Innovating Your Business Model

Thinking Beyond Features

In recent years, we've seen a number of technology companies create or completely transform entire industries. Some examples include Amazon Kindle, Apple iPhone, Google Android, Mint, and NetFlix. In every case, their success was not the result of a new or disruptive technology advancement, but rather a unique technology application based on a business model innovation that was disruptive in some way. This article provides a primer on business model innovation.

What is a Business Model?

When people talk about business model, the focus is generally associated with how a company makes money - the revenue model. It's true that the revenue model is part of a business model, but it also includes the manner in which the financials are generated and sustained and is influenced by the product and cost structure of the firm. Searching for the definition on the web yields these answers:

- The plan a company uses to generate revenue.
- The particular way in which a business organization ensures that it generates income, one that includes the choice of offerings, strategies, infrastructure, organizational structures, trading practices, and operational processes and policies
- Describes the rationale of how an organization creates, delivers, and captures value

The latter version is succinct and allows us to focus on 3 specific areas that support the overall business model:

- **Creates value** - Corresponds to the products or services the company provides
- **Delivers value** - Corresponds to the systems, processes, resources, channels, and brand required to get the value into the customers' hands
- **Captures value** - Corresponds to the manner that revenue and profit is exchanged for the value created and delivered to the customer.

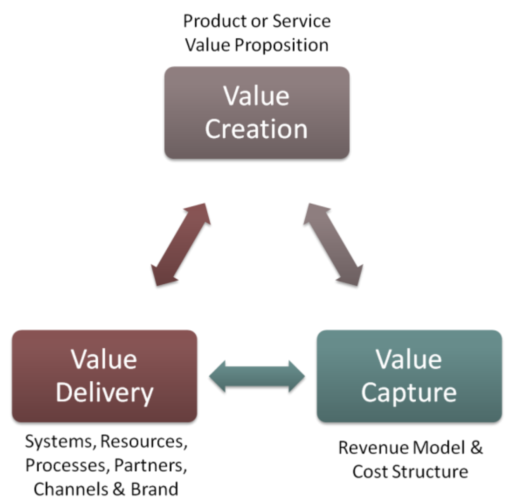


Figure 1 - Components of a Business Model

Here are three example generic types of business models that are common in the technology world. Combinations and hybrids of the models are also common.

Solution Shop - generally associated with service industries, including consulting and professional services, system integrators, outsourced technology developers, etc. These are knowledge-based industries focused on specific and unique problems to analyze and solve. Fees are provided for service and are generally high margin and high overhead. The key resources are people and knowledge and at low scale.

Process-Oriented Business - associated with product and service companies that produce solutions to pattern-based or recurring applications. This would be the output of most manufacturing and software application industries where the same solution is sold repeatedly. Fees are provided to own or use the product. Margins vary widely between hardware versus software and the goal is in achieving high scale of product sales. Key resources and processes involve manufacturing and operations, IT and predictable product operation and processes.

Facilitated Network - connects buyers and sellers, two-sided markets, or individuals. The business facilitates the movement of goods and services, knowledge, information or communication. Examples here are Google, Ebay, Craigslist, Yahoo, and Mobile Operators. Fees are usually through memberships, subscriptions, advertising or transaction fees and the goal is very high scale to achieve network effects. Key resources and processes are the size of the customer base and IT systems for connections.

The Power of Business Model Innovation

As companies become successful with a business model and as they mature, they refine and hone their skills and processes to optimize their model. This helps them to achieve scale and high growth and profits. It becomes corporate DNA. Industries tend to be dominated by a single business model, and the market leader will continue to enjoy leadership as long as the business model satisfies the majority of the segment needs.

This is why a new entrant attempting to attack a market leader head on using the same business model will likely always lose, regardless of a few interesting feature enhancements. The market leader already owns the core value proposition, channels and partners, and enjoys scale economies in its cost structure.

The DNA is also the basis by which incumbents can become trapped when a different business model appears on the periphery of the market. As companies continue to innovate incrementally for their best customers, they overshoot the needs of others in the market, allowing a seemingly inferior or low-end business model to capture these customers, or possibly even non-consumers.

The incumbent is unable to respond to the different business model effectively as the entrant gains market share because its DNA cannot assimilate a major change, such as an overhaul of its cost structure, or development and production processes. The response is then for the incumbents to continue to go up-market to a smaller and smaller segment of customers, while the new entrant continues to improve its business model, capturing more of the incumbent's market or expanding the entire market.

Examples of Business Model Innovation

Amazon is one of the leaders pushing innovative new business models. First, they created the online bookstore market focused on long-tail selection and lower price, then expanded it into all kinds of products. They then added a small merchant marketplace and eventually placed both new and used merchant offerings directly against their own, and even fulfilling some of the competitive offerings. Then they expanded their core infrastructure capabilities into a platform offering with Amazon Web Services. The Kindle has provided a platform for moving to digital book download capability. The Amazon Prime service also creates a strong loyalty hook by providing unlimited free shipping for an annual subscription fee.

Google has created many new products, primarily to drive Search revenue, but innovated a business model with the creation of Google Apps for Business. This offering packages up their consumer versions of Gmail, Google Docs and others into a business package with administration capabilities and a service level agreement for $99/user/year. They innovated a business model again with the Android OS for smartphones as open source, encouraging all manufacturers to develop devices without the typical licensing restrictions and competing against proprietary Apple and RIM devices found in the industry. They derive revenue by enabling more devices for their core Search service.

Apple's iTunes, like iPod, was not the first product of its type on the market for purchasing music online, but innovated the business model to sell more iPods by enabling single song downloads for 99 cents and removing all of the listening restrictions that had existed before then (except for DRM). They innovated again with iPhone and the App Store, not by having these products first, but by creating an app ecosystem that was managed outside of the mobile operators. This was to help sell more iPhones by encouraging app development through splitting revenues with developers and allowing them to set their own prices.

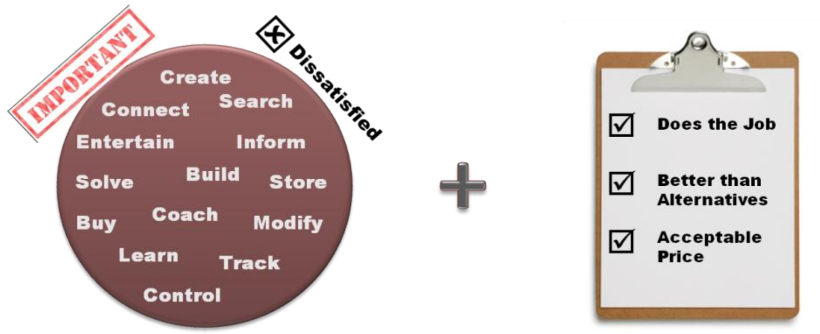
A take-away from these examples is that a business model innovation can accompany a new product endeavor without overhauling the core business model of a company. Or it can apply to an "enabler" of your core business that removes some barriers to the sales of your core product, like the iTunes and App Store and Amazon Prime examples.

It Always Starts with the Value Proposition

Regardless of whether you've got a great revenue model or a structure for delivering a product at very low cost, if your product doesn't actually create value for the customers, you're DOA. Unfortunately, this is where many, if not most, new products fail out of the gate. You fundamentally have to solve some problem or need in a way that customers see a strong benefit before you can ever make any revenue. This is why an actionable business model starts with Creating Value and the starting point ahead of that is discovering an underserved need.

The concept of the "job-to-be-done" identifies the customer need. Customers always have some goal they are trying to achieve, and the methods currently available to them either satisfy accomplishing the goal or not, or they may accomplish it but with a high degree of cost, effort or frustration. Identifying the job, its importance to the customer, and the degree to which they are dissatisfied with current solutions creates the opportunity for innovation.

The second part of the equation is the solution you develop to address the job-to-be-done. It needs to solve the problem in a manner and degree acceptable to the customers and be offered and available at a price the customer is willing to pay. That's a lot of stuff to figure out. The combination of the job-to-be-done plus the solution defines the value proposition. The more important the job is to the customer and the better the solution addresses it relative to alternatives for an affordable price, the higher the value received.



Customer "Job" to be Done Product or Service "Solution"

Figure 2 - Components of the Value Proposition

The value proposition is important not only for what it includes, but also for what it rules out. It's not uncommon for a product to try to focus on too many jobs-to-be-done and is overloaded with too many features, thus complicating and diluting the value. This delivers a product that doesn't do anything well, and features that customers don't need or are unwilling to pay for. Instead, focusing on the minimum feature set required to deliver the core value proposition should be the starting point. This is often referred to as the Minimum Market Features (MMF) or Minimum Viable Product (MVP).

Adding the Supporting Components

Once a compelling solution to an underserved segment is created and validated with potential customers, then the business model innovation comes from matching an appropriate profit model with the key resources and processes to optimize the results and create a competitive advantage.

Let's look at an example of business model innovation above. In developing Amazon Web Services, they already had a strong operations team capable of building and managing high-scale infrastructure as well as anyone, but were limited to their own use as a competitive advantage to support the brand. The value proposition for the Elastic Compute Cloud (EC2) is to enable other software developers to easily deploy new applications in the cloud and scale computing resources on-demand, without investing in and managing their own infrastructure equipment, and without a minimum commitment. Conceivably, some of these developers could even be competitors to their core business, but the market opportunity beyond them is huge.

As a developer, the cost variables associated with deploying your own infrastructure include the capital cost of CPU boxes, storage and OS/server licenses. It also includes the hosting cost in a datacenter driven by how much space and communication bandwidth you need. If you're just starting a new application or product, this upfront and ongoing commitment can be significant and may also be high risk. This is the problem being solved.

The pricing model developed by Amazon is very flexible to satisfy a broad set of customers providing a "rental" model. The basic pricing variables are:

- Platform size and complexity
- CPU hours per month
- Storage amount
- Communication bandwidth required

From this, a predictable cost per month can be calculated. They also offer a free usage tier for one year for small developer shops just getting started. The major resources and processes they need to deliver this service are:

- Self-service ordering, billing, administration and support
- Different configurations of infrastructure from simple to complex, redundant systems
- Rapid and automatic infrastructure provisioning to satisfy "on-demand" needs
- Service level agreement, notifications/alerts on both service and usage thresholds and service dashboards
- Security

The combination of value proposition, profit model and the major supporting resources and process creates a business model much different from Amazon's core business, but leverages the inherent resources needed within their core business. They are effectively selling their operational expertise to others.

The Business Model Canvas

In a terrific "visual" book, Business Model Generation, the authors lay out the concept of the Business Model Canvas which expands the three basic blocks we've discussed into nine as shown below.

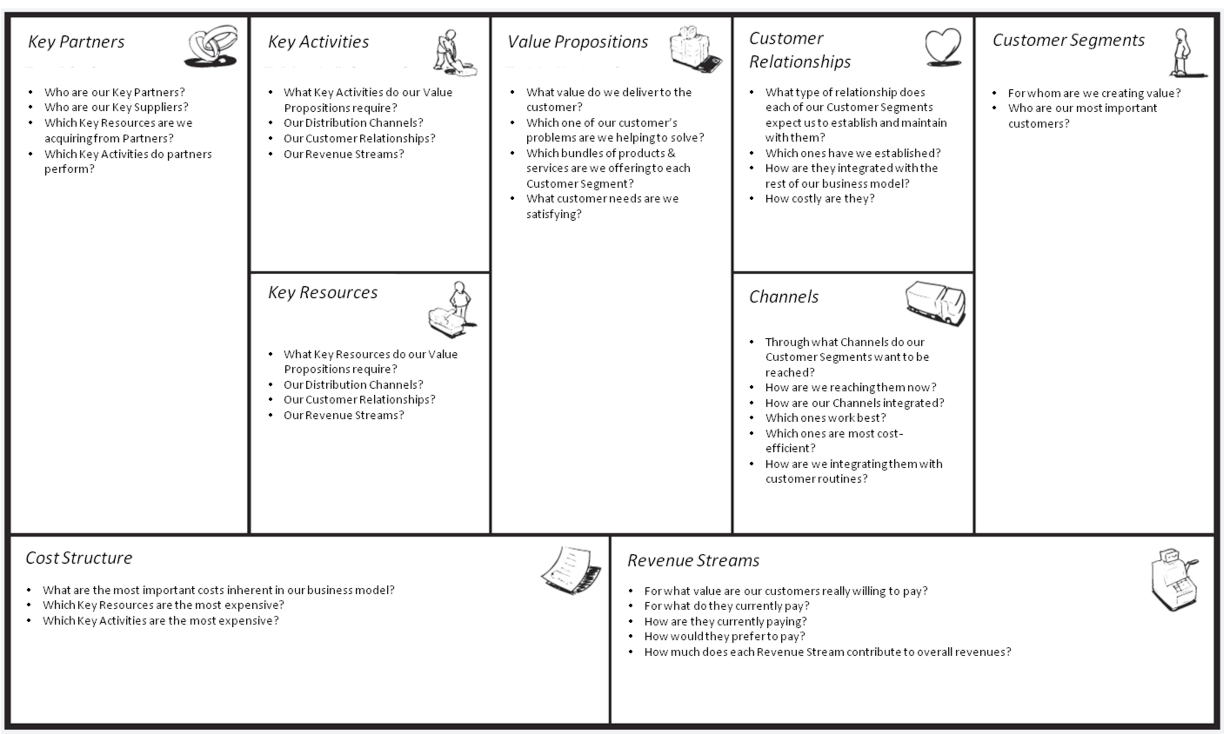


Figure 3 - Business Model Canvas

The book explains each of the blocks and how to apply using the canvas and starts with mapping your existing business model. For mature businesses, this may be difficult to do, as it's not so much written down and thought about as it is the DNA of the company. Then for each new exploration into offering new value propositions to new or existing customers, attempt to identify the optimum business model that would support it.

In comparing the two models, the goal is to decide what the new business can borrow from the old, and what should be discarded. Many new businesses are handicapped by the attempt to force too much of the existing core business model that does not appropriately support the new offering. The intent is to have the discussion of what is truly needed to optimize the business model. The book also talks about activities to identify and validate your business model in an iterative and rapid process to fully understand the impact and costs.

Summary

Your business model is the totality of how you create value, deliver value, and capture value with your customers. It includes creating a compelling value proposition, identifying key resources and processes to deliver it, and a profit model for running your business. Many opportunities exist beyond competing on product or service features and innovating in other areas of your business that optimize the value delivered to your customers.

Additional Resources

References for the business model and other strategy issues discussed in this paper can found in the following:

Seizing the White Space: Business Model Innovation for Growth & Renewal
Business Model Generation - A Handbook for Visionaries, Game Changers & Challengers
What Customers Want - Using Outcome-driven Innovation to Create Breakthrough Products & Services

About Product Arts

Product Arts specializes in Product Management consulting, deliverables and training. Our consulting consists of product strategy and planning, market performance improvements and processes for creating and delivering products. Our deliverables include specific projects for product requirements, competitive analysis and positioning, project plans, roadmaps, go-to-market planning and materials, pricing and business cases, and more. Our training includes public and private custom training for product management and associated staff. For more information, go to www.product-arts.com or email info@product-arts.com.