firm and its business recipe, or it may be incremental, involving more modest change and re-alignment.

The starting point for developing a new business model, or renovating an established one, has often been an insight into how to meet the needs of an unserved or underserved customer group. A clear and strong value proposition for the specifically targeted users (avoiding the temptation of a less focused value proposition aimed at a wider target) is a characteristic of strong business models. Good insight into the behaviour of the target users and the context of their use of the product or service is usually required to make innovation into a business model enduring and effective.

To illustrate examples of innovation in business models, particularly by Australian firms, the following businesses are described, together with several industry-wide cases of business model innovation:

- J. Robins
- Jetstar
- Adroit Lawyers and Bespoke Law
- Orica Mining Services
- Argus Connect
- Beacon Lighting
- Kimberley Kampers
- Zara

These examples of business model innovation variously demonstrate innovation in one or more of the three dimensions of a firm's existing business model – who the business is serving,

what the business does, and how it provides and profits from its business offering. A key lesson of successful business model innovation is the importance of a close alignment between the *who*, *what* and *how* dimensions. When changes in these dimensions reinforce each other in an innovative business model, the capabilities and relationships of the firm underpin its value proposition for customers and enable profitable performance and sustained competitiveness.

The key characteristics summarised from the examination of these cases of Australian enterprises innovating in their business models are as follows:

- Start with a focus on the customer, especially how to meet the needs of an un-served or under-served customer group.
- The power of providing a clear and distinctive value proposition is central to an effective business model. An embedded understanding of what differentiates an enterprise from its competitors in the eyes of customers, together with the right people, skills and technology capabilities, is decisive to competitiveness and longevity of the business model.
- The value propositions in many cases of effective business model innovation are quite straightforward, like healthy fast food; good quality coffee at work; convenient medical services; reliable and environmentally sound motoring; good-value, on demand legal services; quick turnaround fashion clothes or shoes.
- A strength of many business models is having found a way to increase flexibility in meeting customer demands, without increasing production costs. Making effective use of the possibilities of the internet is a feature of many, but not all, business model innovations.
- Outsourcing can be used to increase returns to the firms' distinctive competencies and strengthen the business model. Importantly, outsourcing low value-adding activities can enable a firm to become increasingly specialized and more knowledge and skill-intensive.
- Business models are often proven on a smaller scale and then scaled-up. Business model innovation involves a process of learning-by-doing, but also learning-by-planning and learning-by-studying the experience of others. In many cases the firm had a specific exemplar from outside their industry that shaped the design and implementation of their new business model.
- For a number of firms their business model evolved over time through a sequence of innovations, rather than one radical shift.

The examples of innovative business models in Australian firms show the key role that distinctive capabilities and strong relationships often play in underpinning the 'how' dimension and hence supporting the firm's value proposition. The required capabilities and relationships often had to be built – which may extend or replace existing capabilities and relationships. Specialised capabilities and close collaborative relationships with external partners are features of many successful business models. Competitors find it more difficult to copy an integrated business model that is deeply embedded in the specialised capabilities and collaborative links that a firm possesses.

Business model innovation offers an opportunity for firms to create and capture value without necessarily large capital expenditure or significant technological innovation.

WHY IS BUSINESS MODEL INNOVATION BECOMING MORE IMPORTANT?

A range of studies over the past 10 years have identified business model innovation as a key factor in competitiveness. Opportunities for business model innovation emerge from changing consumer preferences, new regulations, new technologies and new potential partners. Growing competition, including from firms with new business models, is driving the

need to become more focused and more responsive to new trends and to customer demands. Complexity and the pace of change increase the incentive for firms to collaborate. The web helps to lower the barriers to collaboration.

DESIGNING AND MANAGING BUSINESS MODEL INNOVATION

There is an imperative for business model innovation in the face of unprecedented business turbulence and change that is recognized by leading business executives, authoritative business analysts and practitioners and international researchers.

The reality of designing and managing business model innovation, however, is neither obvious nor easy. But, to do so will often be essential for enterprises to grow and in some cases decisive to their survival.

This report distills the essential steps for those assessing the need for and leading business model change. This includes diagnosing the limitations of an existing business model; investigating and assessing possible new approaches; testing and experimenting with different components of potential business models – the who, what and how – and how they fit with the enterprise's aspirations and circumstances; taking soundings of customers and changing and emerging market needs; understanding the barriers and risks of business model innovation; learning from others; securing and acquiring the capabilities and linkages to implement a new business model; and managing the change and implementation of the chosen business model innovation.

This report concludes that the foundations for business model innovation readiness involve:

- formally reviewing the business model at least once a year;
- seeing value through the customer's eyes;
- developing alliances (including tactical alliances, rather than only joint ventures and mergers) to increase flexibility and seeking lean operations through improved business processes, including use of new technology and outsourcing;
- strengthening the defendability of the value chain position, for example by focusing on differentiated knowledge, R&D, design and skill-intensive activities.

In leading and managing the challenges and uncertainties of business model innovation, it is vital to have clarity of vision, a good understanding of change processes, an openness to learning and a capacity to engage staff and partners.

1. Introduction

THE SIGNIFICANCE OF BUSINESS MODEL INNOVATION

A business model is how a firm creates value for customers, partners and itself. It is the firm's answer to the questions: what to produce, for whom and how to make money doing so.

In the past firms often maintained a business model for long periods, but this is often no longer possible. New competitors with different products and services, changing patterns of demand, new product, production or distribution technologies, new communication channels like the internet and new opportunities for collaboration – all may erode the power of established business models. Due to the rapidly changing business environment, firms need to review and adapt their business model – and become adept at doing so.

Apple is an outstanding example of a new business model in an established market that transformed the industry:

CASE 1.1 TRANSFORMATION BY BUSINESS MODEL INNOVATION – THE APPLE IPOD¹

When Apple introduced the iPod/iTunes in 2003 there were other digital music players already in the market – the product itself was not an innovation. The largely producer-led market was based on selling the music player – the physical asset. The Apple iTunes/iPod product and service brought an entirely new value proposition and overall business model. While this was far from the lowest cost digital music platform, it was deeply disruptive for the established firms. The iPod/iTunes offering rapidly displaced the established products. Its business model delivered greater value. Apple differentiated its offering by providing easy access to music and video for downloading. Most of the technical and aesthetic design of the iPod was done by others for Apple and almost all of the components came from suppliers, and all of the manufacturing was done off-shore.

Within a short time Apple had 80% of the US digital music player market. By 2007 the iPod/iTunes combination delivered income of US\$10 billion and accounted for almost 50% of Apple's turnover, leading to a transformation of Apple's market capitalisation from US\$1 billion to US\$150 billion.

The business model innovation transformed Apple enabling value creation and the orchestration of a value network linking producers of recorded music to PC owners. The iPod/iTunes value proposition has several key value dimensions: content, mobility, convenience, choice, web technology, communication technology, artists.²

¹ Johnson, M., Christensen, C. and Kagermann, H., 'Reinventing your Business Model', *Harvard Business Review*, December 2008.

² 'Interview with Dr Bolko V. Oetinger', *Effective Executive*, April 2009.

The term 'business model' began to be widely used in the late 1990s with the advent of the dotcoms and their exploration of new internet-based approaches to doing business. Some web-based business models (such as Apple iTunes, Amazon and Dell) have been major global successes and are now widely known.

New business models have been central to the success of many new entrants to established sectors. Some major new technological product innovations have failed to gain momentum in the market until an appropriate business model is developed, i.e. changing the way the product is delivered, experienced by the customer and revenue generated. The classic examples are the photocopier, the automobile and the PC – all of which only took off after change in the business model rather than the product. The design, testing and often redesign/innovation of the business model is a vital aspect of the early stages in the evolution of a new venture.

Established firms seem to have more difficulty leading business model innovation. It is likely that it is harder for established firms to innovate their business model because their commitment to the logic of their current model can block thinking creatively about alternative futures.

The challenge is then both that of innovating a business model that has lost its effectiveness, and of developing capabilities for ongoing business model innovation. This report shows that business model innovation is a learning process: learning where opportunity is; learning (from other successful business models, through imagination and experiment) what product or service offering aligns with that market opportunity; and learning how to develop the capabilities and business systems to create value and capture that opportunity.

THE AIMS OF THIS REPORT

The Australian Business Foundation commissioned this analysis and report into business model innovation by innovation researcher and consultant Don Scott-Kemmis, through the Australian Centre for Innovation at the University of Sydney.

About the Australian Business Foundation:

The Australian Business Foundation is a collaborative research body at the centre of a vibrant community involving Australian and international business executives, scholars, policymakers and opinion-leaders.

For over a decade, the Foundation has nurtured evidence-based research into business innovation and sustainability, emerging models of business competitiveness and opportunities arising from a knowledge economy.

The Foundation is funded and backed by the business sector and has developed a distinctive model of collaborative and influential research, in partnership with expert scholars and practitioners from Australia and around the world. The Foundation's research strives for depth, rigor and practicality in its character, drawing out original content and insights and interpreting this for impact and use.

Working with our members, we deliver practical and tangible knowledge and findings through published reports, our website, and a robust events program. In 2011 that range of activity will expand to incorporate broader and more diverse dialogue, access and participation in the Foundation's network of business executives, government and political representatives, researchers and academics.

About the Author: Don Scott-Kemmis

Don Scott-Kemmis is a consultant specialising in innovation management and policy. He also teaches innovation management to postgraduates of the University of Sydney and UTS, and is Senior Fellow at the Australian Centre for Innovation, Faculty of Engineering, University of Sydney. From 2001 to 2008 he was an Associate Professor at the Australian National University, where he led the Innovation Management and Policy Program, and previously held research appointments at the University of Sussex and University of Wollongong. He has been a consultant to many national and international organizations. He was also a manager and adviser in the public sector in Australia. He holds degrees from the University of Sydney and University of Sussex.

Business model innovation is becoming a more important type of innovation, and often an essential complement to other types of innovation. Many established industries and firms will face new forms of competition from firms with new business models. Experience shows that even highly successful firms can be vulnerable to insurgent business models, for example, the corner store versus supermarkets in the past, and the main-street travel agents and bookstores versus their on-line competitors currently. Consequently, the capacity to design and implement business model innovation is an increasingly important component of innovation capability.

In this context, the overall aim of this report is to raise awareness of the significance of business model innovation. It sets out the key aspects of the strategies and capabilities for leading and managing this form of change.

Specifically, it aims to provide:

- an accessible overview of business model innovation that provides insight into the drivers and the competitive benefits of these forms of change;
- a guide to the major types of business model innovation, drawing in particular, on case studies from Australia;
- a framework for assessing the implications of business model innovation for strategy and competency development at the firm level;
- a framework for designing and implementing business model innovation.

THE ORGANISATION OF THE REPORT

In the following section, the report clarifies the concept of a business model, differentiating a firm's business model from its strategy and business plan. This section also provides illustrative examples of business models.

Section 3 provides examples of innovation in business models, clarifying the particular nature of business model innovation and what is different from product or process innovation – the more usual focus of innovation strategies and efforts. Business model innovation can sometimes offer an opportunity for a new approach to value creation that does not involve either large investment or major technological innovation.

Section 4 explores the major drivers of business model innovation and discusses why business model innovation has become important for many firms. In many sectors business model innovators have been quite disruptive, undermining the competitive positions of leading firms in ways to which the established firms find it difficult to respond.

Section 5 outlines a strategic framework for designing and implementing business model innovation. It emphasizes the importance of exploration and creativity in re-framing and re-visioning the competitive space, and of fast learning in managing change.

2. What is a Business Model?

A business model is how a firm creates value for customers, partners and itself. It is the firm's answer to the question: what to produce, for whom, and how to make money from doing so. It links a firm's strategy with the operationalisation of that strategy.

While a strategy is a theory of how to compete, the business model articulates the core logic for creating value through using resources and capturing some of that value as returns.³ Hence, the business model is essentially the core commercial architecture of the firm.

More simply, as shown in Figure 2.1, a business model defines the *who*, *what* and *how* of the business architecture:

- Who are the targeted customers?
- What is the value proposition offered to the target customers?
- How is the offering generated and provided and how does the firm capture value from the business?

One of the most significant business models was that of Henry Ford when he introduced the Model T. The change was much more than a new car. It signaled the beginning of mass production and a total shift not only in auto manufacture, but in industry and society. Over the thirty years from the introduction of the Model T, the number of auto manufacturers declined by over 95%, from 250 to less than ten. A few of the traditional manufacturers survived, and some still do survive in niches, although they too have had to incorporate elements of the new business model in their recipes.

Business Model	Traditional Auto Manufacturers	Henry Ford and the Model T
Who	Wealthy clients	Middle Class (a growing market)
What	Expensive luxury cars	Simple, robust and relatively cheap cars
How	Handmade with hand tools, by craftsmen in low volume	Standardised design, standardised parts, assembly line with division of labour, enabling economies of scale.

These basic dimensions - who, what and how - drive and locate the overall focus of a business model for a firm. Each dimension includes one or more components as illustrated in Figure 2.2 and described in Table 2.1.

³ Richardson, 2005; Mayson, 2010; Hedman & Kalling, 2003.

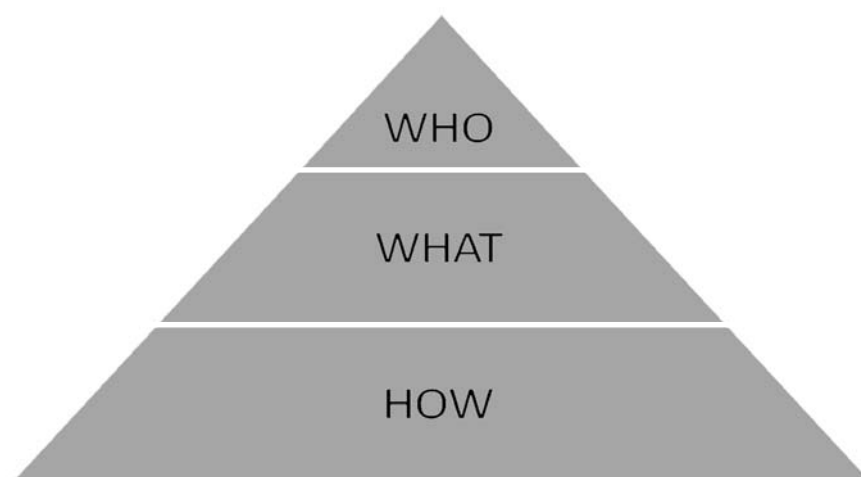


FIGURE 2.1: Key Elements of a Business Model

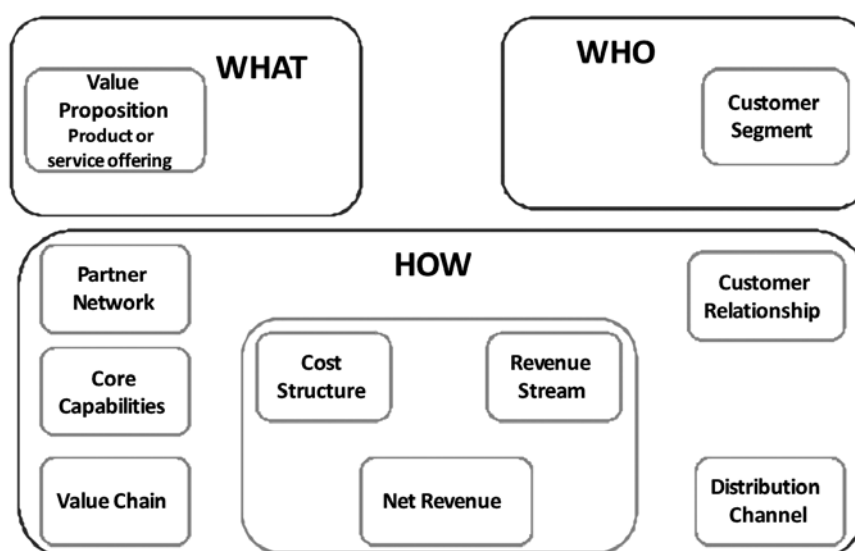


FIGURE 2.2: The Generic Components of a Business Model

TABLE 2.1: The Generic Components of a Business Model

Dimensions	Components
Who	Target Customer: The distinctive segment of customers to which the value proposition is targeted.
What	Value Proposition: The overall bundle of products and services that generate value for the customer.
How	Customer Interface: <ul style="list-style-type: none"> • Distribution Channel: The mechanism for delivering value to the customer. • Relationship: The kind of link established with the customer, e.g. a one-off transaction or longer term interdependence.

(Continued)

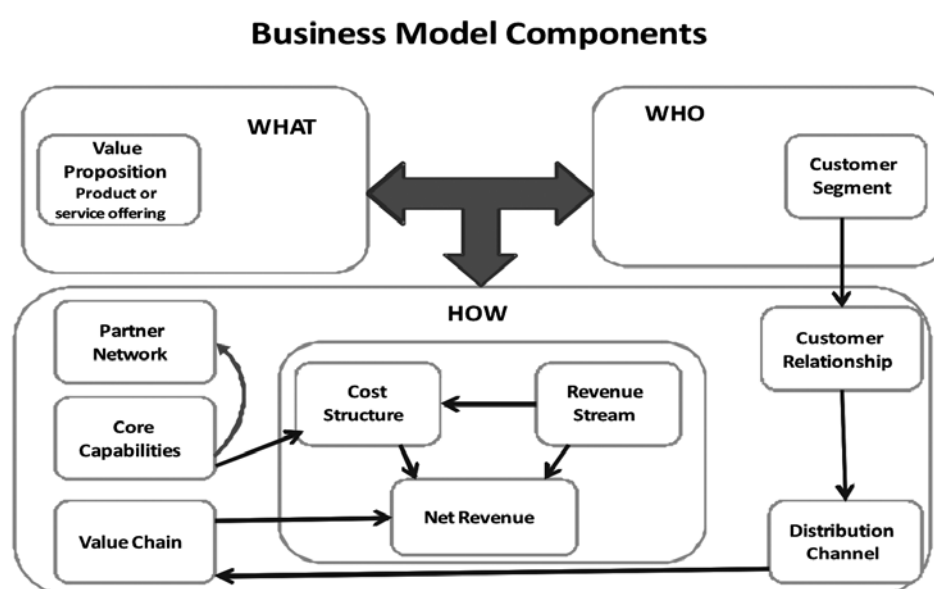
TABLE 2.1: The Generic Components of a Business Model *(Continued)*

Dimensions	Components
How	<p>Capabilities & Networks:</p> <ul style="list-style-type: none"> • Capabilities: The in-house capabilities necessary to create value for the customer – i.e. to design, produce and deliver the product or service. • Partner Network: Linkages with other firms or organizations that access external capabilities. • Value Chain: The configuration of value chain activities that provide value creation or support those activities, eg. Apple's organization of global suppliers to produce the iPod and of iTunes to access music etc. <p>Financial Dimensions:</p> <ul style="list-style-type: none"> • Cost Structure: The sources of cost involved in generating value. • Revenue Model: The way money is made through a variety of revenue flows and how profit is gained.

Based on Osterwalder (2004)

However, for an effective business model it is vital that the components are aligned, each reinforcing the others, as illustrated in Figure 2.3. The value proposition should be carefully designed to appeal to the target market and the components of the 'how' should underpin both a distinctive offering and a profitable business. An integrated and aligned business model, with a high level of distinctiveness in the product or service, and in the capabilities, processes and relationships that support the offering, is also more difficult to copy. These issues are discussed further in Sections 4 and 5.

Where a business model is embedded in specialized skill and knowledge, unique firm culture, close relationships that engender customer loyalty or collaborative links with other organizations in a firm's network or value chain, it is likely to provide a more sustainable foundation for development and performance of the business enterprise.

**FIGURE 2.3:** Business Model Components

Many successful new business models differentiate their offerings by providing value to a specific group of customers. Figure 2.4 illustrates the crafting of Yellow Tail wine for a

segment (*the who*) within the US market. A similar combination of product attributes (*the what*) had previously proven effective for wines such as Jacob's Creek in the European market. In these cases, decades of investment, research and training in Australia and relationships with distributors, retailers and marketers, provided the foundation of the 'how' enabling Casella Wines to produce consistently good quality, low cost bulk wines of wide appeal. This careful targeting and business model alignment paid-off - Yellow Tail became the number one imported wine in the US market in 2003, and Casella Wines expanded capacity tenfold.⁴

As shown in Table 2.3 there are often several options for each specific component of business models. For example, a firm might sell a product directly through franchisees, or through a web portal. Over the past few decades the range of these options has expanded considerably. Demographic changes, new values, new product technologies, the diverse impacts of IT and communications, and the growth of export markets are some of the sources of new options for business model design.



FIGURE 2.4: Distinctive Offering (What) of Yellow Tail for the US Wine Market.

Derived from Kim & Mauborgne, 2005

The emergence of new firms with new business models also creates new business model options for other enterprises. For example, outsourcing creates opportunities for suppliers of specialized services. The growth of eBay has spawned thousands of traders using this platform, just as the advent of supermarkets supported the rise of national brands in an earlier era. The range of options for business models is continuing to increase and hence new opportunities are emerging continuously. At the same time, the foundations of many long established business models are eroding.

Often firms are reluctant to reassess and rethink their business model – “*why change a good thing*”. This reluctance arises in part from a reliance on established ‘industry recipes’ where their business model was essentially just adopted as ‘the way things are done’, rather than consciously and purposively designed. This leads to unconscious conservatism. Conscious conservatism, arising from concerns about the capabilities for change, the risk of destroying an established business and the uncertainties of a new model, is also a source of reluctance to depart from an established business model. These issues are discussed further in Section 5.

⁴ Kim, Chan W. and Mauborgne, Renee, ‘Blue Ocean Strategy: How to Create Uncontested Market Space and Make the Competition Irrelevant’, *Harvard Business School Press*, 28, 189, pp. 31-32, 2005. Bieler, Kristen Wolf, ‘Behind the [Yellow Tail] phenomenon: How it happened and what’s next?’ *Wisconsin Beverage Guide*, March 2006.

TABLE 2.3: Business Model Diversity: Focus Questions and Options

Focus Questions for Each Business Model Component	Examples of Options
<i>Who are our customers and what are their needs?</i>	Business or consumer; mass or niche; global or local; demographic segment, life-style segment.
<i>What do we offer them?</i>	Products, services, solutions, experiences, information; broad or narrow line; integrated, bundled or customizable.
<i>What is our distinctive value proposition for each customer group?</i>	Fun experience, trusted solution, high quality, status, design, reliable service, compatibility, convenience, ease of use, immediate availability, one-stop shopping, low price, trust (eg Whole Foods), free or nearly so (Google).
<i>How do we attract and retain them?</i>	Advertising, PR, word of mouth; high pressure or consultative selling; referrals or pyramid schemes, viral marketing; enabling co-creation.
<i>How do we reach them?</i>	Direct or indirect sales, multiple or focused channels; franchising; web sales.
<i>How do we set a price?</i>	Premium, competitive or low price; negotiated or fixed pricing; sales, coupons or promotions; auction or exchange mechanism; bundled or a la carte prices; pricing on cost plus, per click/transaction, percentage of the deal, number of eyeballs, subscription, value in use.
<i>How do we deliver distinctively?</i>	Standardise processes, drive cash velocity, economies of scale, streamline supply chain, cultivate flexibility and agility, minimize time to market, motivate with leveraged compensation.
<i>How do we develop a distinctive capability?</i>	Recruit and retain great talent, outsource non-core functions, culture of high performance, develop strong IP position, develop long term alliances, IT excellence, brand franchise.
<i>How is our financial structure distinctive?</i>	Employee ownership; use cheap capital; spin off ventures; franchise out retail operations.

Source: Developed from Linder and Cantrell (2000)

EXAMPLES OF AUSTRALIAN FIRMS BASED ON DISTINCTIVE BUSINESS MODELS

There are many examples of Australian firms that have built a successful business in a long established industry by developing a different business model. Many of these are relatively simple, but all address needs often poorly met by the established industry recipe in new ways. Most of these cases have grown rapidly once the business model was established, some have scaled-up the new model through investment or franchise arrangements.

In Table 2.4 several examples of old and new business models are provided. Then each of these cases is discussed in order to identify the target users, the product or service offering and some insight into the business processes that support the generation and capture of value.

TABLE 2.4: Examples of Traditional and New Business Models

Market	Traditional Business Model (Standard Recipe)	New Business Model
Travel Agency	Main street travel agency booking flights and travel packages.	Webjet enables exploring options and pricing and booking travel and related services on-line
Fast Food	Shopping centre fast food for shoppers and office workers: sandwiches, pies, hamburgers etc.	Sumo Salad offers healthy and convenient food options and now a feature of many shopping malls.

(Continued)

TABLE 2.4: Examples of Traditional and New Business Models *(Continued)*

Market	Traditional Business Model (Standard Recipe)	New Business Model
Coffee for Office workers	Typically grubby office kitchen with instant coffee, or a local coffee shop.	Xpresso Delight provides machines for quality coffee in the office with full support maintenance and resupply.
CDs, games and DVDs, and related electronics	Either sold through department stores, in sections of electronics stores or in specialist music, games or electronics stores.	JB Hi-Fi offers a discount product range combined with selected branded products oriented to young customers in stores oriented for that market as a value retailer.
Kitchen design and installation	Kitchen builders either visit with a portfolio from which to choose or have showrooms where design options are displayed.	Kitchener Kitchens enables customers to explore design and materials options and costs on line at their own convenience.
General medical services	General medical services where access is controlled by GPs who often need to be booked in advance – and are usually running behind involving a wait by customers.	Revive Clinics provide convenient basic health services in shopping and other centres, particularly for busy professionals.

CASE 2.1 WEBJET – A NEW TRAVEL AGENCY MODEL

Webjet was founded in 1998 by former Jetset Travel Chief Executive David Clarke. Webjet now dominates the Australian on-line travel retail sector. It developed a Travel Service Aggregator technology platform in conjunction with Galileo and Microsoft. This technology which can aggregate and display product from disparate suppliers has allowed Webjet to grow sales while controlling staff costs. This enables customers to book branded travel offerings over the web. Users can book whole travel arrangements including domestic and international flights, accommodation and car rentals. Webjet has several strategic alliances with on-line travel companies including domestic holiday packages from Qantas Holidays. It listed on the ASX in March 2000. Its share price has risen from \$0.03 to about \$2.30, giving it a capitalisation far above long established retail travel companies.

In addition to the on-line presence, Webjet also operates shopfronts in large part to advertise their presence. Several major travel or travel-related service providers have been investors in Webjet.

Its income is derived from service fees (rather than commissions) on domestic airfares and commissions on international bookings. Webjet charges a A\$6.95 service fee for every transaction, no matter what volume or amount. It aims to increase customer loyalty through software which helps customers to better manage their travel arrangements.

According to the MD, David Clarke, "At Webjet we have 16 full-time staff. The throughput of the best run traditional travel agencies is around \$1 million a year per staff member – we can do A\$6 million per person".

Similar web-based service providers include Wotif, Seek, carsales.com and RealEstate.com.

Sources: Kelly, M., 'Webjet Diversifies as Sales Grow', *Travel Times*, Jan 1 2005; Martin Kelly, 'Defining Year Ahead For Webjet', *Travel Trends*, August 8 2007.

CASE 2.2 SUMO SALAD – SCALING UP THROUGH A FRANCHISE MODEL

Who: health conscious consumers – the entrepreneurs saw a gap in the Australian market after living in New York.

What: “Initially it was a challenge, because salads were looked on as a side meal. We had to try to encapsulate big value, big taste, and something that would appeal to not only the female demographic but the male demographic.”

How: Working closely with suppliers to ensure consistent quality and availability and often through fixed price contracts that enable stable prices. Scaling the business model through franchising to enable rapid growth with low capital. Employing capable professional staff rather than family and friends. Branding: “... we thought the Sumo branding would help us represent something large, value for money, great tasting, different Asian flavors – and that’s why we went with it in a large branding experience.”

Since 2002 the company has grown to operate 74 stores, 62 of which are franchised, and reached a revenue level of \$29.5 million in 2007-08 and forecasts just under \$50 million in 2008-09.

Sources: Patrick Stafford, ‘Sumo Salad finds a healthy model’, *Smart Company*, 13 March 2009.

CASE 2.3 XPRESSO DELIGHT – RAPID GROWTH THROUGH A SIMPLE BUT DISTINCTIVE BUSINESS MODEL

Xpresso Delight was born in 2003, when the two entrepreneurs saw the impact of a coffee machine on the workplace in which one of them worked.

Xpresso Delight franchisees pay an upfront fee of \$64,400 plus GST. For that they receive seven coffee machines, two days training, business cards and everything else they need to operate five coffee stations. The franchisee then provides their machines to client businesses, free of charge. The franchisee charges the business \$1 per cup of coffee made; around 70c goes into the franchisee’s pocket while the other 30c is spent on consumables such as coffee and sugar, which franchisees get via the Xpresso Delight website. The franchisee is then entirely responsible for the weekly maintenance of the machine and also pays around \$25 a month in marketing fees. The company recorded a revenue level of \$2.4 million in 2007-08, and projects 2008-09 revenue to be \$3.7 million.

Source: Patrick Stafford, ‘Xpresso Delight keeps brewing’, 26 March 2009
www.smartcompany.com.au/.../20090327-xpresso-delight-keeps-brewing.htm

JB Hi-Fi was founded in 1974, bought out by investors in 2000 and listed on the ASX in November 2003, following a sell-down by Macquarie Private Equity. JB Hi-Fi trades from stand-alone shops and shopping centre locations, with more than 120 stores in major Australian cities. In 2004 it acquired a controlling stake in white goods retailer, Clive Anthony, and in 2007 expanded into the NZ market with the acquisition of the Hills & Stewart franchise. Its business

(Continued)

model that has enabled it to compete very successfully against Harvey Norman, the Good Guys chain, Woolworths, Myer and the Clive Peters group. Over the past 6 years it reported a compound annual revenue growth rate of over 36%.

The business model has several elements:

- an extensive but also selective catalogue of CDs and DVDs, at discount prices combined with a wide but selective range of branded consumer electronics – an unusual if not unique combination in Australia;
- strong positioning as a value retailer;
- a focus on the youth market and on high growth categories – projecting as a specialist retailer and benefiting from marketing synergies;
- an informal and helpful customer service atmosphere that builds customer loyalty – staff specialise in product categories;
- convenient opening hours – typically to 9pm;
- responsiveness – in 2006 JB Hi-Fi entered the computer/IT market focusing on young and tech savvy consumers. It recognized that personal entertainment hardware such as the iPod and laptops were becoming commodities. It applied its low cost strategies in these markets and captured a strong market share, enabling continued growth and profitability.

These elements of the business model supports the customer value proposition:

- ensuring discount prices through economies of scale in purchasing, advertising and support services. JB Hi-Fi is a member of NARTA, a group of larger independent stores and chains. NARTA is one of the largest industry buying groups in Australia when measured in purchases and is a similar size to Retravisio and Harvey Norman. Being a part of this buying group allows JB Hi-Fi to obtain competitive pricing;
- a high proportion of sales are in discretionary sales items (with very little stocking of high cost larger white goods) leading to high turnover;
- low occupancy costs underpinned by long term leases (store occupancy costs as a percentage of sales are below industry benchmarks);
- siting stores in shopping centres with high customer traffic;
- low marketing costs (about half that of Harvey Norman as a percentage of revenue) due to location and product synergies;
- low supply-chain costs;
- centralised group management ensuring a consistent management of the brand name and business;
- high store productivity – JB Hi-Fi operates with a high proportion of selling space in its stores and a bargain/market style environment;
- recruiting, developing and retaining appropriate staff.

Sources: Thomson, James, 'The 10 strategy secrets of JB Hi-Fi chief Richard Uechtritz – here's what you can learn', *Smart Company*, 9 February 2010; Gottlieb, Robert, 'Vindication for JB Hi-Fi', *Business Spectator*, 11 August 2009; Wang, Felton, 'Sink or Swim: A critical study of the success of the JB Hi-Fi business model', *Ozbankers.com*, 06 October 2009; James, David, 'Method in the madness', *BRW*, 26 June 2008; *JB Hi-Fi Prospectus*, 2003.

CASE 2. 5 KITCHENER KITCHENS – FINANCIAL CONSTRAINTS LEAD TO A NEW APPROACH WHICH GENERATES CUSTOMER VALUE

Started in 2004 by Peter Kitchener, Kitchener Kitchens uses the web rather than a showroom to establish customer contact and generate enquiries. The firm has now established showrooms in Sydney and Melbourne, but more than half of the customers buy without having set foot in a showroom. The firm makes extensive use of IT to monitor progress from design to delivery. It has a strong commitment to environmental sustainability, is carbon neutral through buying offsets and chooses glues and materials for their environmental performance. As the 20,000 small to medium sized businesses in the City of Sydney local government now account for 12.5 per cent of NSW's gross domestic product and nearly 5 per cent of the nation's GDP, business model innovation, particularly those changes that increase the value to users like this one, can spur growth.

Source: Dillon, Jenny, 'Innovation Proves a Winner for Kitchener', *Daily Telegraph*, 26 October 2009.

CASE 2. 6 REVIVE CLINICS – TAKING HEALTH CARE TO THE CUSTOMERS AND ADDRESSING A POORLY MET NEED

Revive Clinics is a chain of nurse practitioner clinics established by Louise Stewart, a former IT executive. The clinics provide primary health care in shopping malls. The firm began in 2004 as an internet portal providing consumer information on local health care providers. It then moved into on-site corporate health services. The first Revive clinic was established in Perth in 2009 and by April 2010 there were 8 clinics across Australia. Each clinic is staffed by an experienced tertiary trained nurse. The clinics do not take bookings but rely on the 'passing trade' in busy shopping centres. The Revive business model is based on patients not receiving a Medicare rebate, but expected legislation will enable rebates for the services that Revive provides.

Who: time-poor, well-educated business person who can access a shopping centre, who will trade off convenience and cost.

What: Primary health care and advice with convenient access.

How: Extensive use of IT to provide information on local health service providers and to manage records; franchise model for scaling-up.

Sources: Kaplan, Morris, 'Healthcare without a Doctor in the House', *The Australian*, 3 April 2010.

The business models of these six Australian firms illustrate several points:

- All are developed around a clear focus on the target customers and the value proposition for that group. The value propositions are often quite straightforward: healthy fast food, good quality coffee at work, convenient medical services. In some cases the businesses are responding to emerging trends in customer preferences. But in all cases the challenge is to provide an offering that is effective, repeatable, scaleable and profitable. For new firms beginning at a small scale, the answers to the key questions of who, what and how of doing business are worked out 'on the job' through experiment when the risks are low.
- Some illustrate the power of web-based customer connections that empower the customer (providing access to information and price comparisons) and also offer lower transaction costs. In some instances, customers chose to deal with the business online in preference to visiting in person.

- All show the importance of integration among the elements of the business model. JB Hi-Fi is a particularly good example of an effective overall framework with careful management of many smaller elements. All of these cases were customer-focused and delivered a value proposition to their target market that was highly valued by that market.
- None of the cases was dependent on significant technological innovation or major capital expenditure.

CONCLUSIONS

The key elements of a business model are based on answers to:

- Who are the targeted customers?
- What is the value proposition offered to the target customers?
- How is the offering generated and provided and how does the firm capture value from the business?

A strong business model has a value proposition carefully designed to appeal to the target market underpinned by the components of the 'how' to ensure both a distinctive offering and a profitable business. The close alignment of the elements of a business model improves effectiveness. Distinctive and closely integrated elements are also more likely to contribute to sustainable competitiveness – the model is harder to copy.

There are often several options for each specific component of business models. The evolution of technology, markets and business has led to a widening range of such options.

3. What is Business Model Innovation?

Innovation in a business model is a transformative change in an enterprise's recipe for doing business. However, the starting point of significant business model innovation is an insight into the key elements of a new business – a re-visioning of the *who*, *what* and *how* that leads to a change in the self-concept of the firm, its target market and its sources of distinctiveness.

The EIU survey of 2006 found that changes in all of the dimensions of business models were being introduced by firms: value proposition, cost structure, targeted customer segment and geographical market, value chain positioning, and revenue generation model. A business model innovation might begin with a focus on one of the major dimensions of doing business – *who*, *what* or *how*. But the essential realignment for effectiveness and coherence will generally involve change in all of the dimensions. For many new business models, the key insight is an idea for how to profitably create value for a new or underserved customer group.

This chapter will give several examples of firms that have developed new business models, from different starting points. Table 3.1 provides examples of now large and successful United States firms that have built sustained growth on new business models.

TABLE 3.1: New business model examples showing scope, characteristics, processes and outcomes

Company	Opportunity	Who	What	How	Sustainability	TSR
Dell	PC industry based on build-to-stock	Experienced PC buyers	Self service PC solutions	Build to order, direct channels	Incumbents focused on build to stock and established channels	52%
Charles Schwab	Scope for online information access for financial services and products	Lifelong average net-worth investor	Multi-channel, multi-product access, including from competitors	Integrated channels	Incumbents unwilling to sell competing products	26.2%
Paychex	Small business underserved by outsourcing industry	Small business	SME focused payroll outsourcing	Brand, low cost operations	Incumbents unable to profitably serve SMEs	32%
Harley Davidson	Non-distinctive Japanese motorcycles	Rebel image	Branded motorcycle rebel lifestyle	Brand, Harley owner groups	Distinctive 'rebel' brand	35%

TSR: Total shareholder return (five year annualised rate, including dividends)

Source: Based on Deloitte Research, 2002

A business model innovation is more than the introduction of a new product or service innovation – i.e. a new or different *what*. In fact, the success of a significantly new product or service is often dependent on developing the business model that drives both customer value and profitability, and disrupts the established players. Over the last 30 years many firms have grown rapidly through business models that, supported by deep change in processes and value chain relationships, provide improved services to customers, for example: McDonald's Fast Food, Dell Computers, Netflix, eBay, Amazon.com, and ING Direct. In all of these cases the offering met the needs of a significant customer group better than did the alternative offerings. Table 3.2 provides several examples of new firms that have grown to be leaders in their sector through business model innovations.

TABLE 3.2: Business Model Innovation Cases Selected in the Deloitte Research Study

Company	Business Model Innovation	Year introduced
Start-Ups		
Amazon	Online retailer	1995
AOL	Online content provider	1993
Southwest	Low-cost air travel	1971
Starbucks	Multi-channel experience retailer	1971
Wal-Mart	Mass discounter	1962
Transformations		
Columbia	Specialty clothing mass merchandiser	1985
GE	Bundled product/service solution provider	1990
Wal-Mart 2	One-stop mass merchandiser	1987
WellPoint	Customized health insurer	1986

Source: Deloitte Consulting, 2002.

An innovative business model might be introduced by a new firm entering a sector with a new approach, different from the established industry recipe. Ford's Model T, Webjet and Revive Clinic are examples. The success of eTrade, and similar on-line share trading services, is based on both the facility provided by the web and the emergence of active traders who use a range of sources for investment information, rather than rely on one broker. These users prefer to unbundle the service offering and pay for the specific elements they value.

Established firms can innovate in their business model, either to move into a new market or to strengthen their position in their current or closely related market. For example, Casella Wines was an established business prior to the successful move into the US market with the Yellow Tail line of wine. An extensive study of successful business model innovation in large US firms over the 40 years up to 2002 found that in more than half of the highest performing cases the business model innovation was by an established firm (Deloitte Research, 2002) – see also Table 3.2.

As with any form of innovation there is a full spectrum from minor or incremental innovation to radical innovations.⁵ Minor change may involve a re-alignment or extension of a business model, for example by adding a web-based marketing and sales portal to a traditional retail business, or by outsourcing activities previously carried out in-house. Radical business model innovations, based on new concepts and new capabilities, may have major impacts on the market and industry – as was the case with the Model T, the PC and today with the iPod/iTunes and the iPhone.

⁵ The novelty of a business model innovation might be high (new to the world), moderate (new to the sector or country), or low (new to the firm), but is nevertheless an innovation for the firm.

The Benefits of Innovating the Business Model

Business model innovation can sometimes offer an opportunity for new approaches to value creation that do not involve either large investment or major technological innovation. In fact, without business model innovation the returns to investment in equipment, research or marketing will often be poor.

A shift in focus and an exploration of new paths through internal and external engagement and experimentation can lead the way to deeper change and more sustainable competitiveness.⁶ In such cases, a new business model may extend and add value to an existing business model and open a path of evolution into new lines in business, as in the case of Orica Mining Services moving from selling explosives to providing blasting services (see Case 3.6). Firms often respond to pressure by adjusting their processes or products/services, for example by cutting costs or upgrading product, without revisiting the basic business architecture. This is a lost opportunity to benefit from more comprehensive and coherent business model innovation.

EXPLORING BUSINESS MODEL INNOVATION – THE ‘WHO’ DIMENSION

There are usually some customer groups (market segments) for whom the mainstream products or services are not appealing – because, for example, they are too expensive, too complicated to use, not accessible due to distance or utility requirements, or not fashionable. This is particularly the case when industries mature and their offerings become standard commodities. Demographic change, or changes in wealth, values or fashions may lead to growth in the size of such disaffected market segments, making them more attractive to serve. Changes in available technologies, materials or services may make it possible to meet needs that could not profitably be met in the past. For example, the internet makes it possible to provide customized information services at low cost.

Many firms have been successful with new business models that target **emerging** customer preferences, often not adequately met by established firms. Table 3.3 provides several examples of firms that have developed business models to address new market segments. Some of these firms (and other examples listed in Table 3.2, such as Amazon) have grown from small start ups to be major global businesses through a business model that effectively addressed an inadequately met ‘need’. In Australia, Sumo Salad (Case 2.2), for example, targeted those consumers seeking healthy and convenient eating options. This illustrates just how frequently new firms replicate long established business models, as has been the case for most ‘fast food’ outlets in shopping centres (eg sandwiches, kebabs, hamburgers, pies etc). Micro and boutique breweries and ‘Starbucks style’ coffee lounges are other examples of trend-based new business models – all based on new business models in the US and Europe.

TABLE 3.3: Firms that Found New Market Segments⁷

J. Robins

J. Robins focused on retailers who aimed to meet changing demand for fashion shoes and who valued rapid supply of designer shoes.

Jetstar

Travellers who prefer unbundled service offerings so that they can choose only those services they wish to pay for.

(Continued)

⁶ Mitchell, D. W. and Coles, C. B., ‘Learning Agendas: Business Models that Work’, *Chief Learning Officer*, October 2003.

⁷ The US examples used here are from Deloitte Research (2002).

eTrade

Following deregulation of brokerage, eTrade focused on experienced investors and day traders who were happy with low-cost on-line do-it-yourself share trading and did not want full service advisory arrangements.

Paychex

Established firms focused on providing payroll services for large firms. Paychex focused on small firms – which the established firms ignored.

Columbia Sportswear

Columbia transformed from a regional hat distributor to a large distributor of outdoor sports clothing through identifying the lifestyle shift to outdoors activity and the growing demand for competitively priced, branded outdoor clothing. Established firms were either producers of branded outdoor clothing or distributors of largely unbranded low-priced outdoor clothing.

America Online

Targeted novice users of the internet largely ignored by CompuServe which focused on the more computer savvy users who needed few support services.

General Electric

GE recognised that manufacturing customers were seeking more than the supply of one-off equipment items and that the market was shifting from being transactional to relationship-driven as users sought solutions rather than simply hardware.

Harley-Davidson

Harley Davidson faced declining market share due to competition from Japanese motorbike producers and inefficient manufacturing facilities. They repositioned as a lifestyle product appealing to a wider range of users, leveraging their status as an icon, their loyal customers and their distribution.

To better understand business model innovation focused on new customer groups (ie the *who* dimension), we examine three case studies of such innovation in Australia:

- **J. Robins** (Case 3.1) found a market in Australia for quality women's fashion shoes designed and delivered to meet a specific short-term demand. With that focus, and following successful overseas exemplars, *J. Robins* evolved a 'lean manufacturing' and mass customisation business model for manufacturing shoes in response to growing competitive pressure from imports.
- **Jetstar** (Case 3.2) was introduced by Qantas in response to the loss of market share to Virgin Blue. The design and introduction of the new business model was carefully planned and managed. The new venture with a new business model has been highly successful.
- **Adroit Lawyers and Bespoke Law** (Case 3.3) responded to the growing number of smaller corporate clients who sought lower cost and more flexible legal services. Addressing that market segment required changes in the offering and the organization of the business.

J. Robins is now the only volume producer of women's shoes remaining in Australia. The firm developed a new strategy following the tariff reductions of the 1980s and the inevitable rise in competition from offshore low cost producers. Spurred by the realization that major change was essential, the firm benchmarked world's best practice. It drew in particular on lessons from the Japanese auto industry to develop a stronger alignment between business processes and the creation of customer value. 'Just in time' and 'lean manufacturing' using production cells (teams) and modular manufacturing were the foundations of a new approach.

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J. Robins survives by focusing on mass customization. It cannot compete with the low-cost offshore producers on price, but it can provide high quality shoes to customer specifications in a fraction of the time that it takes offshore producers to supply. The key features of their business model are:

- Small batches.
- Designed range of shoes set out in a catalogue and on a website.
- Radical reduction in 'work in progress' and in lead times.
- Advanced equipment with CAD/CAE/CAM to support quality and the most efficient cutting of leather.
- Outsourcing of the most labour-intensive work overseas.
- Increased vertical integration to give control over leather supply.
- Multi-skilled workers in self organizing teams (production cells) with staff moving around work stations to produce the product.
- Devolving to teams decisions about training and internal organization.
- Rapid turnaround from order to dispatch – five to ten days. (compared with three to four months from China).
- Enabling retailers to carry less stock and hence have lower risk of unsold inventory.
- Focus on customer specifications.
- Selling through a range of retailers including fashion brands.

This performance is supported by investment in training and by organizational innovation. It is also enabled by investment in high quality German and Italian machinery. Achieving high performance in a team organization required a focus on the social relations in the workplace. The team-based approach and concern about social relations has led to a very low turnover of staff.

As other Australian shoe manufacturers ceased production in Australia, the survival of the local suppliers of components and services was threatened.

Sources: Roberts, Peter, 'Shoemaker puts best foot forward', *Australian Financial Review*, 26 May 2009; James, David, 'Process of Creativity', *Australian Business News*, October 2006; Warnock, Alyson, 'Fashion Manufacturing', *ABNews*, October/November 2006.

CASE 3. 2: JETSTAR – DRAWING ON INTERNATIONAL EXPERIENCE WITH NEW AIRLINE BUSINESS MODELS

In 2001 Virgin Blue announced expanded services, reducing Qantas domestic market share to 60%. Qantas responded by creating Jetstar, a new cut-price subsidiary airline. Jetstar Airlines was established by Qantas in 2003 as a low-cost domestic carrier. It commenced operations to NZ in 2005. Jetstar Asia Airways (a joint venture with Qantas having a 49% stake) began in 2004. Jetstar Asia and Valuair merged in July 2005, consolidating some routes in SE Asia. Jetstar's strategy, informed by market studies, was to focus on the domestic and international leisure market. Qantas focused Jetstar's activity on low margin routes and has progressively shifted more of its capacity to Jetstar. Jetstar aims to become the world's first global low cost airline. In 2007, Jetstar won the Skytrax World Airline Award as the best low cost airline in the world. In January 2008, Jetstar carried 680,000 domestic passengers, up 12.8 per cent on January 2007, and 149,000 international passengers, up 65.7 per cent in the previous corresponding month.

(Continued)

"The barriers to entry have...got lower. Airports... have more available slots than they had years ago. There are a lot of new and second-hand aircraft The Internet has simplified distribution systems, so that aspect, too, is less formidable than it was [about 80% of bookings are directly from the web and passengers can book their seat at the time of booking]." (Alan Joyce).

Alan Joyce commented that the challenge in rapid market entry was as much a capability as a resource issue:

"We did bring in outsiders where we needed them, not necessarily from the airline industry. The person who oversaw the set-up of all our distribution systems, for example, came from Boston Consulting Group. Our head of HR, at the other hand, had worked with many airlines across the world, particularly with Southwest Airlines in the US, where they had had good experience with the rapid recruitment philosophy of 'recruit for attitude, train for skill' that we wanted to implement. Other key members came from Qantas, such as our head of network planning and revenue management, and other airlines, especially Impulse. Around half of the management team came from Qantas businesses, the rest came from outside."

They looked carefully at successes and failures launching low cost airlines around the world, they looked at: *"Ryanair for efficiency, Southwest for recruitment, Jet Blue for their use of technologies and so on. The challenge, of course, is to translate those lessons to the unique market place we are operating in today, rather than just simply imitate something unthinkingly."*

To support effective implementation of the business plan a decision was made to have the planning team be the implementation team so that they were responsible for delivery on the plan. In the implementation the team were aware of the risk of cannibalising the full service airline and the risk of failing to execute a low-cost airline. They took the approach 'hire for attitude, train for skill':

"We wanted people who were very energetic and customer-focused, from all ages and ethnic groups. Unlike our competitors, for instance, over half of our customer service people are over 35 years of age."

"The cannibalisation risk can be mitigated in a number of ways: coordination of networks so that the products don't compete too much on exactly the same routes, coordination of pricing, and making sure your brand is targeted at different segments. One bonus of entering the market was that the perception of Qantas was elevated, as the contrast between a full-service and a low-cost position become more apparent."

"You need to have a strong vision of what you want to achieve, but you need to keep it general enough to allow your people to work out the details as you go along. It's very easy to get bogged down in the details of planning."

Source: <http://www.ceoforum.com.au/article-detail.cfm?cid=6216&t=/Alan-Joyce-Jetstar/Fast-takeoff>

Until recently the drivers of change in the legal services sector may not have been so forceful in Australia:

"I came back to Australia thinking that the Australian legal industry here is still quite outdated. There is still an antiquated model of only, or predominantly, using and relying on external and private practice lawyers. It's time to move on and think beyond the circle." – Jeremy Szwider, Bespoke Law.

(Continued)

In Australia, the virtual lawyer (Disbursed Virtual Business Model) has been introduced by for example, Adroit Lawyers, Idealaw and Bespoke Law. This low overhead model involves lawyers who work from a variety of locations – home office, client's office, coffee shop – and make extensive use of communication technologies. These business model innovations are stimulated by clients' search for ways to cut costs:

"In the current economic climate, the idea of the virtual lawyer makes perfect sense. Gone is the elaborate office, the marble reception area, the bells and whistles of a more traditional law firm that, in a recession, can look fiscally indulgent. And for organisations questioning the costs of in-house lawyers, the virtual lawyer can offer the chance to deploy legal expertise only as the need arises, instead of committing to a full-time salary."

Mark Toohey, the founder of Adroit Lawyers, identified a gap in the market for a "contractor" style of general counsel and this led to his introducing a new form of business. The essence of the business model is:

Who: Small and medium size firms that question the cost of in-house lawyers and the high cost full service legal service provider. Focus on IT and media sectors, particularly helping start-ups, and deals for the coverage of major national sports and international events. Work in broader areas of corporate and finance law. Many SMEs and start ups: "just need someone to come in a few hours a week – or maybe a few hours a month – just to keep oiling the machinery, to provide someone they can go to when there is a problem."

What: legal services provided by lawyers with General Counsel level in-house experience combined with the engagement flexibility of an external law firm, so avoiding salary costs and all related employment obligations. The customer value proposition also involves:

- Lower costs.
- Flexible billing – billing is determined by individual clients who might prefer time-billing, a fixed-fee or to place their "legal consultant" on a retainer.
- A willingness to work in clients' offices provides a more personal service: *"I act for clients as if I am an employee ... That's where I get this hybrid model. I sit in their offices if they want me to. I'm not fixated on a location, I can rotate and fees and billing can be adjusted accordingly."* – Jeremy Szwider, Bespoke Law.

How: Strong expertise in the legal dimensions of the client's business, with good knowledge of the client's business sector, and extensive use of IT and communication technology to support flexible connection:

"I view my practice as being run from my BlackBerry, my office, my teleconference facility, or my client's office. All I need is a BlackBerry, and with a personal touch, you can achieve anything. You don't need to be sitting in a large building with a fancy boardroom." – Jeremy Szwider, Bespoke Law.

Sources: Quoted in 'Lawyers on the road: a virtual reality', *Lawyers Weekly*, April 28 2009.

http://www.lawyrsweekly.com.au/blogs/slide_show/archive/2009/04/28/lawyers-on-the-road-a-virtual-reality.aspx;

<http://www.adroitlawyers.com.au/whats-so-different-2/>

EXPLORING BUSINESS MODEL INNOVATION – THE 'WHAT' DIMENSION

The *what* of a business model includes the offering, the channels to market, and the users' experience (from being aware of the product or service to their after-purchase use) - all form the overall value proposition. A characteristic of strong business models is a clear and strong value proposition for the target users, avoiding the temptation of a less focused value

proposition aimed at a wider target.⁸ The critical dimensions of the product or service are those particularly valued by the target users and which differentiate them from competing offerings. Table 3.4 on Design of the 'What' Dimension of Business Models defines some of these key differentiating elements. This process may involve insight into the behavior of the target users and the context of use of the product or service.⁹

TABLE 3.4: Design of the 'What' Dimension of Business Models

- Time – readily available services, e.g. basic health services provided by nurses in shopping centres rather than booking appointments with doctors.
- Capital costs – users hiring rather than owning equipment.
- Unit costs – providing a product or service with only the elements sought by the user group and removing high cost elements.
- Expertise/ skill – providing after sale maintenance or easy to use applications software.
- Access – small and light netbooks that are highly transportable, digital music devices that enable access to music anywhere.
- Speed – more rapid provision of a service, e.g. Fedex's system for very fast parcel delivery.

A targeted and differentiated value proposition might involve removing or reducing some dimensions of the product or service. For example, the lean service model of low-cost airlines. The alternative is to enhance some attributes of the product or service. For example, ease of access as in on-line share trading. Hence, unbundling and restructuring of the value dimensions can enable improved targeting to specific types of customers.

A carefully orchestrated and integrated set of service attributes (the *what*) has enabled low-cost airlines in many countries to both undermine the dominance of long established full-service airlines, and provide air travel services to a much larger number of customers. In this way, they are transforming the industry and tourism. See Figure 3.1: Ryanair's Disruptive Value Proposition.

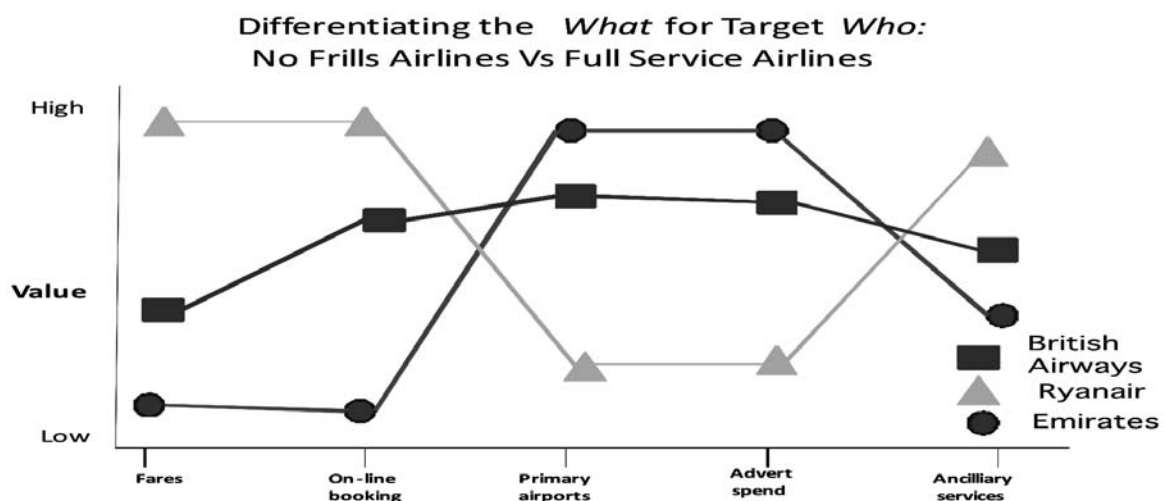


FIGURE 3.1: Ryanair's Disruptive Value Proposition.

⁸ A Deloitte Research study (Deloitte Research, 2002) found that, having chosen a target group of customers, most business model innovators carefully developed their offering for that group.

⁹ See Kelley, T., 'The Art of Innovation: Lessons in Creativity from IDEO, America's Leading Design Firm', Doubleday, 2001; Brown, Tim, 'Innovation through design thinking', <http://mitworld.mit.edu/video/357/> 2006; Hagel, J. Brown, J. and Davison, L., 'The Power of Pull - How Small Moves, Smartly Made, Can Set Big Things in Motion', Basic Books, New York, 2010.

New offerings can also be more attractive if they provide opportunities for customers to access the product or service through channels familiar to them, enable a wider range of choice, or enable users to reconfigure the specific offering themselves. Having built a loyal new customer base, it is often possible to sell related products and services to those customers. For example, Amazon and Dell both offer self-service options that are highly attractive to many customers. Both provide customers with a great deal of valuable information – considerably more than a direct service provider could manage – at very low cost to the provider and the user. As discussed above, many product firms face the challenge of commodification, that is a declining scope for differentiation, increasing competition and hence shrinking margins. The more innovative firms facing these challenges have sought to develop new business models that provide new value propositions. An outstanding example is IBM with its transformation from a supplier of hardware and software to a supplier of integrated solutions, using hardware and software from many suppliers. Through the 1990s IBM began to search for new sources of growth and profitability. It experimented with increasing the provision of services to customers. By 2006 it had sold its PC business to Lenovo and had built a global IT service business, focused on providing comprehensive IT solutions to customers, which accounted for half of the firm's US\$90 billion revenue.¹⁰

The internet provides a powerful new mechanism for transmitting information and for facilitating transactions – it radically reduces search costs for users and transaction costs for buyers and sellers. In the process it provides the basis for a diverse range of new and augmented business models. It also weakens existing business models that have relied on 'captive' users – captive, for example, because it was difficult to compare the offering with competitors or because suppliers were offshore and the transaction costs were prohibitive or risky. For example, many Australians now buy almost all of their books from Amazon in the United States. It takes a fraction of the time involved in visiting a book store and the additional services provided through the on-line store (reviews, access to second hand or discount suppliers, compilation of purchasing history, alerts for new books, vast searchable database) are far superior to those of retail bookstores. It appears that the next stage in this path of evolution is likely to be distribution of many books (and music and films) as digital files with virtually zero transaction, distribution and storage costs, along with the capacity for the customer to instantly search inventory and independent product information. It appears unlikely that retailing books, music and film embodied in the physical format, will be a viable business model in its current form.

While the foregoing examples of new value propositions based on on-line service delivery address the 'what' dimension of business model innovation, clearly the use of the internet is also central to the development of the 'how' dimension of the business model. For example, ING Direct focuses on telephone and internet banking, so avoiding the costs of a branch network. As a result ING Direct has costs to assets less than 20% those of conventional banks. As a result of the sharper pricing which the 'lean service' business model makes possible, it has won market share from established banks, grown rapidly in nine countries and become highly profitable.¹¹

The Brisbane-based wealth management provider and accounting firm, Logiro, provides an on-line accounting interface for users. In order to better meet customer service needs they are using a Software as Service model (SaaS) based on the Australian-made product Saasu. Customers enter their financial data on line where it can be accessed by Logiro. The system lowers costs, provides up to date information on the status of customer accounts and enables Logiro to focus on value-adding rather than transaction services. This approach will also be likely to enable the firm to survive the major shake-out in the accounting industry that would follow removal of the requirement for all individuals to submit tax returns.

¹⁰ Harvey, J., 'Transitions: The IBM Story', Switzer Communications, Sydney, 2008.

¹¹ EIU, p.19-20, 2006.

An increasing proportion of retail expenditure is now through one of the many on-line retail sites, some with new approaches to discount sales (such as Zazz), others idiosyncratic and catering to specialized markets (such as Stiletto Moody) and an increasing number that are the on-line interface of established traditional ('bricks') retail outlets – see Case 3.4: On-Line Retail.

CASE 3.4: ON-LINE RETAIL

Online retailing has grown strongly over the past decade and many successful firms have been established by entrepreneurs and by firms with existing physical retail outlets. One outstanding example of an entrepreneurial start up is Net-a-Porter, founded in the UK in 2000, at the height of the dotcom bust. The site sells up-market fashion including brands such as Burberry and Jimmy Choo. It targets customers who want the convenience of buying fashion online before these items are in the stores. Net-a-Porter reached revenue of about \$200m by late 2009 (50% growth over 2008) with average transactions of \$830. The site had over three million visitors a month attracted by the editorial content which provides current fashion news. In early 2010 Richemont (owner of brands such as Cartier and Montblanc) agreed to buy Net-a-Porter for \$580 million.

Australians are spending considerably less shopping online than other countries, according to a global digital study by market information group TNS. The Digital World, Digital Life study, which investigated online behaviour in 16 countries, found that those Australians who shop online spent an average of \$760 in the past month compared to the global average of \$3160. The most common items bought by Australians who purchased or ordered something online were electrical goods (25%), books (22%), clothes (18%), and tickets to theatre and cinema (17%). Britons are mainly spending on books and music and most of Americans' online spend is on books and clothes. IBISWorld estimate that Australian online spending will grow by about 5.5% annually for the five years, from \$15.1 billion in 2007-08 to \$21.2 billion during 2013-14.

Online retailers focus on providing a customer experience that generates sales, and goodwill and loyalty. But building trust (over product quality, honest product statements and secure transactions) and efficient logistics remains a challenge.

Examples of online retailers in Australia include:

- **DealsDirect.** This online department store is Australia's largest, selling everything from office chairs to blenders. Auctionbrokers founded in late 2000 enabling businesses to clear excess stock via an online auction. The site became eBay Australia's number one seller by dollar value, and among the top 10 in the world by US dollar value. In 2004 the founders of Auctionbrokers founded DealsDirect.com.au as an online department store. The site has grown rapidly with revenue over \$50m in 2007-08.
- **Kogan Technologies.** Founded in 2006, the company assembles televisions, DVD players and other electronics with components from different manufacturers. The devices are sold at cheaper price, but with the same parts from larger brand names, such as Samsung or Sony. Revenue is projected to be between \$15 million and \$20 million for 2008-09.
- **Zazz.** Zazz sells a single discounted product each day. Its product range is diverse low cost personal and household goods.
- **RedBalloon.** RedBalloon is a gift purchasing site that focuses on selling an experience, offering vouchers for interstate trips, massage services and even cooking classes in the form of vouchers. The firm uses customer feedback to improve products and service. Revenue in 2007-8 was about \$18m.
- **Catch of the Day.** Similar to Zazz the site sells one product a day until it sells out, but customers can also buy different products from other sections of the site. Revenue in 2007-8 was reported at \$40m and the firm has grown rapidly.

(Continued)

- **Officeworks.** The online version of the office supply superstore has widened the product range from the stores, selling for example discounted computers and software.
- **Dick Smith.** Dick Smith's online site has developed into the 18th most popular Australian shopping website according to Hitwise.
- **Peter's of Kensington.** With a well known homewares shop in Sydney, the firm opened an online site in 2000. It focuses on discounted brand-name kitchen products, but is widening its product range.

Sources: Stafford, Patrick, 'Online retail does pay', *Smart Company*, 6 April 2010; Gome, Amanda, 'Why online retail in Australia is lagging the world', *BRW*, 10 March 2009; Smith, Jasmine, 'Why e-tailing is in its infancy in Australia', *Inside Retailing*, 25 June 2007; Stafford, Patrick, 'Top 10 online retailers', *Smart Company*, 10 February 2009.

One area where new business models have been particularly effective is the advertising websites – see for example On Line Real Estate (Case 3.5). The growth of on-line advertising and auction sites (such as CarSales.com and eBay) is eroding the long established business model of the newspapers which have relied on advertising revenue to supplement their income from newspaper sales and so support journalism.

CASE 3.5: ON-LINE REAL ESTATE

According to Nielsen Online, by 2008 87 per cent of buyers, 85 per cent of renters and 79 per cent of sellers of real estate were conducting research online. The dominant sites are Realestate.com.au (largely owned by News Limited) and Domain.com.au (owned by Fairfax Digital). Realestate.com.au, the portal of the REA Group, had revenue of \$156m with after tax profit of \$22.3m in 2008 – a 48% increase over the year. The site enables real estate agents to advertise using a range of promotional approaches. It supports 3D imaging and video, providing additional value to users and advertisers. Although by 2008 the REA Group operated in 10 countries in Europe, the Middle East and Asia, the great majority of revenue came from the Australian business. In the ACT market the dominant portal is Allhomes.com.au which was launched by an ACT real estate agency, Blackshaw.

Source: Sinclair, Lara, Jackson, Sally, *The Australian*, 10 November 2008.

To better understand business model innovation initially focused on new value propositions (ie the *what* dimension), we examine in more detail two Australian case studies:

- **Orica Mining Services** evolved from a business model based on selling a commodity (explosives) to mines and quarries. The new model, which provides blasting services customised to the users' needs, was developed for the Australian market and is now the basis of a global business.
- **Argus Connect** provides software which enables medical service providers to securely exchange documents via the internet. Regulatory change will require GPs to participate in an e-health system and hence to use a product such as that provided by Argus Connect.

The core of Orica's business is its Mining Services Group, although it remains involved in a range of chemicals sectors. Orica was formed in 1998 after purchasing the majority shareholding in ICI Aust and NZ from ICI PLC. At that time the explosives industry had become commoditized due to competition. It has progressively moved out of fertilizers and consumer products sectors. Orica is now the world's leading supplier of commercial explosives and explosives services.

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A large proportion of the explosives were used in mining and quarrying industries. With a view to commodity squeeze, Orica developed electronic blasting systems and software that could enable customers to better manage their blasting. But users were generally not willing to pay for these additional products.

For regulatory reasons explosives could generally not be stored on-site and hence had to be ordered when needed. However, the best composition depended on the weather and so the precise specification was a last minute activity. Orica began to supply explosives as an emulsion in bulk form which was mixed to the required specification on-site.

Orica then began to use laser technology to survey and model rock faces to identify the optimum location of drill holes for blasting. "The exacting combination of laser technology, detonation software and emulsion explosives resulted in both significant cost savings and improved yields. The broken rock was of a more uniform and optimal size from the operator's perspective." The combination of capabilities led to Orica offering 'tailor made' solutions to customers, eventually moving from 'selling kilograms of explosives to billing customers according to quantities of broken rock' that meet customer's specifications – i.e. to selling solutions. Orica usually offered customers a 3-6 month trial to test the service.

Managing blasting on the site of a customer's operations gave Orica detailed data on the site and hence increased the intimacy of the business relationship. Similarly, operating mining services in many different contexts around the world substantially strengthened Orica's knowledge and capability base – which is partly embodied in Orica's IT tools.

In 2006 Orica acquired the global explosives operations of Dyno Nobel, consolidating its position as the dominant global supplier of blasting solutions.

Mining Services is Orica's largest business, offering a range of blasting products, services and technology to the mining, quarrying and construction industries. Operating globally, Orica has regional offices in Australia, Asia, Europe, the Middle East, Africa, North America and Latin America. Orica partners with customers across several industries including the open cut coal, open cut metal, underground mining, quarrying and construction industries.

Orica focuses on leveraging technical superiority, innovation and scale to achieve strong growth, aided by the sustained growth of the mining industry. Orica responded to low cost suppliers of explosives by shifting to a solutions provider – providing broken rock rather than explosives. It developed capabilities in designing drilling and blasting to ensure greater effectiveness. These services led to the customer having reduced downtime for drilling and blasting and improved processing due to better rock fracturing. Orica has invested in R&D to develop explosives, detonators, site measuring equipment and software to improve the productivity of blasting. Precise location of blast holes leads to few drill holes and higher rock yields with lower costs.

Sources: Sequeira and Ryans, 'Orica Mining Services', *IMD Case Study*, IMD-5-0725, 2008; Dick and Merrett, 2007; Kumar, 2006; Dun and Bradstreet, *Jobson's Yearbook of Public Companies*, 2005.

CASE 3.7: ARGUS CONNECT – RESPONDING TO EMERGING MARKETS IN HEALTH CARE

Argus Connect is a Ballarat-based company that began in 2004. It now has a presence on the desktop of almost 10,000 healthcare professionals. Medical Objects and HealthLink are the other two players in the industry. Argus Connect's software, which was initially developed under a government contract, enables health service providers to securely exchange clinical documents between their computer systems via email.

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What: The software product can provide doctors and other healthcare providers with access to pathology and imaging results, specialist letters, admission and discharge summaries, emergency department notifications and other related documents electronically and can import these documents into the patient notes. The software is provided for free to users - it operates as a for-public-good entity with open-domain parameters. But users must pay for support services.

Who: GPs and medical service providers. In March 2009, the Federal Government announced the new eHealth Practice Incentive Payment scheme that requires all GPs to use secure messaging. To receive payments under the scheme, GPs must first install a National e-Health Transition Authority (NeHTA) compliant secure messaging system instead of using unsecure emails to send patient information.

ArgusConnect has developed into a successful business with an annual turnover of \$1.3 million. The company now also has a 10 per cent interest in Medisecure, a company that will deliver prescriptions electronically between GPs and pharmacies. In May 2010 all the business operations of ArgusConnect were acquired by Database Consultants Australia, Melbourne.

Sources: Beauchamp, Paula, 'Medical technology has finally got the message Health leader works social conscience' *Herald-Sun*, 24 June 2009; company website <http://www.connectingcare.com/resources/lmha/Pages/Argus%20Connect.html>

EXPLORING BUSINESS MODEL INNOVATION – THE 'HOW' DIMENSION

The *how* dimension of a business model determines how the product or service is developed and delivered and how the firm generates a profit. It includes the:

- the link to the customer, including both the distribution channels through which value is delivered to the customer, and the nature of the relationship with the customer (particularly as experienced by the customer);
- capabilities of the firm from product development to after-sales service and including the culture, organization and values that underpin performance and create value;
- networks that enable access to external capabilities;
- configuration of the value chain that provides or supports value creation;
- financial aspects including the structure of the costs involved in value creation and the revenue mechanism through which revenue flows and how profit is gained.

A key lesson of successful business model innovation is the importance of a close alignment between the *who*, *what* and *how*. In an aligned business model, the capabilities and relationships of the firm underpin the value proposition and enable profitable performance and sustained competitiveness. Two case studies of Australian business model innovators provide excellent examples of comprehensive and effective development of the 'how' dimension of a business model:

- **Beacon Lighting** (Case 3.8) has developed a range of related business lines, all leveraged by the core business model based on the 'bookend approach' – distinctive strengths at the front of the value chain, in designing the products and the supply chain, and at the customer interface, through the provision of wide choice and value adding services. The firm evolved from a retailer of lighting products and has scaled up its business model to a national network of outlets. Beacon Lighting has also continued to innovate its business model, developing new competitive strengths.
- **Kimberley Kampers** (Case 3.9) has targeted the growing market for off-road camping trailers by developing a distinctive range of robust products. It has developed integrated set of capabilities, activities and relationships (the *how*) that supports the value proposition and enables profitable growth.

CASE 3.8: BEACON LIGHTING – A ‘BOOKEND BUSINESS MODEL’ WITH CONTINUOUS INNOVATION

Beacon Lighting was founded in 1974 and opened its first franchised store in Frankston, Victoria in 1989. In 1998-9 the company expanded into Queensland and NSW, and later to all States.

The traditional industry recipe in the lighting industry involved the local production of long standing designs and of designs based on copying those of international firms, plus some importing of light fittings from international suppliers. This limited and slow changing product range was marketed through specialist lighting shops and through department stores.

Over the past 20 years demand for lighting products has grown and changed as houses expanded, outdoor living increased, lighting became an important aspect of design, energy efficiency grew in importance and tastes widened. Customers building new homes or undertaking renovations are more likely to take an active role in choosing their light fittings. At the same time, manufacturing in Australia became very expensive due to labour costs and the trend toward shorter production runs.

In the business model of Beacon Lighting:

- Manufacturing is outsourced to several firms in China – some branded products are also imported.
- A strong product design team has been developed in Melbourne drawing on design trends internationally – “When we discover a new trend, we’ll develop and design the product to meet Australian standards, then have it manufactured and in stores within months”.
- Quality Control is maintained through Beacon engineers in Melbourne and Hong Kong.
- The product range has been substantially increased and new product ranges are being introduced frequently.
- There is a focus on energy-efficient lighting.
- Staff are trained to be able to provide professional advice to customers.
- The centralised and automated stock management systems with internal e-commerce supports efficiency and speedy logistics.
- Stock ordering systems based on sales history, seasonal and trend factors and business intelligence tools enable rapid re-stocking while limiting inventory.
- The products are marketed through stores owned by Beacon Lighting and through franchise arrangements. Beacon Lighting now has 65 stores across Australia.

Continuing Business Model Developments:

- Wholesale Division developed a large and IT based warehouse for incoming logistics and distribution, including fulfilling international orders.
- Beacon Lighting Commercial is developing a dedicated trade product range and new commercial offices in Melbourne, Sydney, Brisbane and Townsville. Beacon Lighting Commercial creates specialist lighting solutions for large developers, architects, contractors and specifiers for use in hotels, conference centres, retail outlets, offices, schools, warehouses and private residences.
- Beacon Solar - launched in April 2008, Beacon Solar offers grid connected photovoltaic solar power systems, ranging from 1kw and upwards including expert installation.

(Continued)

- Beacon Lighting Installations - launched in 2005, Beacon Lighting Installations provides a full service solution from in-home lighting design advice to product selection to installation.
- International Sales – from 2008 Beacon, which has become the leading retailer in Australia, has begun to distribute globally. Products are designed to meet the standards of specific markets.

Beacon Lighting won The AgeID&B Victorian Business Award for the Retail Category in 2007 and 2009 and was also the Overall Award Winner in 2007.

Source: http://www.beaconlighting.com.au/pdf/Beacon_CorporateProfile.pdf

A characteristic of the Beacon Lighting example is the sequence of business model innovations that leveraged the core platform of design capability, supply chain links and logistics. Ongoing innovation that strengthens, adapts and extends the initial business model innovation has also been a feature of several of the cases included in this report. For example, the financial service firm Charles Schwab was a small share brokerage house which in 1975 decided to shift to discount broking, doing away with fixed commissions. It began the growth from a small standard broker to a national firm with over 5 million customers. But this growth involved a continuing evolution of the business model¹²:

- As the discount brokerage service was easily imitated, the firm lowered costs, by having salaried salesmen, and increased promotion through advertising.
- Independent financial advisors were brought into the Schwab business by offering them convenient business services.
- To become more customer-centric, Schwab opened the products available to customers to those of all mutual funds, rather than only Schwab's, without charging transaction fees.
- Expanding on-line services and providing personalised information to customers.

CASE 3.9: KIMBERLEY KAMPERS – CUSTOMER FOCUSED, DESIGN-LED SUPPLY CHAIN

Kimberley Kampers designs, makes and distributes camper trailers, off-road caravans, modified long-wheelbase vehicles and roof-top tents at its factory in Ballina, NSW. Kimberley has been manufacturing off road accommodation since 1994, with over 5000 trailers and caravans shipped. The Managing Director and owner since 2003, Bruce Loxton, is an engineer with extensive international experience of management in the engineering sector, including Managing Director of Asea Brown Boveri in Australia. He has led a process of business model innovation that has resulted in a profitable and growing firm exporting to five countries. The framework of the business model is a customer focused, design led supply chain strategy. The innovations it has introduced range from design of the equipment through to the supply chain and distribution network, all modelled on the successful European H&M clothing chain and the approach of Harley Davidson in the US.

Who: Travellers – particularly older 'grey nomads' who want the option of traveling and camping in remote off-road locations.

What: A range of 8 models of high quality and innovative trailers and off-road caravans.

(Continued)

¹² Kador, John, 'Charles Schwab: How One Company Beat Wall Street and Reinvented the Brokerage Industry', Wiley, New Jersey, USA, 2002.

How: The integrated components of the 'how' are set in the following diagram and include:

- The design-led supply chain strategy focuses on a product of high value to customers, based on fit for purpose, ease of use, robustness, light weight, environmental features (eg low energy use and renewable energy options). The quality of the design and manufacture of the product contributes to a high resale value.
- The extensive use of IT enables the integration of design and manufacturing software, enabling automation and accuracy in procurement, clear communications and efficiency in all operations. In 2007 integrated design and manufacturing software so that design led directly to specifying the required materials and instructions for processing.
- The location in Ballina contributes to the capacity of retain staff, but this is supported by investments in training, a flat structure, team-based working, and recognition of achievement.
- The overall factory and organisational design for lean manufacturing, with work teams and 'Kanbans' supports efficiency and a greater level of customer option choice within a limited product range.

Kimberly Kampers:
Customer -focused, Design -led Supply Chain Strategy.



Sources: Jenny Dillon, 'Changes make for happy Kampers - Telstra Business Awards', *Daily Telegraph*, 22 July 2009; Bruce Loxton, pers comm; <http://www.kimberleygroup.com.au>

The women's fashion clothing chain, Zara, (Case 3.10) is also an excellent example of a business model where the 'how' dimension has been carefully developed to support the value proposition for the target market. The firm closely monitors what customers are buying in its shops as well as assessing fashion trends. It has built a supply chain that is extraordinarily flexible and it has an internal culture that supports experiment and change.

Why Zara has grown rapidly taking market share from the high fashion stores (too expensive) and the department stores (too out- of-fashion).

1. Target Users

Young fashion conscious consumers – Zara avoids being out of the price range or out of fashion for its target market.

(Continued)

2. Defining the What:

- Customization with low cost.
- Combination of low cost, reasonable quality – fast changing to reflect current fashion.

3. Business Model Design Dimensions Addressed:

- Accessing current designs – scan, select, copy & simplify current fashion.
- In-house designers modify and develop based on customer purchasing.
- Avoiding excess demand to which a slow supply chain cannot respond.
- Developing a supply chain/demand chain that is highly responsive.
- Enabling rapid feedback from customers purchasing to product designs.
- Create an in-store experience.
- Limited but fast changing range of clothes.
- Cost saving through avoiding the excess supply that must be discounted, little advertising, copying design from 'the market', reduced range of types, sizes and colours enables low overhead with fast turnover reduces working capital.

4. Developing the How – Critical Capabilities:

- Lean enterprise.
- Developing sharp competencies in picking fashion trends.
- Managing a very fast and responsive supply chain – 7 day turnaround.
- IT – library of designs on CAD/CAM.
- Small and flexible sewing shops in Spain.

5. Key Lessons of the case:

- The importance of market focus.
- Quality is in the eye of the customer.
- The power of lean and flexible supply chains for mass customization.

Source: Van der Heyden, L., 'M&S vs Zara: Case Analysis' 2007; Harlé, N., Pich, M., and Van der Heyden, L., 'Marks & Spencer and Zara: Process Competition in the Textile Apparel Industry', INSEAD, France, 2002; Santos, Jose, Spector, B. and Van der Heyden, L., 'Toward a Theory of Business Model Innovation within Incumbent Firms' 2009/16/EFE/ST/TOM, 2007.

ALIGNING THE 'HOW' DIMENSION TO SUPPORT THE VALUE PROPOSITION

As noted above in effective business models, how firms provide and profit from their business offerings is closely aligned with the other dimensions of their business model, supporting the targeted value proposition and enabling sustained and profitable competitiveness. Table 3.5 summarizes the key aspects of the *how* dimension of some successful innovative Australian business models.

TABLE 3.5: Key Aspects of the 'How' Dimension of Some Successful Australian Business Models

Example	Industry	Key Aspects of the Enabling Capabilities, Activities & Relationships
J. Robins	Fashion Shoes	Multi-skilled work groups, flexible equipment
Jetstar	Low cost airlines	Extensive use of IT, staff selection and training, stripping out costs

(Continued)

TABLE 3.5: Key Aspects of the ‘How’ Dimension of Some Successful Australian Business Models
(Continued)

Example	Industry	Key Aspects of the Enabling Capabilities, Activities & Relationships
JB Hi-Fi	Music & Games	Staff selection and training, stock selection.
Orica Mining Services	Chemicals, Mining	Sustained investment in research, capabilities in IT and engineering, close relationships with customers.
Adroit Lawyers	Legal services	IT savvy lawyers, culture change to a service orientation.
Beacon Lighting	Residential and industrial lighting	Design capability, highly organized supply chain with most manufacturing outsourced to China, franchise model for most retail channels.

Building the capability to generate value for customers through the offering may leverage some existing assets, but is likely to require developing new assets (such as facilities, reputation with the customer group, or possibly IP) and possibly new relationships with suppliers and channel owners. For example, Harley Davidson re-used its brand equity and loyal customers, while Wal-Mart leveraged its inventory management and distribution system to extend into groceries.¹³

An important issue for an established firm is whether to develop and launch a new business model in a new firm. The decision depends in large part on whether the existing assets of the firm (for example, brand name, supply chain, management and other competencies) are re-used in implementing the new business model, or whether the new business model requires identifying, exploring and building new assets. For example, when Dow Corning established a new business model for a specific segment of users it decided to do so in a new firm. As a market segment emerged that sought to purchase high-end silicon products, but not the support services that Dow Corning bundled with them, a new business unit (Xiameter) was formed to focus on that segment with a much more flexible business model.¹⁴

Both in-house assets and assets accessed through relationships can support activities that create value - from product design to delivery and product support. The 2006 EIU survey found that alliances with major customers, the public sector and even with competitors, were increasingly important aspects of the successful implementation of business model changes – more important than mergers and joint ventures. Alliances may offer faster and more flexible mechanisms to access capabilities.

The development of unique assets and of high degrees of control over the value chain contributes to sustainable competitive advantage. Achieving significant cost reductions (for example through product/service simplification or supply chain management) often strengthens the potential of the business model to sustain competitiveness. Significant cost reductions can also often be achieved through structural cost advantages such as through direct selling models.¹⁵ Disintermediation saves distributor costs, make-to-order removes the cost of inventory and greater focus can create efficiencies. Competitive performance is hard to copy when it is due to deeply embedded value chain relationships and difficult-to-develop competencies.

Re-design of the business model is often vital for driving down costs beyond that achievable through incremental rationalization. Re-design might be used to introduce greater

¹³ Deloitte Research, 2002.

¹⁴ Johnson, M., ‘The Time has Come for Business Model Innovation’, *Leader to Leader*, Summer 2010.

¹⁵ Deloitte Research, 2002, p 16 ‘A clear example of structural cost advantages is the direct selling model of Dell’.

automation, the outsourcing of labour-intensive activities, streamlining the supply chain to reduce inventory, developing closer relationships with some suppliers, centralizing procurement, outsourcing and off-shoring, and developing leaner sales and service channels.¹⁶ However, experience shows that outsourcing and off-shoring must be a strategic decision. Suppliers need careful selection and often support to raise performance, and these new supply relationships require management. As with all other aspects of the business model there will be trade-offs among performance objectives. For example, between cost reductions through centralization and outsourcing on the one hand, and quality and flexibility on the other. In any restructure of the supply chain it remains vital that the customer offer is enhanced and that core knowledge is retained in-house.¹⁷

For an increasing number of firms, re-design of the business model involves a greater focus on high value activities such as design and R&D on the one hand, and close customer engagement on the other – the so-called ‘bookend’ business model of firms such as Beacon Lighting. In such models all or most production activities may be outsourced while retaining distribution, or designs may be licensed to firms which then manufacture and distribute. However, global outsourcing trends are evolving rapidly and increasingly skill and knowledge-intensive activities are being outsourced, particularly to countries like India and China which are increasingly competitive in R&D and design. This trend needs to be taken into account if global outsourcing is a feature of the business model innovation being considered.

KEY CHARACTERISTICS OF BUSINESS MODEL INNOVATION IN THE CASE STUDIES

While each of the business models described in this chapter is unique, there are some common characteristics:

- Imagining what most thought was not possible, *asking ‘why not’* and then finding a way to achieve that vision has been the foundation for businesses providing legal services over the web and in coffee shops and enabling customers to choose and order their kitchens, shirts or suits through a virtual showroom.
- The power of a *clear and distinctive value proposition* is a strong characteristic of effective business model case examples. All have a very strong focus on the key basis of differentiation, the offering or value proposition, that provides the foundation for competitiveness in a specific market segment. For example, for J. Robins, this is a very fast supply chain from design to delivery for women’s fashion shoes. For both Adroit Lawyers and Orica it is providing a high quality service which meets user needs, while saving the user money and eliminating the need to maintain a range of capability in-house.
- The *‘how’ of the business models carefully developed and aligned with the ‘what’* enables consistent performance. For example, Orica developed new capabilities in software, modelling and on-site mixing to support its ‘explosions as a service’. J. Robins and Kimberly Kampers had to transform their equipment, organization and shop-floor skills to make lean manufacturing possible. Consequently, in all of these cases, the development of the new business model took some time. Jetstar worked to develop the systems, skills and culture, significantly different from those of the parent, to support performance. The alignment between the value proposition and capability is important in general, but the cases illustrate the importance of capability building and innovation to enable a compelling value offering. The cases show the importance of an ongoing synergy and interaction between the design of the value proposition and technological capability and innovation - each driving the other.

¹⁶ EIU, 2006.

¹⁷ EIU, p.50-2, 2006.; Stabell and Fjeldstad, 1998.

- A strength of many business models is having found a way to *increase flexibility in meeting customer demand, without increasing production costs*. In the case of two manufacturing firms this has involved major changes in the organisation of production, production equipment and workforce skills.
- The starting point for developing a new business model, or renovating an established one, has often been an insight into how to *meet the needs of an un-served or under-served customer group*. Alternatively, technological or regulatory change may make it feasible to profitably meet latent or unexpressed 'needs' that could not be met in the past. For example, low-cost airlines and searchable on-line inventories lead to new customers and sales, rather than only the displacement of existing business.
- *Outsourcing is used to increase returns* to the firms' distinctive competencies and strengthen the business model. This enables the firm to become increasingly specialized and more knowledge and skill-intensive. Orica has evolved from a supplier of commodity explosives to a global leader in mining services. Beacon Lighting has evolved from a domestic retailer of household lighting fittings to a supplier of a diverse range of lighting services and an exporter. In both of these cases the synergies in the business models formed a robust platform for the further evolution of the business. The temptation to respond to market change and competitive pressure by, for example, just downsizing or extending the product range, outsourcing or using web-based marketing and sales, but without reassessing the continuing viability of the business model as a whole should be avoided. This approach merely builds on a weakening platform, unlikely to secure the benefits of business model change.
- In most cases the firms had a *specific exemplar* that shaped the design and implementation of the new business model. Jetstar reviewed low cost airline models around the world and learnt both from the effectiveness of the models and their implementation. The process of implementation was carefully managed. J. Robins and Kimberly Kampers were inspired by the models developed in some European firms to enable high value flexible production and studied the role of the various elements of these models before embarking on the long and challenging transformation required to embed a similar model into the long established firm.
- In most cases the business model was *proven on a smaller scale and then scaled-up*. This is clearly the case for Beacon Lighting, Jetstar and Orica Mining Services. Business model innovation involves a process of learning. Where a firm is a new venture starting at a small scale, that learning is evolutionary. Planning is important, but rigid dedication to a carefully constructed plan may limit experiment and openness to feedback and the need to change direction. In fact, 'learning-by-doing', i.e. working through the options, finding what works and sorting out a good business model 'fit' is one of the most vital tasks for a new venture – one with which many novice entrepreneurs have great difficulty. In the case of a large firm, or where there are only limited opportunities to experiment with business model change, then learning-by-planning and learning-by-studying the experience of others becomes vital, as in the case of Qantas, J. Robins and Kimberley Kampers.
- Making effective *use of the possibilities of the internet* is a feature of many, but not all of these business models. The web is clearly vital for the many e-commerce business models such as Webjet, and the on-line share trading services. Some web-related business models are simply extensions of 'bricks and mortar' retail business models (such that of Dick Smith), but others, such as Zazz and RedBalloon, are novel experiments with new web-enabled service ideas. The internet enables some service firms to deliver elements of their value offering over the web, while flexibly relocating other aspects. For example, some of the new legal service firms provide standard forms and information to clients through an accessible website while enabling their lawyers to work from any location. Online services enables Jetstar to lower its transaction costs. But internet-based technologies are also important for Beacon Lighting in coordinating the information flows and logistics of international and national supply chains.

- For a number of the firms, their business model evolved over time through a *sequence of innovations*. In the case of the US financial services firm, Schwab, this evolution was both to widen the offering, but also to drive a closer alignment between the business model components, responding to opportunity and the lessons of experience. In the case of Beacon Lighting and Orica, this evolution took the form of developing a range of business lines with a clear focus on the core capabilities that underpin the business model.

4. Why is Business Model Innovation Becoming More Important?

There is increasing evidence that business model innovation is a key factor for competitiveness in many industries. In 2006 the IBM Global CEO Survey of that year¹⁸ raised awareness that business model innovation was of wide significance. That study found that high performing firms were almost twice as likely as poorly performing companies to have implemented business model innovation. Based on this and subsequent surveys, many now see business model innovation as a new strategic differentiator.

An earlier study by Deloitte Consulting¹⁹ found many cases where business model innovation had enabled rapid and substantial growth in market share and profitability. A worldwide survey in 2004-5 by the Economist Intelligence Unit (EIU) of 4000 senior executives found that over half of the respondents considered that new business models were a more important source of future competitive advantage than new products or services.²⁰ In 2006 the Economist Intelligence Unit carried out a survey for KPMG of 336 senior executives from a range of sectors and firm sizes, with an emphasis on larger firms. On the basis of its survey and analysis, their report argues that the more successful firms will be those that can adapt their business models more quickly and effectively. Research by the EIU in 2005 and 2010 has also found that the majority of global executives now see an increasing need to pursue competitive advantage through innovation in the business model in addition to product/service innovation.

Similar to the IBM study discussed above, the Business Week/BCG Innovation Survey of 2008 found that business model innovators achieved a substantially higher shareholder return than firms that introduced only product or service innovation. The survey found that over a three year period the business model innovators achieved total shareholder return averaging 8.5%, compared with 1.7% for product/service innovators. This superior relative performance was sustained over 10 years.

The IBM survey also found that high performing firms were much more likely than were poorly performing firms to see business model innovation as a priority. But a second key finding of these surveys was that, although a high proportion of CEOs believe that fundamental change will be required to ensure future growth, only a minority were confident of their organization's ability to develop and implement such change.

¹⁸ IBM Global CEO Survey 2006.

¹⁹ Deloitte Research, 2002

²⁰ EIU, 'Business 2010: Embracing the Challenge of Change', 2005.



FIGURE 4.1: Business Model Innovators and Profitability

Source: The Global CEO Study 2006: Expanding the Innovation Horizon

It is increasingly recognized that, with higher rates of market, regulatory and technological change, managing a business is more complex than in the past and firms face more risks.²¹ In this context, firms must be built to learn and transform, rather than to last.²² Many firms have reasonably systematic processes for planning and managing new product or service improvements and innovations, and have developed the metrics to guide and monitor those dimensions of performance. Few firms have similar capabilities for business model innovation.

While information technology is an important enabler of many new business models, a wide range of drivers is now shaping business development. Outsourcing some or all production or service activities (and franchising to leverage a business recipe while limiting capital requirements and risk) is now widely used. Discount retailers have taken the major share of the retail sector, low cost airlines in many countries have built strong market share and shareholder value. The business model that enabled Xerox to rapidly win market share, the 'razor blade', or 'bait and hook' model, is still widely used today. In this model a product is offered at low cost but the inputs needed to maintain it are the source of profit, as is the case for shavers, mobile phones and desktop printers.

A clear identification of the drivers and directions of change in an industry – in markets, substitute and complementary products and services, product and process technology, and in value chains – is a good starting point for re-thinking the business model. In this section, the broad drivers, or push factors, that are leading firms to look for ways to renovate or change their business models are discussed. Also examined are the enablers, or pull factors, that shape the direction of innovation in business models.

DRIVERS OF BUSINESS MODEL INNOVATION

Increasing Competitive Pressure

There is no doubt that more open economies and deregulation have increased the level of competition in most industries. Where competitors have strong competitive advantages, working harder to reduce costs within the structure of the old business model is unlikely to be a basis for

²¹ 'Global Forces', *McKinsey Quarterly*, June 2010.

²² Johnson, Mark, 'Companies fail when faced with disruptive technology', *The Economic Times*, 20 March 2010.

sustainability. Survival is likely to require a new business model. In many cases individual firms explore new approaches only when faced by a crisis of some form (e.g. J. Robins in Australia and Harley Davidson in the US). A clear example of this situation is the Textiles, Clothing and Footwear industry in Australia. The only firms that have survived are those that have innovated their business model.

CASE 4.1 BUSINESS MODEL CHANGES IN THE TEXTILES CLOTHING AND FOOTWEAR INDUSTRY

All labour-intensive manufacturing industries in developed economies are facing increasing competition from the exports from low labour-cost economies. Producers in Australia have responded by combinations of the following strategies:

- **Repositioning in the value chain – specialisation and outsourcing.**
Residual difficult-to-automate activities are outsourced to overseas producers or to outworkers while the firm focuses on creating value through design, marketing and orchestration of the value chain. This is sometimes termed the 'bookend model'. Remaining production activities are automated to ensure flexibility, quality and lower labour intensity. By redesigning the production system, firms can increase their capacity to respond to demand, be profitable with short runs and customize their products.
- **Shifting down the value chain.**
Some firms have sought to secure market access by developing their own retail outlets and/or direct factory outlets. A further step is then to outsource all production and become an importer.
- **Shifting to another value chain.**
Some firms move out of commodity production and focus on the high-value fast moving fashion segment of the market. Another strategy has been to move into specialized products where technical product characteristics are the basis for competitiveness. Process and product innovation, and close relationships with users and market channels, are essential to sustain competitiveness.

Sources: Green, R., 'Building Innovative Capability: Review of the Australian Textile Clothing and Footwear Industries', *DIISR*, 2008; OECD, 2007; Webber and Weller, 2001.

The Diffusion of Information and Communications Technology (ICT)

The 2005 EIU global survey of over 4000 senior managers from 20 sectors concluded that technology will be a strong driver and enabler of business model innovation. The overwhelming majority of respondents to the survey thought that IT would be a key factor in the capability of firms to effectively develop and implement new business models over the 2005-2010 period. The role of IT (the internet, digitisation and communications) in lowering transaction costs and facilitating different forms of coordination has been a strong driver in many business model innovations. The majority of global executives (93%) expect continuing changes in their firms' business model over the next few years.²³ The 2005 EIU survey concluded:

"To succeed, characteristics of flexibility, openness, collaboration and speed will be increasingly critical. Many of these attributes will depend on information technology (IT), which is regarded by more than 80% of respondents as critical to their ability to change their business models over the next five years. It is also coming to be seen as more of a competitive tool than simply a driver of cost efficiency."²⁴

²³ EIU, 2006.

²⁴ EIU, 'Business 2010: Embracing the Challenge of Change', Executive Summary, 2005.

While almost all firms have introduced IT in some form, few have done so in a way that has generated the level of strategic and operational performance improvement that is possible. Most firms simply lack the in-house capability to adapt hardware and software to their needs and to reconfigure their operations to take advantage of the opportunities provided by IT. IBM, themselves facing the commodification of much IT hardware, innovated their own business model to become a service and solutions provider working with users to enable them to capture the potential of IT applications – not least through business model innovation. The diffusion of ICT tends to reinforce the impact of globalization and competition and other trends. For example, ICT lowers search costs and hence also enables users to more readily compare the offerings of suppliers. This drives down prices, but also enables visibility and entry by new firms.

Declining Product Differentiation

Mature industries such as consumer electronics, automobiles and clothing often experience long periods with little major product innovation. As a result, products begin to become commodities. In such situations, these stages of the product cycle, where product offerings differ little and much of the competition is based on price, exports from low-cost countries tend to dominate the market. Consequently, Australian producers must find a basis for differentiation, most often on the basis of a combination of the target market segment (Who) and the offering (What). For example, J. Robins has been able to compete in the women's fashion shoes industry through offering designer shoes with a one-week turnaround when the minimum supply time for the high volume offshore suppliers is three months. Orica Mining Services evolved from a supplier of explosives, a commodity product, to a supplier of blasting services - 'designed explosions for materials transformation services' - contracting to convert a rock structure to fragments of a specified size range.

Disruptive Business Models of New Entrants and Competitors

The sustainability of existing industry recipes can be undermined by the entry of new firms with new business models. The entry of Jetstar rapidly eroded the competitive advantage of the Virgin Blue low-cost business model, just as the entry of Virgin Blue had taken market share away from Qantas. The entry of Amazon with its user-friendly book purchasing service has led other book distributors to attempt to build a similar on-line presence.

Enablers of Business Model Innovation

As the competitiveness of established business models declines, firms must seek new foundations for survival and growth. A real risk for many firms is to persist with an old but previously effective business model, seeking new methods of cost reduction often by modifying the model in ad-hoc ways, until financial, staff and reputational resources are exhausted. A reluctance to re-think the business model is particularly common where change is gradual and responsive adaptation has been reasonably successful.

IT, the Internet and On-line Services

ICT is being used in every sector to improve efficiency in almost all processes that involve information processing and coordination. The combined effect of IT and communications (eg via e-commerce) lowers the cost of internal coordination and of doing business with other firms (transaction costs). This enables three major directions of change in business models:

- The much greater effectiveness of external coordination enables *outsourcing* and closer integration along *supply chains* and production networks. Detailed information, including specifications and models, can be transmitted over any distance, and logistics can be managed.

- The introduction of IT into design, inventory management, monitoring, control of equipment, administration etc enables much higher levels of *flexibility*.
- The offering of *new service dimensions*, for example the combination of IT and the internet has enabled some law firms to have 'remote' lawyers. These can access legal documents and databases over the web, keep in close contact with customers and exchange documents. As a result these 'virtual' law firms can provide a more flexible and lower cost service – see Case 3.3 (Adroit Lawyers) and Case 4.1 (Disruptive Business Models in a Sector with a Traditional Business Model).

The internet enables the development of a diverse range of firms that are flexible intermediaries giving users access to information on available offerings and the capacity to compare and select. Some of the many Australian examples include the holiday accommodation site Stayz, the hotel accommodation site Wotif, the housesitters site Aussiehousesitters, and travel deals site needitnow. Further, the internet is an enabler of some outsourcing business models where the quality of interaction supported by the web reduces the costs and risks of coordination.

CASE 4.2 DISRUPTIVE BUSINESS MODELS IN A SECTOR WITH A TRADITIONAL BUSINESS MODEL

Stimulated by the recession, but also by the opportunities for new approaches based on new technology platforms, exploration of new business models for legal services is increasing.²⁵ A recent comprehensive review of the evolution of law firms predicted:²⁶

- Technology will continue to lower the cost of coordinating with economically-priced, appropriately skilled workers wherever in the world they may be found. Down-sourcing, in-sourcing and outsourcing will become more and more prevalent.
- Legal process and similar routinised and commodified work will less and less support elite-firm rates. As such work is pushed down and out at large firms, fewer conventional partnership-track associates will be needed to staff it. The demand for new law graduates in large firms will decrease.
- A completely separate underclass of staff and contract attorneys will develop at many firms. Their work will be limited to routinised and commodified work such as legal process, and possibly the kinds of routine legal work large companies are outsourcing abroad.
- Because the highly leveraged work that tended to provide law firms the greatest profit margins will be under continuing cost and price pressure, margins will erode and that higher-margin work will become more scarce.
- As technology allows small firms to enjoy scale economies, some may be able to enjoy margins that approach the margins of large firms in similar market segments, and boutiques may be an important part of high-margin practice in the future.
- The larger law firms have grown strongly over the past 20 years. These large firms have high overheads and the level of their legal fees has also grown. In response to rising costs many larger companies have formed internal legal. But most smaller firms do not have sufficient need for a dedicated in-house counsel but also find it difficult to afford the high legal fees of external firms.

(Continued)

²⁵ 'Law Firm Evolution: Brave New World or Business as Usual?' *Georgetown Center for the Study of the Legal Profession*, March 21-23, 2010. <http://www.law.georgetown.edu/LegalProfession/ConferencePapers.htm>

²⁶ Burk, B. A. and McGowan, D, 'Schumpeter, Coase and the Future of the Law Firm', *Conference on Law Firm Evolution: Brave New World or Business as Usual?*, March 2010.

Changes in economic conditions and technology regulatory change (such as permitting external investment into law practices and some non-lawyer directors/partners of legal firms) has stimulated the development of new business models. A recent discussion of new business models for law firms in the UK identified three new approaches:²⁷

1. **Dispersed Virtual Law Firms** – firms which have largely dispensed with physical premises and work virtually - from home or a satellite office. This enables lower overheads and fees. The individual solicitors share IT solutions and software and have a common company policy. Examples include:
 - **Adroit Lawyers** – Case 3.3;
 - **Keystone Law** (www.keystonelaw.co.uk) – 10 different commercial practice areas and 85 solicitors;
 - **Lawbridge** (www.lawbridgesolicitors.com);
 - **SpringLaw** (www.springlaw.co.uk) – A boutique city law firm which announced in October 2009 that it was expanding across the UK by bringing in “legal consultants” working from their own workspaces;
 - **Woolley & Co** (www.family-lawfirm.co.uk).
2. **Virtual legal services** – firms offering legal services directly from the Web and selling legal services online, typically, basic legal services such as wills and conveyancing. If the clients’ needs develop to a requirement for greater advice, the site can advise on possible suppliers. For the client, legal fees are reduced as they are doing some of the basic legal work themselves and services are available at any time. For the legal services provider, less time is spent on low-value legal work and the Internet presence can attract new clients. Examples include:
 - **DirectLaw** (www.directlaw.co.uk) – from Epoq Group Ltd. DirectLaw, already with a strong client base in North America, enables a law firm to offer automated legal documents, legal advice, and other online legal services on the Web. By using the DirectLaw platform, any law firm, however small, can become virtual without spending capital resources for developing or licensing complex software applications;
 - **Everyman Legal**. (www.everymanlegal.com) – Everyman Legal offers selected legal services for personal and business users, combining a disbursed working model with the online provision of some template documents. Everyman Legal seeks “entrepreneurial solicitors” who would run legal shops under the Everyman brand.
3. **Law Firm Networks** - law firm networks are groups of independent solicitors and law firms that work under an umbrella national brand. Examples include:
 - **Lawnet** (www.lawnet.co.uk) – network of 66 law firms established in 1989. Offers a wide range of marketing;
 - **The Legal Alliance** (www.thelegalalliance.co.uk) – formed in 2009 as a network of independent law firms;
 - **Quality Solicitors** (www.qualitysolicitors.com) – for an annual fee law firms and solicitors are listed on a web site which directs users to specific firms on the basis of a basic on-line assessment of the issue.

Beacon Lighting (Case 3.8) is an example of a business model based on reconfiguring the value chain; in this case developing a ‘bookend’ model. The firm focuses on the front end (design) and customer end (marketing/service provision) of the value chain, outsourcing the manufacture of most of the product range to offshore suppliers.

²⁷ ‘A Quiet Revolution – Changing business models for legal services’, *IRN Research*, November 2009. www.irn-research.com/index.php/download_file/view/38/

Changing Patterns of Demand

New user needs or preferences are often overlooked by established firms – particularly if it is thought that there is little commercial benefit in this market or if there are doubts about the ability of the current business model to address these needs. Qantas did little for the budget traveller until Virgin Blue took away market share. The full service stock brokers were slow to recognize the latent market for low transaction cost, on-line share trading by individuals who did not want to pay for the full-cost bundle of advice and trading services. Often established firms are concerned about cannibalising their business, whereas a new firm has no such concerns.

New patterns of demand arise from a diverse range of changes, for example: in demography (e.g. the ageing population); lifestyle (the singles lifestyle and market segment, outdoor and adventure activities); values (e.g. organic food, personal health, environmental consciousness); and regulation (feed-in tariffs for electricity, building standards). They also arise as users rethink their own operations, seeking to lower costs, increase flexibility and perhaps change their business models. For example, many users of legal services are dissatisfied with the supply-driven billable hours approach of the major law firms (see Case 3.3, Adroit Lawyers). New firms offering much more flexible and low cost services are growing rapidly. Revive Clinics offering health services that are essentially 'GP equivalent' provide an alternative to the inflexible and supply-driven current GP model, unattractive to busy people.

Some changes in preferences may be latent or expressed clearly in only some groups or circumstances. But when an opportunity to exercise those preferences arises, the latent demand is expressed and can be the basis for rapid growth of firms attuned to the change.

Enabling user-driven content on web-sites and user-driven input to design and product configuration has become a major driver of many new business models. The open-source software movement and user-content driven internet sites such as Wikipedia and Eatability.com.au are examples. Other examples are Web-based firms such as The Cloakroom, Shoes of Prey and Blank Label which enable users to design their own suits, shoes and shirts (respectively) from a diverse range of fabrics, patterns and styles and then have these made off-shore, so enabling customization and low prices.

Exemplars, New Business Models and Network Relationships

In developing their response to Virgin Blue, Qantas looked carefully at the business models of 'no frills' airlines like Ryanair and Southwest Airlines. J. Robins and Kimberley Kampers drew on business models developed in Europe.

The now widespread use of franchising for scaling-up a business model has led to a degree of standardization of franchise structures. This standardization reduces risks for franchisor and franchisee, and leads to wider replication of this particular aspect of business models. Beacon Lighting (Case 3.8) have used franchising to extend their retailing capabilities, while overcoming capital constraints.

As firms introduce new business models, this can lead to a restructuring of value chains, which opens the scope for other new business models. Global markets are increasingly accessible because of the development of many forms of collaboration, including many forms of complementary alliances. Consequently, even small firms can often develop a position in a global value chain while retaining a high level of specialization.²⁸ For example, Laura Benini designs fashion shoes in Sydney which are then marketed through a network of consultants

²⁸ KPMG, 2006; EIU, 2006

using the 'party plan' marketing method. Laura Benini was a manufacturer, using traditional shoe making methods, but as demand grew, rather than invest in new equipment, the firm has co-located with J. Robins in Belmore in Sydney and Laura Benini shoes are made by J Robins.²⁹

There are a number of examples of firms that have built a network or ecosystem which creates and sustains high levels of value for final users and for network members (including suppliers and providers of complementary products and services). The core enabler of these networks (sometimes termed the 'keystone firm') creates a platform of services, tools and technologies which serve to support and coordinate the contributions for the other ecosystem members. These platforms, such as Wal-Mart's procurement system or Google's search engine and related advertising tools and systems, provide a common asset that generates (and hence shares) value for all ecosystem members. Continuous improvements in those platforms and in the related services drive productivity, innovation and diversity in the ecosystem.³⁰

The example of Apple's iPod/iTunes value system was discussed earlier. Another outstanding example of a firm that has built a powerful ecosystem is that of Microsoft. Thousands of firms either write applications based on Microsoft operating systems or provide services to users that add value to those systems. Microsoft provides software producers in other firms with access to source code and development tools to assist their work. Wal-Mart also links thousands of firms into its ecosystem creating benefits for them through detailed information on customer demand trends and through an e-commerce platform that enables supply chain productivity. Other examples include eBay, Google and Amazon. The sustainability of the ecosystem is critically dependent on the role of the core firm in driving productivity, responsiveness to change and disruption and development of greater diversity and functionality within the ecosystem.

An increasing number of firms are incorporating network relationships into their business models. Sourcing new ideas, capabilities and technologies through 'open innovation' approaches has become a major dimension of innovation strategy for many firms. Virtual or 'lean' business models involving outsourcing all non-essential business activities are increasingly common in e-business firms but are being explored in other sectors.³¹ In these cases the key firm retains the role of coordinating the value creation activities. These network-centred business models are facilitated by the internet, but they are also possible because an increasing number of firms are prepared to participate in value networks. Such networks are of several types, but network-based business models range from those where:

- the central coordinator designs the value network and the value proposition offered to the market, for example the Apple iPod/iTunes value network;
- those where the central coordinator develops a platform onto which other organizations (or individuals) add content in order to pursue their own business model, for example Apple's iPhone, where application developers add value to the basic product, and the iPod platform where content providers access users via the iTunes portal; and
- the central coordinator builds a platform which then develops value through user-driven content, for example such websites as Eatability (for restaurant reviews) and Trip Advisor (for traveler tips).

²⁹ Green, R., 'Building Innovative Capability: Review of the Australian Textile Clothing and Footwear Industries', *DIISR*, 2008.

³⁰ Iansiti and Levien, 2004.

³¹ Nayak, N., Bhaskaran, K, and Das, R., 'Virtual enterprises: building blocks for dynamic e-business', *Australian Computer Science Communications*, Volume 23(6): 80-7, 2001.

New Capabilities

When a new capability is developed, whether in-house or acquired, it might be used to support the existing business model. For example, purchasing new equipment may enable production at lower costs or higher quality, which extends the life of the established business model – the combination of who the business serves, what business offerings are provided and how profits are made. However, in some cases a change in capabilities can stimulate the formation of a new value proposition, or a redesign of the *how* dimensions, to create a new business model. For example, the R&D group within the confectionary firm Mars developed a new flexible printing technology. Intrapreneurs in the firm then developed a new business model for a venture aimed at the corporate market and event planners (and hence not distributed through retailers) and based on printing customized words on M&Ms.³²

In some cases a new capability requires a new business model in order to become commercially viable. For example, Vision Systems the developers of the Laser Airborne Depth Sounder (based on earlier work by DSTO) found that very few customers were interested in buying the instrument. The technology is now owned by the Dutch company Fugro-LADS who offer bathymetric survey services based on using the instrument, rather than attempting to sell the instrument itself.³³

It is often unclear how best to commercialize a new capability. Evolution Tankers has been in operation for 25 years and has built strong capabilities in the design and production of vessels based on composite materials. The Omni Tanker is a new business line by Evolution Tankers and Evolution has a strong IP position based on patents, secrecy and accumulated tacit knowledge. The Omni Tanker has a thermoplastic interior which is impervious to chemicals. Tanks can be washed out to be then used for any new liquid. Hence tankers can do one leg with one chemical, wash out and back-load with a different chemical. This provides the opportunity for users (haulage companies) to have few dedicated tankers and hence to make much greater use of their capital stock. Evolution are also developing a new tanker which, with a rigid body, will remove the necessity for a steel chassis. The overall combination of the integrated chassis and the new material will be a 30% reduction in weight, hence enabling the tanker to carry significantly more liquid. Evolution Tankers may gain more value from their innovation by themselves moving into the haulage business rather than by selling tankers.

Effective use of Omni Tankers and the chassis-less tanker is likely to mean that Evolution's customers will need to change their business model. But it also raises the question of the appropriate business model for Evolution Tankers. To make the most effective use of this new capability should they:

- Not only sell tanker trailers but own the whole rig and provide haulage services;
- Export from Australia, open manufacturing offshore for export markets or licence others to manufacture for offshore markets.³⁴

CONCLUSIONS

There are many factors which are drivers of business model innovation or which shape the directions of change. Perhaps the most significant underlying factors are the pervasive impacts of ICT and the changes in user preferences.

³² Cited in Santos, et al, p21, 2009. See also Iansiti & Levien, 2004.

³³ This is an example of the evolution in many high-technology product firms toward marketing product- service bundles. See, for example, Australian Expert Group in Industry Studies, 'Selling Solutions: Emerging Patterns of Product-Service Linkage in the Australian Economy', AEGIS, ABF and ARC, 2002. http://www.abfoundation.com.au/research_project_files/21/Selling_Solutions.pdf

³⁴ www.evolutiontankers.com.au

ICT (including the internet) creates new patterns of demand, makes information more available, enables more flexible production, lowers the cost of customization, supports greater coordination along the value chain and provides new mechanisms of distribution.

Better educated and informed users and a wide range of competing products and suppliers leads to increasing customer power – a shift from the ‘push’ of mass production to the ‘pull’ of discriminating and heterogeneous users.

Together, these two factors drive the necessity for new business models and create a widening range of opportunities to innovate with new approaches that address new needs with new products and services.

5. Designing and Managing Business Model Innovation

REASSESSING THE ESTABLISHED BUSINESS MODEL

In earlier less competitive and turbulent times, business models had greater longevity. Now, however, the capability to design and implement innovation at the level of the business model will often be essential for growth and in some cases decisive for survival. That is clearly the message of the several recent surveys discussed earlier.

Established firms with well entrenched business models often find it challenging to assess and manage the risks and uncertainties of business model innovation. The existing business model, often based on the mainstream industry 'recipe', may have become deeply embedded in routines and norms, and largely taken for granted. Understandably, in this situation firms tend to take a cautious approach, continuing to emphasize the forms of product/service innovation they have pursued in the past. One consequence of this is that new product or service concepts or technologies that require new business models to be successful, are either not pursued or yield limited success.

Envisioning and creating new business models in an established firm often calls for a clear vision and strong leadership, particularly when there is competition between the new and the old business models. Some firms locate new business models in new companies, sharing only some corporate assets – for example, Qantas and the formation of Jetstar. This is also the reason why new firms, without corporate 'baggage' (legacy systems and culture) are often the champion of new business models, as is the case with radical product innovations.

There are several signs that a reassessment of the business model is either required, or opportune. These are set out in Table 5.1: How do you Know if Your Business Model Needs Reassessment?

TABLE 5.1: How do you Know if Your Business Model Needs Reassessment?

<p>The scope for developing a new business model should be assessed if:</p> <ul style="list-style-type: none">• firms with new business models are gaining a larger share of those market segments that are growing;• imports are reducing your market share;• in other countries your industry is undergoing restructuring and business model-related change;• a map of your value curve indicates that your key differentiators are weakening;• a map of your value curve indicates that you are not well oriented to growth segments;
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(Continued)

- you can identify neither major opportunities for cost reduction nor significant sources of growth;
- your key customers are not satisfied and the most dynamic are moving to other suppliers – even if many are reluctant to switch;
- your customers are innovating their business models;
- you are finding it harder to profitably meet the needs of your key customers;
- your most talented staff are heading off elsewhere; or
- when you ask what would dynamic companies, like Apple, Nike or Virgin, do if they were in your business, and the answer is innovate the business model.

This chapter discusses approaches to re-assessing a firm's business model and designing significant innovation either through modifying the existing business model or developing a new business model.

STRATEGY FOR INNOVATING THE BUSINESS MODEL

There are four, often complementary approaches to identifying new business models:

1. **Systematic analysis:** An analysis of industry, market and technology trends may identify new customers, offerings or ways of creating and capturing value. The analysis of the value curve as shown in Figure 3.1 along with a review of the options for each component of feasible business models will help to identify options for new models. Many of the web-based models are based on an initial identification of underlying trends – see for example the range of legal services models set out in Case 4.2 and the on-line retail models in Case 3.4.
2. **Building on exemplars:** Having identified the need for a new direction, many firms have developed a new business model from an exemplar, often from a different industry. For example, in building a new business model for making shoes in Australia, J. Robins learnt from the example of Zara in Spain. Similarly, Kimberley Kampers derived their new business model from the example of H&M Stores, and Jetstar learnt from the approach of other low-cost airlines.
3. **Evolutionary responses:** A third approach is essentially evolutionary, responding to emerging customer needs and technological opportunities, within an overall strategy that shapes the direction of change. Orica Mining Services' evolution from supplier of commodity explosives to global leader in a range of mining services is an example of this approach.
4. **Focusing on an unmet need:** The fourth approach is less about predicting the future and more about identifying significant perhaps emerging market segments whose needs are not well met by current offerings. Sumo Salad and Revive Clinics, among many other successful new business models, have targeted needs that had been poorly met. The greater efficacy of this approach was the conclusion of the 2001 Deloitte study of business models. Another major study found that most successful business model innovators developed their approach by targeting customers who were under-served or even ignored by established firms – underserved because the dominant assumptions were that it was not possible, too risky or unprofitable to do so:³⁵

³⁵ Deloitte Research, 2002

“...creating blockbuster new business models doesn’t require you to predict the future. Rather, it calls for an ability to redefine the present...” “To be truly innovative, businesses have to go far beyond identifying the next big product innovation. They have to start by identifying an un-served or under-served market segment (i.e., changing just the ‘who’). Each of the companies also carefully designed and built the ‘what’ (the product or service offering), and the ‘how’ (operations and supplier relationships) of its model to produce extraordinary customer value. The innovators also captured sustainable competitive advantages and preyed upon competitors’ inherent disadvantages.”³⁶

In many cases, the business model innovators rapidly built market share in mature industries with high levels of competition but little diversity in business models. In such mature industries, the dominant firms are often vulnerable to, but initially underestimate, new entrants who change the focus of competition. The business model innovators in these cases were often not leaders in technological innovation.³⁷

While the emergence of new customer segments is often related to regulatory, technological or socio-demographic trends, focusing on the specific needs of the customer group is a more useful target for business model innovation than responding to the trends that lie behind those market changes. Hence, a clear focus on an under-served customer group is often the foundation for a business model which wins market share and changes the nature of competition in an established industry – see Table 5.2: Ingredients of a Disruptive Business Model.

TABLE 5.2: Ingredients of a business model that disrupts incumbents

There is scope for a new business model to rapidly gain market share if:

- there is a significant user group whose needs are underserved or not met;
- this user group is growing or indicates the direction of overall market trends;
- the value proposition for this user group is compelling and substantially different from the standard offering in the industry;
- the business model is scalable so as to enable rapid growth after a period of de-bugging and tighter alignment;
- the value proposition leverages unique and deeply rooted capabilities or is based on resources which are not accessible to followers;
- there is a strong alignment between the offering, the business processes, the capabilities and the accessible resources;
- there is a high level of ‘freedom to operate’ in the new business model unencumbered by the values, structures and processes of the old business model; and
- there are strong barriers to entry and growth for others seeking to copy this business model.

To be effective, all of these approaches require a customer-centric perspective to the business model. Successful business model innovators have often invested in customer research, exploring new ways to deepen their understanding of customers. Whichever approach is taken it is clear that a strategy for business model innovation must address developing:

- a clear strategic vision;
- an internal culture that can support change, accept uncertainty and learn rapidly; and
- a capacity to handle disruption and the risks of destabilization.³⁸

³⁶ Deloitte, 2001.

³⁷ Deloitte Research, 2002.

³⁸ KPMG, 2006.

An overall strategy for business model innovation, whether modifying an existing model or developing a new model, involves a series of stages from exploration and assessment, to identifying and evaluating the options for the elements of the business model and their overall alignment, to selecting the best fit and specifying the linkages, processes and capabilities required, through to the tasks of implementation. A framework for such a strategy is summarized in Figure 5.1. In practice, as with any innovation process, these stages are not necessary linear – a good deal of iteration, forward and backward, may be involved as issues become clearer and some lines of development are closed. In the following we discuss each of these stages in more detail.

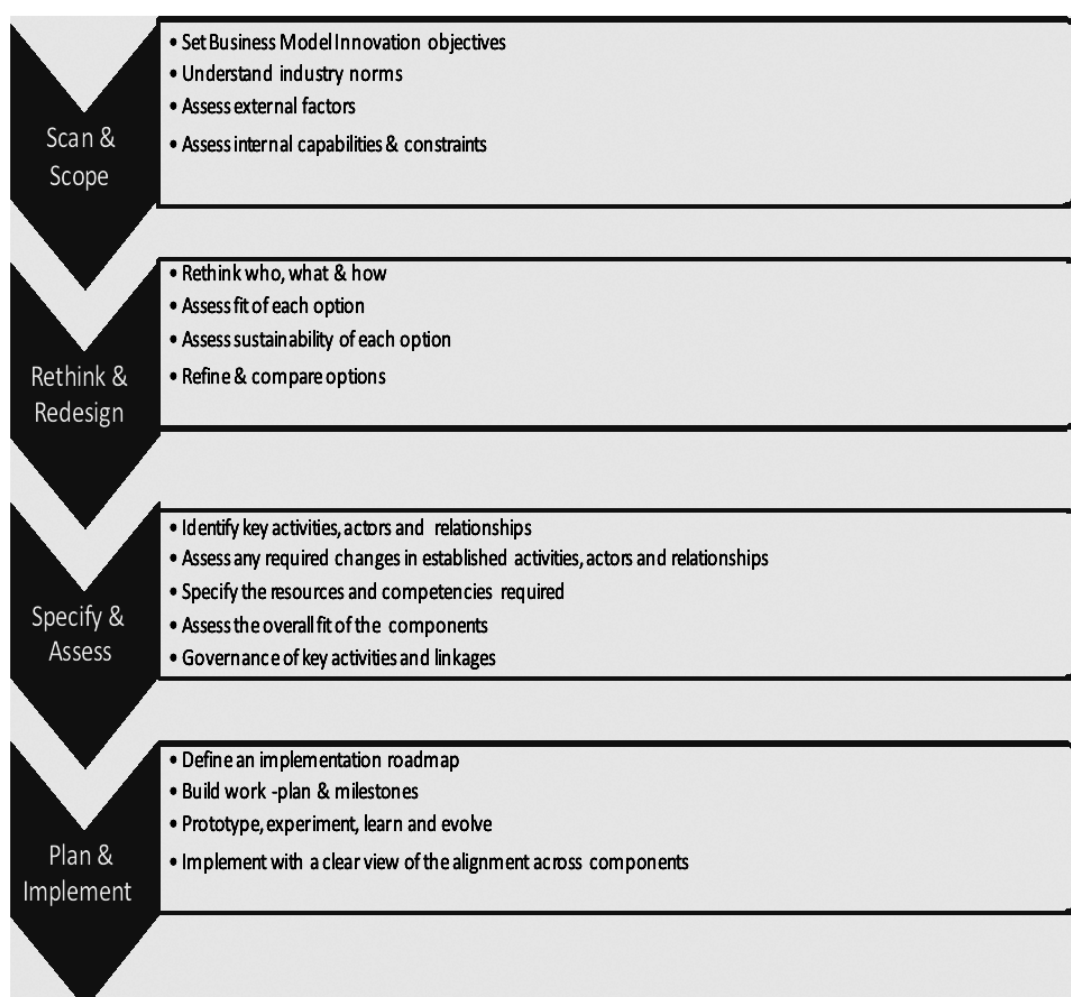


FIGURE 5.1: Overall Strategy for Developing Business Model Innovation

Developed from Deloitte Research (2002)

BARRIERS TO BUSINESS MODEL INNOVATION

Reassessing the current business model and re-visioning the *who*, *what* and *how* is an analytical and a creative process that will usually be iterative and interactive. That may be challenging where:

- the 'old' industry recipe (which defines the market, what customers want, the ideal products, the channels to market etc) dominates perceptions, a form of 'cognitive lock-in';
- the corporate culture, internal structures, communication patterns, personnel, skills, external links, etc define and embed the 'right way of doing things';

- there is strong internal focus on the trajectories of improvement within the dominant industry business model and a personal commitment by many to those goals and implicit values (e.g. high quality, where 'quality' is defined in terms of the 'old' model);
- there is a lack of capacity or willingness to free intelligence and imagine alternative possible futures;
- concerns about disruption of the current profitable business model, and hence risks to established customers and revenue streams that restrict experiments;
- an emphasis on short term performance and a lack of understanding that it may take time to experiment with and introduce a new business model;
- concerns about how to implement and migrate to a new business model diminish the commitment to change;
- lack of clear leadership and authority, particularly because business model review and innovation, as it is not a technology function, requires the CEO's leadership and also involves all other functions.

These types of barriers also contribute to some of the risks of innovation, as discussed below.

Identifying and Managing Risk

Business model innovation involves risks - as with any type of change. As summarized in Table 5.3, many of these risks are similar to those of product or process innovation.

TABLE 5.3: Risks of business model innovation³⁹

- Portfolio bloat – too many bottom-up innovation initiatives, none attracting the focused support of senior management.
- Failure to scale up – lack of follow through from a pilot experiment possibly due to ambiguous interpretations of the results.
- Pet ideas – projects that are maintained despite failing to gain traction.
- Isolated efforts – failure of effective handover from innovation project groups to the main organization.
- Fixation on ideas – too much focus on the idea stage and inadequate selection and progression through pilots and scale up.
- Internal focus – inadequate focus on value creation for customers but taking an inside-out approach.
- Historical bias – overvaluing the established model and unwillingness to consider disruptive ideas.
- Technological immaturity – reliance on a product or process technology that remains unproven.
- Customer caution - leading to slow uptake.
- Internal resistance - lack of commitment to establishing and improving the new business model.
- Confusion among staff, suppliers, market channels or customers – due to the changes to the existing business model.

There are also risks in copying a business model from another firm. These arise from the difficulty in fully understanding all the key components of a business model and the relationships among them. Delta and Continental tried to replicate the business model of Southwest Airlines but failed to do so successfully. Jetstar aimed to build a low-cost airline in Australia, carefully studied the international experience, and succeeded.

³⁹ Lindgardt et al, p 4-5, 2009; Deloitte Research, 2002.

DESIGNING A BUSINESS MODEL INNOVATION

How are opportunities for new business models best identified and assessed? First, by re-assessing the current business model and exploring opportunities for strengthening this model. Or for introducing a new model, by focusing on exploring in more detail the *who*, *what* and *how* of a new innovative business model.

Competitive new business model innovation is often associated with new answers to the '*what business are we in?*' question. A clear example is the case of the pharmaceutical industry. These erstwhile highly profitable firms are under siege from many directions: the returns to investment in R&D are declining; governments are moving to restrict prices for medicines within health schemes; expenditure on alternative health products is growing more rapidly than that on patented products; the major growth markets are in emerging economies, aged care and small market segments with diseases that are not common, and in 'wellness' rather than illness products and services. The traditional industry recipe of 'blockbuster' drugs for disease treatment of common diseases accounts for a declining share of the industry. Developing new offerings for the evolving market for health and wellbeing products and services takes the pharmaceuticals firms far away from their core capabilities, as shown in Figure 5.2.

Identifying opportunities for new business models is helped by making explicit the components, and related assumptions, of the current business model. As noted previously, some of the foundations of the established model are likely to be taken-for-granted and hence have largely implicit assumptions, beliefs and values. Bringing these out facilitates both re-assessment and creative thinking about alternatives.

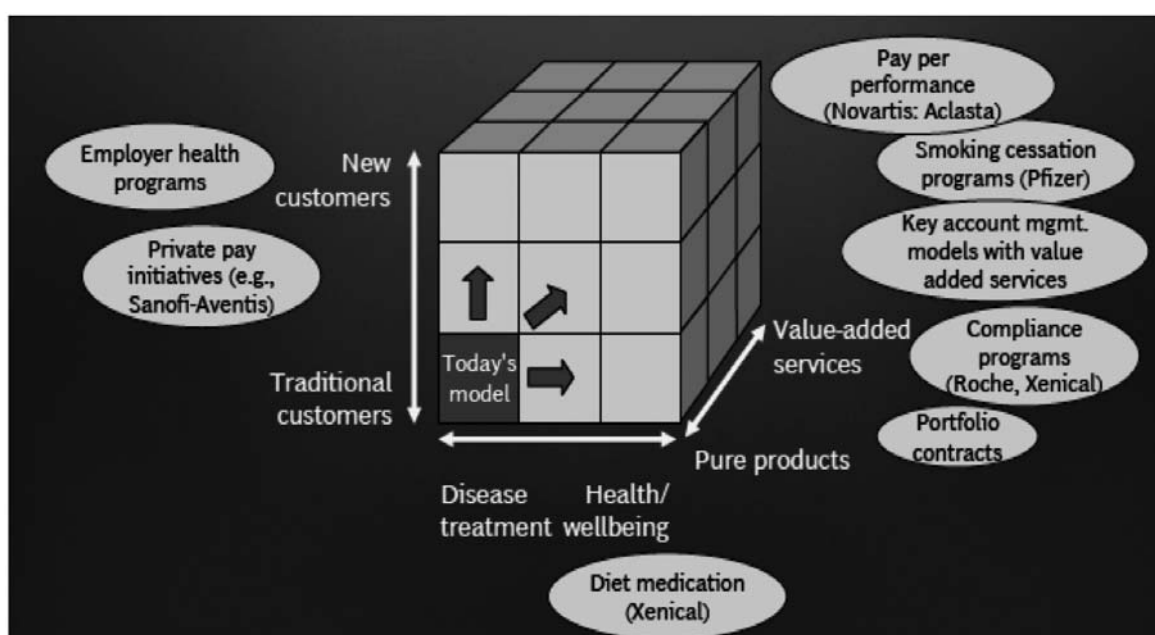


FIGURE 5.2: The Transformation of Business Models in the Health Sector

Source: Reeves, M., 'Why Business Model Innovation?', BCG, 2009.

The re-assessment visioning process involves:

- unpackaging the dominant business models in the industry in terms of who, what and how and identify the assumptions in each of these dimensions;

- recognising the strengths and limitations of the current business model – why does it work? (What are the weaknesses of the current business model - why do these remain weaknesses? Are the reasons why the business model was designed that way still valid?);
- assessing the longevity of the current business model;
- reassessing how each element aligns with current customer preferences, competitor positioning, technology trends (What compromises does the current business model force customers to make? Do any competitors offer a superior value proposition?);
- identifying underserved or dissatisfied customer groups (Why are those who don't or who stop using our offering dissatisfied?);
- identifying assets (e.g. customer loyalty, or process strength) that could be leveraged into new business models;
- encouraging a preparedness to identify and question the assumptions of the current model and to creatively consider alternatives.

Recognising Under-served 'Needs'

As noted above, many business model innovations begin with a recognition of significant customer groups with different needs. These may be emerging markets that are difficult for large established firms to address. They may initially be small compared with the mainstream market and their needs may be difficult to profitably address. But they may signal future trends. Approaches to identifying opportunities for new business approaches are summarised in Table 5.4.

TABLE 5.4: Identifying Opportunities for New Business Models

- Identify significant user groups whose problems are not being addressed by current market offerings.
- Identify the key dimensions of the business model space drawing on insight about the likely evolution of the industry, the changing patterns of potential user needs/wants (and the most useful way of segmenting user groups), the evolution of potentially relevant technologies and the likely directions of regulatory change.
- Reassess how each element aligns with trends in customer preferences and competitor positioning, in emerging market segments. [Are any alternative business models emerging and gaining customers in some market niches or in similar markets?]
- Reassess how emerging technologies might enable a different approach to each element of the business model.
- Identify and discuss buyer behaviour in the broad target market – explore trends and events and seek to understand whether they might signal new imbalances, new trends.
- Review successful business models in other industries, particularly those of new entrants who are gaining market share.

A strong and intimate market focus is often a place to begin, and this can be explored and developed by:

- Identifying inadequately met customer needs and assessing the value curve that might best address their priorities.

Many firms have effectively brought employees into the search for improvement and new ideas, rewarding them for their initiative and commitment. In larger firms with many business units, the 'collective intelligence' of the different businesses may be able to identify new business model opportunities and tap into distributed assets in the group.⁴⁰

- Exploring the scope of the apparent opportunity.

⁴⁰ Santos, et al, 2009.

Does this gap indicate a broader opportunity? Is this customer group growing? Does this group signal shifts that will shape the general market?

- Assessing possible business models.

What models could underpin an effective integrated high value solution for the opportunity area?

- Identifying how to develop deep customer relations and value chain links.

Are there opportunities to develop high customer value and strong links to other organizations in the value chain/ value network that provide a second level of integrated competencies?

- Experimenting with the elements and alignment of the *who*, *what* and *how*.

It is often essential to experiment, to assess the outcomes of these experiments and pursue further experiments in promising areas and perhaps for specific segments. It is often possible to test elements of the new business model through small scale experiments. This may be much easier to manage in a new organisation with selected staff and will often require a separate line of funding. Many firms have successfully brought customers into the process of exploring new market segments and new value propositions – see Table 5.5: Engaging Customers in the Search for Business Model Innovations.

TABLE 5.5: Engaging customers in the search for Business Model Innovations

Pursuing the dominant industry recipe means being a rule follower and almost certainly means focusing on the articulated 'needs' of the mainstream customers. It usually leads to minor variations on the established business models. To identify new opportunities, ensure that design, product development and production personnel as well as marketing, are involved in user interactions and explorations.

1. Getting out to engage with users:
 - Ethnography – see how people actually behave;
 - Bringing people together – active and open focus groups.
2. Bringing users into the creation process:
 - Design workshops with customers.
3. Identify leading edge users:
 - Find users who are pushing the product/service beyond its design space, but adapting it themselves to generate new value.
4. Test your product/service design.
 - Scaling up new models.

Scaling-up after testing the assumptions of a business model design will be important whether the new business model replaces the old model or targets a different market segment and is developed as a separate business line. New venture entrepreneurs also need to test the assumptions of their business model prior to any detailed business planning. The new venture business plan is likely to evolve in some or many dimensions as the entrepreneur engages with potential customers, suppliers, investors and tests the assumptions of the model.

SUSTAINING COMPETITIVE ADVANTAGE FROM A NEW BUSINESS MODEL

Established firms are often taken by surprise by new business models which undermine the taken-for-granted recipe of the industry, or which better meet the needs of a market segment previously not seen as attractive. But new business models that are easily replicated generate profits for a

short time. If they undermine established firms in mature industries, they are sure to face a response from those firms. If they show a new market opportunity, they will attract followers. The sustainability of a disruptive business model depends on the capacity of the innovator to defend their advantages. For example, Virgin Blue entered the Australian market in 2001 with an airline offering low fares but a good quality flight experience. It gained a 30% market share quickly. Qantas responded through launching Jetstar in 2004 with a new business model, offering lower fares than Virgin Blue. Jetstar further developed the business model by initiating international services in 2006 - the world's first low-cost long-haul airline. Customers can choose and pay for the services they want as these are unbundled from the airfare. Virgin Blue's growth was reduced and in 2007 Virgin Blue abandoned the discount segment to target business travelers.⁴¹

In designing a business model it is advisable to try to leave little scope for followers to copy the business model, and for incumbents to re-establish dominance through modifying their old business model while leveraging off their often deep assets. Business model innovators will be best able to defend against the responses of established firms when:

- The established firms are deeply committed to their business model and value systems and cognitive frameworks on which it is based – such that they are reluctant to question these assumptions, giving the insurgent firm an opportunity to consolidate the business model and build market share.
- The established firm risks eroding the strength of their successful business model by stretching it to contest the newcomer. For example, IBM and other PC manufacturers risked disrupting their established distribution and support channels if they emulated the direct marketing approach of Dell, and full-service providers (airlines, stock-broking) risked eroding brand equity if they also offered discount services.⁴²

Several strategies can strengthen the sustainability of the business model by reducing the scope for replication:

- building brand equity – generating loyal customers through being responsive and addressing their needs, creating a market 'buzz' through recognition of the novelty of the new approach;
- ensuring a tight alignment of the *who*, *what* and *how* dimensions, with elements of the *how* dimension that are deeply embedded in corporate routines and culture that are tacit and hence particularly difficult to replicate;
- consolidating economies of scale, and managing learning to drive continuous improvement.

IMPLEMENTING A BUSINESS MODEL INNOVATION: ACTIVITIES AND CAPABILITIES

The overall business model innovation process was summarised in Figure 5.1. A more detailed guide to specific implementation activities, enablers and barriers is in Appendix A.

Some of the major risks involved in business model innovation point to the competencies that are likely to be vital. These risks are:

- A strategic vision that rapidly becomes unviable due to unpredicted change in the business environment. According to the EIU an increasing number of companies, recognizing the turbulence in their environment, formally review their business model regularly;⁴³

⁴¹ Lindgardt et al, 2009.

⁴² Deloitte Research, 2002.

⁴³ The 2006 EIU survey found that almost 50% of the companies they surveyed reviewed their business model annually.

- A slow re-orientation as the culture, values and routines of the old business model continue to shape approaches and expectations;
- Employee resistance to restructuring – particularly (and understandably) where change involves outsourcing;
- Underestimating the time and resources required to follow through with the development of the new offering and the supporting business processes.

These risks point to three difficult challenges for leadership and management. First, clarity of vision and focus is essential but in a context of uncertainty that is particularly demanding. Second, understanding what will be involved in redesigning the business model, implementing change and predicting barriers requires a high level of managerial insight. Third, selling a new approach to employees (and other stakeholders, including alliance partners) and developing an open discussion of changes and impacts demands a high level of management skill.

Drawing on these points and the previous discussion, these are five areas of capability that have been essential for the effectiveness of many business model innovations:

- **Customer insight**

Insight into value from a customer's perspective will provide the key focus, the sense, of the business model. By encouraging a wide range of staff to understand the customer's use of the firm's products, a deeper foundation of insight can be built.

- **Exploration and experimentation**

Imagining future scenarios, conducting low cost low-risk experiments of the potential business model elements, encouraging an exploratory approach by staff and (where appropriate) delegate decision-making that does not need to be centralized, and brainstorming new ideas for developing business model innovation teams. Some firms have drawn customers and suppliers into the process of exploring and experimenting with new business models.

- **Business design**

The competencies and processes for effectively identifying, developing, aligning and managing the components of a business model are critical. While the specific capabilities will depend on the context and the change, these may include, for example: market analysis and marketing, building collaborative links with customers, forms of strategic alliance management, outsourcing, and supply-chain management, acquisitions and spin-outs. This also involves the capabilities that underpin the wider changes needed to support the core business model, e.g. in R&D, operations, culture, leadership skills, training, incentives, metrics, information systems.

- **Acquiring new competencies**

In several of the examples of business model innovation discussed, the firm has had to build new capabilities, usually through hiring and training. In the case of Orica its development of mining services involved a substantial investment in research and staff recruitment to build strengths in IT.

- **Managing change**

The rising significance of business model innovation is increasing the importance of high quality strategic leadership and of multifunctional structures and teams. The typical directions of change in business models increase the importance of managing emergent strategy development and implementation, and hence more internal entrepreneurship. Managing culture change, supporting rapid learning and ensuring clarity and communications are vital as in any change process.

The evidence from the surveys cited in this report indicate that a capability for business model innovation is now an important dimension of overall innovation capability.

The foundations for business model innovation readiness include:

- formally reviewing the business model at least once a year;
- seeing value through the customer's eyes;
- developing alliances (including tactical alliances, rather than only joint ventures and mergers) to increase flexibility and seeking lean operations through improved business processes, including use of new technology and outsourcing;⁴⁴
- strengthening the defendability of the value chain position, for example by focusing on differentiated knowledge, R&D, design and skill-intensive activities.

Business model innovation is a form of innovation that may involve change in only some aspects of a firm's products, processes, methods, capabilities, and external linkages. But it may require, or begin a path of change that leads to, deep change. Hence, business model innovation is often a co-requisite or complement to other forms of innovation. Effective business model innovation draws on many of the same processes and capabilities that are vital for any type of significant innovation – all of which are becoming more important for sustained competitiveness.

⁴⁴ EIU, 2006.

6. Conclusions

This report has explored the characteristics of business models and of business model innovations, providing a diverse range of Australian examples. It has aimed to raise awareness of the significance of business model innovation in responding to competition and in finding new avenues for growth. It has also aimed to provide practical frameworks to guide all stages of business model innovation - assessing the scope for innovation, designing a new model, implementing change, and learning to improve and build on the model and on business model innovation capabilities.

Several overall conclusions emerge from the review of international studies and experience and many Australian cases.

Innovation at the level of the business model has become a powerful source of competitive advantage.

That is the message of several recent surveys that have shown that it is often a characteristic of high performance firms. With rising levels of competition and more rapid change in technologies and markets, the competitive assets of any firm can depreciate very rapidly. Consequently, the capacity to review and renovate a business model and to undertake deeper business model innovation, will often be essential for survival and growth. The case studies in this report have shown that new business models can be the path to major market opportunities for new ventures and for established firms.

A business model is how a firm creates value for customers, partners and itself.

A business model is a firm's answer to the questions: what to produce, for whom and how to make money doing so. A more detailed framework for describing a business model has several components that elaborate these three primary dimensions. The range of options for each of these dimensions is widening. New services like PayPal support other new web-based business models, and illustrate how the introduction of new business models can open the scope for a chain reaction of other new business models. Many new business models are relatively simple. Whether simple or complex, the power of a business model comes from focus on the target customers and value proposition and from integration where the 'who', 'what' and 'how' components supports each other, providing an overall synergy.

Business model innovation finds new ways to combine the components of what to produce, for whom, and how to make money from doing so, and involves a realignment around a significant change in one or more of those dimensions.

Business model innovation may develop from the modification of an existing business model or involve a new concept, as in the case of Apple's iTunes/iPod. Such innovation is often at the

heart of successful high growth new ventures. But business model innovation is just as likely to be introduced by established firms, as was the case with Jetstar, launched by Qantas. Business model innovation can be used defensively to extend the competitiveness of an established business. It has particular benefit when it is used to open a new path for business development - enabling a shift to higher value-added activities, products or services to escape commodification or to engage with an emerging growth market.

The increase in innovation at the level of the business model reflects systemic change in the economy – in business and in markets.

Several surveys have shown that business model innovation is becoming more important for sustaining competitiveness. Why is this so? The scope for new business models is increasing - there are many more feasible answers to the questions of 'who', 'what' and 'how' to produce. There are several drivers but the most important are changes in technology, in markets and in business dynamics. The growing utility of the internet, including rapid learning by users and consequent changes in behaviour, is clearly one important driver. More generally, IT and communications technologies support higher levels of flexibility and coordination – including with distant and dispersed customers and suppliers. Users are better educated, better informed and have a widening range of choice. There is an interaction between flexibility and market segmentation. As the capacity for customisation increases, the diversity of market demand also increases. While the level of competition is rising in most industries, so also is the exploration of new opportunities for business development, and hence the diversity of competitive challenge. Emerging opportunities are more quickly pursued by new entrants, if not by established firms. More firms are prepared to collaborate and specialise in value chains and value webs. Business model innovation is both a response to change and a driver of continuing change.

Business model innovation is not 'all about the web' – although the internet has enabled the development of many new business models.

Many new business models do not involve the internet. Neither Orica's development of mining services, or Kimberley Kampers success in off-road equipment, relied on the web. However, the internet is a significant aspect in other cases. It can enable new forms of interaction with dispersed customers and also empower customers through the provision of information and greater choice and convenience. Amazon is an outstanding example.

Business model innovation does not require technological innovation – it is an issue for all firms and not only for high-tech firms or for new ventures.

While technological innovation is an important aspect of some new business models, it is neither necessary nor sufficient. Many Australian firms of all sizes, both new and established, and in a diverse range of industries have successfully introduced business model innovations. In several cases, the new business model has been the foundation for rapid growth and entry to export markets.

The starting point for business model innovation is often recognising an unmet or under-met need, along with an insight into a feasible value proposition.

A combination of insights around who are the customers and what can be done to create new value for them has been the starting point for many successful new business models. New needs may emerge for many reasons: demographic change (e.g. ageing); regulatory change (e.g. carbon pricing); and new knowledge (e.g. the health effects of a food or chemical). New technology or new supply options may make it feasible to meet existing needs in new ways or to profitably meet needs previously unmet. Opportunities for new 'who', 'what' and 'how' combinations are constantly emerging.

An effective business model has a clear focus and strong alignment among its components.

The examples of successful business models in Australian firms illustrate the importance of a focus on the target market, the specific preferences of those users and a value proposition designed for that target.

A business model is hard to copy, and hence more likely to be sustainable, if it is also based on unique elements, along with particularly strong synergies among the components.

As alignment among the business model components is vital for effectiveness, so is a business model incorporating assets deeply embedded in the firm and its business ecosystem. Such assets can include, for example, a distinctive culture, unique workforce knowledge or skills, protected intellectual property, reputation with customers, or close collaborative relationships with suppliers or market channels.

Innovating at the level of the business model involves learning – from analysis, imagination, experiment, and successful models elsewhere – and hence planning to learn.

Developing a new business model may require a challenging process of learning across a broad frontier, including learning about, for example, new (possibly unexpressed) preferences, the behaviour of potential customers, the combination of product or service attributes that is feasible, effective and profitable, the organisation of product/service production, delivery and support, and the capabilities and business systems required. Developing effective alignment is likely to require ongoing adaptation in the light of experience. For many new ventures, an effective business model is developed through experimenting, often at a small scale, before being refined and scaled-up. Learning from the experience of others is a valuable foundation for many firms, such that a specific exemplar can be useful in shaping the design and implementation of the new business model.

A new business model might enable entry to a market, but often ongoing innovation is required to improve the strength of the business model or to extend the business opportunity.

Often the firm that is first to develop an effective business model in an area of new opportunity can build a strong and sustainable position. But many examples of such success are also stories of ongoing evolution of the business model. This evolution involves both the strengthening of the core business model and the extension of that foundation model into a family of business opportunities based on the re-use of a key asset such as reputation, customer relationships, market knowledge or a production system. Orica Mining Services and Beacon Lighting illustrate the power of re-using the business model platform.

Business model innovation has been used to maintain the competitiveness of manufacturing in Australia.

Commodification, competition and high relative labour costs are a formidable challenge for many Australian manufacturers. Some firms have responded by innovating their business model, focusing on market segments with specific preference combinations (for example high quality off-road equipment, high quality shoes in the current fashion, lighting solutions) and developing the value propositions and capabilities to competitively address the target segment. The new business model may involve outsourcing low value-added stages of the value chain, while increasing capability in the skill and knowledge-intensive components.

The capability to assess, design and implement a business model innovation is an increasingly important competence.

While many firms have reasonably systematic processes for planning and managing new product or service improvements and innovations, and have developed the metrics to guide and monitor those dimensions of performance, few have similar capabilities for business model innovation. There is a need for a systems perspective, imagination and insight to explore potential new models, coordination across many functional areas and an ability for experimentation and fast learning. There is also a need often to develop new relationships with partners in value chains or value webs.

Reluctance to change a successful and long established business model should not inhibit the exploration of possible future paths.

The success of a long-established business may have led to a business model so entrenched in relationships, organisation, routines and culture as to be almost invisible. That can make it hard to diagnose weaknesses, design changes, and take on the risks of new approaches. This is one reason why new firms, without legacy systems and culture are often the champions of new business models.

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APPENDIX A: IMPLEMENTING BUSINESS MODEL INNOVATION

TABLE A.1: Implementing Business Model Innovation: Processes, Activities, Enablers and Impediments

STAGE 1: SCAN & SCOPE

Process	Key Activities for Effectiveness
Set Business Model Innovation objectives.	<ul style="list-style-type: none"> Identify internal and external drivers that are changing the fit of the current business model with opportunity and competitiveness.
Understand industry norms.	<ul style="list-style-type: none"> Make explicit the industry recipe and its assumptions.
Assess external factors.	<ul style="list-style-type: none"> Review the drivers from the market, suppliers and competitors Review the firm's role in the value chain and value network.
Assess internal capabilities & constraints.	<ul style="list-style-type: none"> Identify the capabilities that underpin performance and the sources of their renewal and development.

Enabling factors	Potential impediments
<ul style="list-style-type: none"> Relationships with customers and suppliers. Knowledge of business models in other firms and sectors. A deep understanding of customers. Extensive external networks. Rethinking like an insurgent Rethinking like a customer 	<ul style="list-style-type: none"> The 'old' industry recipe, which defines the market, what customers want, the ideal products, the channels to market etc, dominate perceptions (a form of 'cognitive lock-in'). The corporate culture, internal structures, communication patterns, personnel, skills, external links, etc, define and embed the 'right way of doing things'. A strong internal focus on the trajectories of improvement within the dominant industry business model and a personal commitment by many to those goals and implicit values (eg high quality, where quality is defined in terms of the 'old' model). A lack of capacity or willingness to free intelligence and imagine alternative possible futures. Lack of clear leadership and authority, particularly because business model review and innovation, as is not a technology function, requires the CEO's leadership but also involves all other functions.

Based on: Santos et al (2009); Mayson (2010); Deloitte Research (2002).

STAGE 2: RETHINK & REDESIGN

Process	Key Activities for Effectiveness
Rethink who, what & how. Identify options.	<ul style="list-style-type: none"> • Develop ideas for business model innovations. Learning from other business models. • Diagnosis and specification of requirements to support value creating performance. • Use cross-functional teams to explore perspectives and dimensions (and to build internal engagement and commitment). • Develop insight into alternative ways that value might be created.
Assess the fit of each option.	<ul style="list-style-type: none"> • Listen to ideas and inputs from a diverse range of sources. • Identify trade-offs among elements. • Make explicit the specification of key functions and activities to support the business model and how these fit to form an effective model.
Assess sustainability of each option.	<ul style="list-style-type: none"> • Identify key complementarities that would link the elements of the business model and support firm-specific competitive advantage.
Refine & compare options.	<ul style="list-style-type: none"> • Workshop options to test their assumptions, alignment and fit.

Supportive factors	Potential impediments
<ul style="list-style-type: none"> • Encouragement of initiative and risk taking. • Capacity to resource a new initiative. • Insights from other business units. • Corporate level creative spaces and facilities. • Culture of sharing and supporting change in the organization through mutual engagement. • Open dialogue between middle, business unit and senior management. 	<ul style="list-style-type: none"> • Low appetite for risk. • A lack of capacity or willingness to free intelligence and imagine alternative possible futures. • Focus on short term performance. • Lack of a good understanding of the current business model. • Large power differences with the owner/manager not being inclusive – which can lead to distrust and poor communications.

Based on: Santos et al (2009); Mayson (2010); Deloitte Research (2002).

STAGE 3: SPECIFY & ASSESS

Process	Key Activities for Effectiveness
Identify key activities, actors and relationships.	<ul style="list-style-type: none"> Assess whether to introduce the new business model in the core business or in a separate operation. Assess the merits of re-using resources, brand names, structures, personnel, customers etc. Identify the role of activities, actors and relationships in value creation. Assess whether your new business model initially focuses on a new market segment and hence different customers, and hence whether an orderly but creative process of migration or of destruction is needed. Assess options: out-sourcing (contract, alliance, joint venture, in-sourcing, location etc). Identify activities that can be added, augmented or removed.
Assess any required changes in established activities, actors and relationships.	<ul style="list-style-type: none"> Assess the likely level of disruption - what needs to change? Identification of the need for reorganization, reintegration, relocating, relinking etc.
Specify the resources and competencies required.	<ul style="list-style-type: none"> Identify the resources and competencies required to underpin value creation through activities, actors and relationships: eg finance, technology, human resources, linkages, systems. Identify the values, routines, culture, and relationships needed to underpin the business model.
Assess the overall fit of the components.	<ul style="list-style-type: none"> Alignment of the components of the business model. Fit with the existing business model of the firm. Fit with the external environment.
Governance of key activities and linkages.	<ul style="list-style-type: none"> Specifying performance metrics. Developing incentive structures. Developing appropriate reporting structures.

Supportive factors	Potential impediments
<ul style="list-style-type: none"> Support for a thorough exploration of options and the implications for stakeholder within and outside the organization. Scope for synergies with other activities (horizontal coupling) in the organization and a preparedness in the other business units to re-align to support these. 	<ul style="list-style-type: none"> Concerns about the changes in scope for the firm, e.g. entering new markets, new countries. Large power differences between those leading BMI and the ultimate decision makers. Distance from customers and suppliers. Too much emphasis on fit with the existing BM may diminish alignment within the components of the new BM. Concern about the impact on other business units. Organisational rigidity. Too much emphasis on incremental change based on a high level of reuse of the structures, reporting arrangements, personnel, etc from the old business model. Concern that the changes will introduce new risks. Distance from customers and suppliers

Based on: Santos et al (2009); Mayson (2010); Deloitte Research (2002)

STAGE 4: PLAN AND IMPLEMENT

Process	Key Activities for Effectiveness
Define an implementation roadmap.	<ul style="list-style-type: none"> Strategy for leading the shift toward the new alignment: structure, processes, information flows, relationships, values.
Build work-plan & milestones.	<ul style="list-style-type: none"> Develop a flexible roadmap with key decision points.
Prototype, experiment, learn and evolve.	<ul style="list-style-type: none"> Develop strategies for testing the key assumptions with customers and with staff. Identify the approach to learning and knowledge capture and diffusion. Assess whether to develop and launch a new business model in a separate venture.
Implement with a clear view of the alignment across components.	<ul style="list-style-type: none"> Building internal engagement and commitment through participation and communication. Building external engagement and commitment – developing reciprocal links in the value network. Developing the levels of trust and shared objectives and learning necessary to sustain relationships in the value network.

Supportive factors	Potential impediments
<ul style="list-style-type: none"> Clear go/no go decisions. Clear lines of accountability. Thorough and open evaluation of outcomes. Building internal engagement and commitment. Building external engagement and commitment. Collaboration in the development of the business model. Clear recognition that there is likely to be strong resistance to moving away from a business model that has been successful for a firm and its managers – the success of the current business model may be the major barrier to change. Decision-making seen as sound and fair. Explanation of the strategy and the changes in roles. Effective communications. 	<ul style="list-style-type: none"> Innovation champions not sensitive to the potential impacts of change on the overall organization. Concerns about how to implement and migrate to a new business model diminish the commitment to change. An emphasis on short term performance and a lack of understanding that it may take years to experiment with and introduce a new business model. A strong concern about disruption of the current profitable business model, and hence risk established customers and revenue streams, restrict experiments. Punishing risk takers diminishing experiments Lack of preparedness to change the model if it is not achieving traction with users. Lack of awareness that changes in activities are likely to mean changes in relationships. Decision making perceived as inadequate in terms of process or unfair in terms of the distribution of costs and benefits. Passive and active internal resistance. Exclusive top-down decision-making. Lack of awareness that changes in activities are likely to mean changes in relationships. Inappropriate frameworks, standards and performance metrics based on the old business model remaining the basis for judgements about what is appropriate.⁴⁵ A continuing but implicit systems of values and norms blocking the evolution of the new business model.

Based on: Santos et al (2009); Mayson (2010); Deloitte Research (2002)

⁴⁵ This section draws on Johnson et al., 'Reinventing Your Business Model', *Harvard Business Review*, Summer 2008.

TABLE A.2: Innovation Management Processes and Capabilities.

Processes		Capabilities [Resources , Positions]	
Innovation Processes	Enabling Routines/ Systems	Frameworks	Skills
Recognising technical and economic clues [Sensing, Opportunity discovery]	Scanning Forecasting Assessing Business intelligence Benchmarking Networking tools Idea management Creativity tools	Relevant Technologies Market, social & industry dynamics Technology evolution Ethnography	Analysis Communication Persuasion Leadership Tolerating ambiguity & uncertainty Entrepreneurship
Aligning business strategy and innovation strategy	Risk Management Roadmapping Business case analysis Financial analysis Impact assessment Risk analysis Decision making	Competitor Analysis Strategic analysis Business planning Design thinking	Cultural awareness Culture change Planning
Acquiring new knowledge from outside the firm	Collaboration management Alliance management Licensing IP management Networking	Knowledge transfer	Negotiation Valuation Communication
Generating new knowledge in-house through eg research, development, engineering business experiments	Stage gate Product development	Relevant science and technology, organisational application, regulatory knowledge	Creativity IP management Research Design
Choosing an innovation focus that is appropriate to the opportunity and capability	Evaluation Portfolio management		Communication Persuasion Leadership
Executing projects	Project Management Team Management Problem Solving Marketing Cross Functional teams IP management	Budgeting Personnel assessment	Communication Team building Delegation Empowerment Motivation Conflict resolution Leadership Self management
Implementing change in the organisation	Change management Incentive systems	Organisational change dynamics	Stress management Change management

(Continued)

TABLE A.2: Innovation Management Processes and Capabilities. *(Continued)*

Processes		Capabilities [Resources , Positions]	
Innovation Processes	Enabling Routines/ Systems	Frameworks	Skills
Learning through the evaluation of experience and the incorporation of 'lessons' into routines	Review Monitoring Evaluation	Learning processes	Problem solving
Developing the organisation through embedding effective routines in structures, processes and behaviours	Failure tolerance Training TQM Codification Experiment Auditing Idea management Incentive systems Continuous improvement Human resource management Knowledge management		Communication Team building Delegation Empowerment Motivation

Sources: Based on: Tidd, J. Bessant, J. and Pavitt, K., 'Managing Innovation: Integrating, Technological, Market and Organizational Change', 3rd Edition, Wiley, 2005; Carlopio, J., 'Changing Gears: The Strategic Implementation of Technology', Palgrave Macmillan, 2003; 'IMP³rove for Innovation Management Professionals, The IMP³rove Approach, The IMP³rove Platform', Version 1.3 November 2007, http://ec.europa.eu/enterprise/newsroom/cf/document.cfm?action=display&doc_id=3048&userservice_id=1; Rae, D.M., 'Teaching entrepreneurship in Asia: impact of a pedagogical innovation', *Entrepreneurship, Innovation and Change*, Vol. 6 No. 3, pp. 193-227, 1997; Lee, H. & Kelley, D., 'Building Dynamic Capabilities for Innovation: an exploratory study of key management practices', *R&D Management* 38 (2): 155-168, 2008; Teece, D.J., Pisano, G. and Shuen, A., 'Dynamic capabilities and strategic management', *Strategic Management Journal*, 18, 509-533, 1997; Winter, S.G., 'Understanding dynamic capabilities', *Strategic Management Journal*, 24, 991-995, 2003; Zollo, M. and Winter, S., 'Deliberate learning and the evolution of dynamic capabilities', *Organization Science*, 13, 339-351, 2002.