

Sustainable Value Creation

Securing success and exploiting growth opportunities by turning business model innovation into a process

By Juergen H. Daum and Karl F. Gruber

CEOs agree that successful business model innovation is set to become the most prominent source of competitive advantage and of sustained, profitable growth and success and, consequently, of shareholder and stakeholder value. The key success factor will be, if companies are able to develop the capability to adapt business models to a changing market and competitive environment in time. This requires a systematic and comprehensive process of business model innovation that fits into the complete management system seamlessly. Developing this process will become one of the most important management tasks in the coming years. For most companies, this is uncharted territory. There are no generally accepted best practices in this area yet. The European Business Model Innovation Forum (EBMIF) founded by the authors has made it its task to develop these. In the following article the authors explain, based on several examples, why developing the capability for systematic business model innovation will become a question of survival for companies from all industries and how companies can institutionalize business model innovation as a process.

Can a successful business model turn into a strategic risk for a company's continuing success? It may sound like a paradox, but: Yes, it can, if many years of success based on "proven value creation" have made a company's management negligent and blind to those developments in the company's broader environment (technology, economy, politics, culture and society), in its industry, and in its relations with its stakeholders (shareholders, customers, suppliers, employees) that can undermine the success of the established business model in the medium or long term.

In this case, the proven concept for success has the effect of blinders that systematically prevent looking at developments and at what lies beyond the actual, existing business model. In most cases, these developments and their possible effects are discovered far too late. The consequence: the company is forced into the defensive against its competitors, its risks increase, prices fall, losses are made, and soon the survival of the company itself is at stake. This happens far more often than one would like to assume.

One of the main reasons for this is that the diversity, scope and pace of change outside and within a company that can quickly turn into strategic risks have increased significantly in almost all industries. Consequently, the foundations of a previously successful business model can come into conflict with the competitive and market environment quickly and, initially, unnoticed. As a result, the company will not only be unable to rely on habitual and familiar growth drivers, but even its usual crisis reactions (such as cost reduction programs, increased marketing activities, or mergers&acquisitions aimed at attaining a "critical size", etc.) will have no effect.

The danger of such "systematic failure" of established success models can only be evaded by working with a system. A company needs to develop and institutionalize a system of strategic enterprise management that enables it to be *agile* in identifying developments that jeopardize its existence promptly, to interpret the possible effects of such threats correctly, to introduce innovations into its own business model *proactively* and to *reinvent* the latter in a comprehensive

manner. This is the only way a company can be successful in the long term and create new growth.

This requires:

- Defining the success factor "right business model" as objective of strategic enterprise management
- A continuous analysis and critical examination of stakeholder expectations and relations as well as of the competitive and technology environment
- A clear understanding of a company's own resources and core competencies and their role in the business model
- Establishing business model innovation as an institutionalized, systematic process

"The Right Business Model" success factor as objective of strategic enterprise management

If, in the past, it was sufficient to bring the right product onto the right market at the right time, the pace of technological development, particularly in information technology, and the hyper-competition brought on by globalization have changed the very foundations of the formula for success for businesses. It is not really *what* a company produces and offers on the market that determines success anymore, but rather *how* it goes about it: how *creative* the company is in shaping its value-added offering, value creation model and profit model in a way that will result in a business model enabling the company to stay ahead of the competition in the next market development phase and to continue creating added value for customers, shareholders, and other stakeholder groups by its activities.

In other words, instead of placing the right product on the right market, it is essential for a company to have the *right business model* for the right target group at the right time and to be able to recreate this congruency whenever required and before it is too late. A business model is only the "right" one as long as the value-added offering, value creation model, and profit model fit in with the external market conditions in such a way as to be attractive to core target groups and other company stakeholders, thus, resulting in a competitive advantage. Preserving this congruency despite growing change and competition has become the core task of strategic enterprise management and must be its declared goal.

It is essential to look at the business model as a whole – both at its current structure and orientation and at the as yet unused potential that may be hidden within: considering the current and potential future *value-added offering* for stakeholders, viewed from the perspective of each of the target groups involved; considering the current and potential future configuration of the *value creation model* that creates this value-added offering and that consists of business processes, organization, business infrastructure, business partner relations, core competencies, and corporate culture; and also considering the current and potential future *profit model* defining revenue sources and cost structures. Only looking at the whole, including the existing and potential future needs of target groups, creates the basis for even just recognizing positive and negative developments relevant to one's own future market position at an early stage.

However, this still presents a challenge to most companies. Managers mainly view the market and technology environment from the inside, that is, from the internal perspective of the company's current value creation model and its dominating processes and organizational units on the one hand, and from the perspective of the current profit model and its dominating revenue sources and cost components on the other. Both perspectives only permit a very limited view and

prevent managers from recognizing dangers promptly as well as growth opportunities that may be developing outside the company's current configuration.

This can have fatal consequences – especially in view of an increasingly global economy and rapid technological development, particularly in information technology and the Internet. This applies to almost all industries. Below some examples for illustration – starting with the music industry.

New risks and new growth opportunities in many industries

The music industry is currently going through a fundamental transformation. For many years, it had benefited from an extremely successful business model: selling relatively high-priced music CDs which could, moreover, be marketed worldwide, facilitating substantial economies of scale. Technological progress and changed customer behavior have now brought on profound changes.

The starting point is the demand profile of many consumers for whom buying CDs had not been an ideal solution, since if you wanted to listen to one particular song, you always had to buy a whole album, that is, a complete CD. The moment consumers were able to digitally download music from the Internet, they started shaping their own offering to suit their individual tastes and stopped buying CD albums.

The traditional music industry ignored this development for too long and mainly concentrated – legitimately, but consequently only defensively – on protecting its own rights and prosecuting copyright piracy and users and operators of illegal Internet file-sharing networks. In the end, it was the outsider Apple that established a new business model that met the consumer requirements and made active use of the opportunities offered by the new situation. The iPod, Apple's digital music player, gives the consumer direct and easy access to legal Internet music downloads by using Apple's online service iTunes. Result: In the US, Apple is already selling more music than the previous market leader Wal Mart. Consumers can happily access their favorite songs at a low price (each song only costs USD 0.99), and even big music companies are not left empty-handed anymore. For them, iTunes paved the way for a major breakthrough in legal and chargeable online music distribution.

However, whether this will allow the music industry to earn enough money in the long term and compensate for losses in the traditional music recording business still remains to be seen. At the same time, the industry is under pressure from elsewhere too: the importance and profitability of organizing and marketing live concerts and merchandise items is continuously on the rise compared to the traditional business of selling recordings only. The consequence: Concert promoters involved in merchandising are about to outdo the big music companies. This is made quite clear by the case of Madonna: In October 2007, it was announced that she was leaving her long-standing record company and had signed a USD 120 million contract with Live Nation, the largest concert promoter worldwide.

Both developments show that the great danger faced by traditional music companies is that of losing the active role in their own business model and being placed in the value chain far away from the paying customer – with the probable consequence of reduced margins and profit opportunities.

However, in other industries, changes in the market and technology environment are also generating new strategic risks, as well as new growth opportunities, continuously and at ever-shorter intervals. This is especially true of the latest developments in information technology and the Internet. Some examples:

Newspaper and book publishers: The traditional business model followed by newspaper and book publishers is increasingly under pressure on account of the Internet: Since consumers are

more and more likely to read and research news on the Internet, as well as exchange information and generate their own content in a decentralized way, the publishing business model based on central editorship and information processing and generation is increasingly at risk. Reader numbers and, consequently, advertising revenue have been dropping for years. In the US, even high-profile newspapers have lost a fifth of their readers and in Germany, the Bibliographisches Institut & F.A. Brockhaus has announced that the current edition of their famous Brockhaus encyclopedia, which has been running for 200 years, is going to be the last to be published in book form. In future, and as part of a new business model, the content is to be made available on the Internet free of charge. What exactly this new business model will look like, how attractive it will be for its target group, and whether it will generate new growth remain to be seen.¹

Banking: The Internet could also affect the traditional loans business model of banks, due, for example, to loans being offered through Internet-based social networks. Online offerings, such as Prosper.com and LendingClub.com, in which every participant amounts to something like a little bank, show that this is more than pure speculation. It is easier for participants to lend each other small sums because they know each other or at least trust each other based on their involvement in the social network that rates them. At the same time, the social network is satisfied with a minimum or even no interest margin at all. Repackaging this model in a new, expanded value-added offering for certain types of potential loan customers could result in an entirely different business model that, similar to the Apple case in the music industry, could be highly attractive to specific target groups, and would compete with the traditional banking model and its earning potential and would promise a competitive advantage to the “first movers”.

Software industry: The next technical revolution in the Internet, referred to as “the cloud”, is expected to overturn the traditional business models of the software industry. This means that not only documents, Web pages, pictures and videos, but also software codes will no longer be stored or installed on your own PC, but somewhere in “the cloud”, that is, in huge data centers somewhere in the world. Where this exactly is, will no longer be of any concern to the user. The advantage: Users can access all their data, objects, and software applications from any location in the world and using different end devices (mobile phones, PCs, and so on). As a result, the “software on demand” model, that is, software leases, would become significantly more attractive and relevant to users and start replacing the traditional software business model based on selling licenses. At the same time, this would result in entirely new opportunities for target group specific bundling of services and, consequently, for new business models. The increasing trend toward open source models for which a community of software developers organizes software development outside established company structures could boost this development especially in the area of add-on components and services.

Manufacturing industry: Even in the traditional manufacturing industry, the rapid development of information technology has paved the way for entirely new value creation models enabling companies to outsource parts of their business processes or even whole value chains to partners in such a way as to not only preserve process integration and efficiency, but even gain additional benefits resulting in new or improved value-added offerings. This can put established market leaders under enormous pressure, but allows successful innovators to improve their competitive position with existing customers, and at the same time to open up new, previously inaccessible market segments, for example, by means of new, complete packages comprising the traditional product as well as a service component. These kinds of business networks based on close interaction between a company’s own value creation activities and those of its partners may include everything from cooperation in research and development (for example, co-development

¹ See: Clausen, S., Lachmann, J., Knappmann, L. und Lamprecht, M., Brockhaus kapituliert vor dem Internet: Verlag stellt Lexikon kostenfrei online. Reaktion auf Kundenschwund. Zweifel an Geschäftsmodell, in: Financial Times Deutschland, 13.2.2008, p.1 and 23.

with customers and suppliers) or supply chain management (for example, operator models for warehouse management) to marketing (for example, collaborations with service partners for an “end to end solution”).

However, not only developments in the areas of information technology and the Internet lead to change causing strategic risks as well as new growth opportunities. In addition to these, an increasingly global economy and demographic shifts will lead to significant market changes in the coming years – both on the markets of the “old” industrial countries and in the emerging markets. In the former, an increasingly ageing population of consumers and an ageing workforce, and the latter, the emergence of millions of new consumers will change the overall conditions for “successful business models.” A similar effect will be achieved by changes in the companies’ regulatory environment – mainly on account of new rules meant to ensure sustainable and environmentally sound management.

To summarize: Without a systematic approach to strategic enterprise management, which makes business model innovation its declared goal and core task, and establishes it as an institutionalized process, escaping the danger of failing to notice a previously successful model and missing new strategic growth options becomes a matter of sheer coincidence. Unlike start-ups, where a gifted entrepreneur generally runs his business by instinct and “gut feeling,” successful business model innovation in established companies requires specific, repeatable systematic action which includes and integrates all relevant internal functions and external partners. This starts with an analysis and critical examination of stakeholder expectations and relations as well as of the competitive and technology environment.

Continuous analysis and critical examination of stakeholder expectations and relations as well as of the competitive and technology environment

Each successful business model innovation starts, first, with a deep and comprehensive understanding of what your own ‘product’ means to the consumer or customer, that is, where the added value you offer your customer lies. In the case of the music industry, this is not the CD itself but the music experience with a favorite song and, for real fans, being able to see the musicians at a live event and to identify with them by acquiring merchandise and fan articles – in each case, at prices subjectively perceived to be reasonable. This would include an analysis of the offering’s price and profit options (profit model), including an analysis of further possible options of generating additional or alternative income (as, for example, in the Google business model: the consumers, that is, the users of the search engine are not the ones generating the income; similarly, in the case of cheap airlines, a large part of the revenue is not generated by the passengers but by third parties such as airports). The next step could be a customer-oriented added value analysis that would put the added value of a company’s offer - from the consumer’s or customer’s view - in relation to competing offers and would explore price sensitivities.

Secondly – and this is especially important for identifying possible future risks as well as growth opportunities – managers should continuously monitor and strive to understand how market and technology developments will influence the future preferences and buying behavior of customers and how this will affect the long-term attractiveness of the value-added offering inherent in the company’s current business model. As part of such an analysis, the latent, previously unsatisfied need of music consumers to be able to buy individual songs, which already existed in pre-Internet times, could be identified early on and therefore provide an indication as to the premises under which the current business model could encounter difficulties. Subsequently checking regularly whether such premises are likely to occur would provide an effective early warning strategy which, if taken up by strategic enterprise management, would ideally flow into an organized and

timely business model innovation enabling the company to benefit from the growth options of such developments, and limit risks.

Consequently, identifying possible strategic risks for the existing business model is not the only goal of detecting such agents of change. The focus is really on identifying possible new growth opportunities, that is, the “upsides” of the new developments. The goal is to leverage these opportunities by proactively changing the existing business model.

The first aspect, understanding added-value from the customer and consumer perspective, not only requires the ability to foreground customer and stakeholder interests, but also suitable processes that establish a close link between the company and its current and potential customers and that would enable managers to obtain answers even to unpleasant questions – these often being the only ones that lead to the discovery of previously unknown customer wishes and problems, which could become the basis for new, improved business models.

The second aspect, identifying and understanding possible future market and technology developments, requires professional scenario planning, which, by continuously monitoring the driving forces of change in the market and technology environment, even beyond the existing business system, and by matching the result with the knowledge arising from the customer and stakeholder analyses, could produce the first important eye-opener for the company and its management that could trigger a change of strategy and consequently spark business model innovation.

The goal is to define a new strategy for both, maximizing relative added value for the customer under the new market conditions (from the point of view of the customer comparing it with the competition), as well as for maximizing value added for the company in form of improved revenues and income through a new business model, which can consequently serve as a basis for safeguarding the company’s competitive position, success, and profitable growth.

A clear understanding of a company’s own resources and core competencies and their role in the business model

Innovation, including business model innovation, does not start in a vacuum. The individual company must start with its current situation and its present strengths and weaknesses: its existing resources and core competencies, which are then transformed by the innovation process into new architectures and new configurations, and thus into new business competencies and opportunities, and are adapted to a new environment and developed further. However, this is where most established companies encounter difficulties.

The existing business model and the procedures and ways of thinking that have accompanied it and people have been used to for years distort not only the ways of looking at the external but also the internal environment: the way of looking at a company’s essential resources and true core competencies that can make a difference in a future market as part of a new business model. The traditional record company saw its core competency in marketing musicians by selling CDs, and also in the processes and structures this involved. Yet the existing business model might be hiding other and additional competencies, for example, in the form of intellectual capital unknown or only rudimentarily known to management; this might include certain types of procedural or technological know-how or relations to cooperation partners that could be important for a new business model.

An integrated analysis of existing resources and core competencies from a broad perspective that would include the viewpoints of different functions and hierarchy levels within the company, as well as the viewpoint of important external stakeholders, and that would take into account previous analyses of stakeholder expectations and relations and the competitive and technology environment, can become the second eye-opener, which would then show the course for the

business model innovation itself: that is, for a new value-added offering and a new value creation model, enabling the company to transform its own strengths into a competitive advantage and an attractive profit model under changed market and technology conditions.

Establishing business model innovation as an institutionalized, systematic process

The real challenge, however, is to make sure that the new configuration is implemented successfully while at the same time ensuring that the whole process of business innovation is repeatable. The latter aspect is important because the company's environment will keep changing in the future; the business model will then need to be adapted to these changes or be replaced by a new business model. And this will happen more often in the future than it did in the past. The reason for this is that competitors will also try to secure advantages by implementing new business models. However, the more the playing field in the competition is shifted from the pure product to the business model, the more process security is required for business model innovation. This can only be achieved by institutionalizing the business model innovation process.

The way companies today are used to act in a systematic manner in product development, i.e. based on a defined process, will equally apply to the field of business model innovation in future. What is being done by gifted entrepreneurs today, for example, by Steve Jobs at Apple, must also become feasible for managers in companies forced to carry on without the company founder. To achieve this, all competencies relevant to business model innovation and that are usually distributed among a great number of individuals and departments, must be bundled and integrated by means of a systematic business model innovation process and secured in the form of explicit procedural knowledge. Continuous and successful business model innovation requires that such a process is institutionalized within the company.

The transformation of business model innovation from a spontaneous event into a systematic, institutionalized process entails identifying individual tasks, combining these in processes, defining responsibilities, and setting up a professional change management.

Process steps comprise:

1. Analyzing the existing business model (internal view): How are we creating added value today, and for which customers, stakeholders, and shareholders? How do we make money?
2. Analyzing customer and stakeholder requirements as well as the market and technology environment (external view): Which drivers exist that may put our market position – based on the current business model - at risk in the future?
3. Strategic value creation, resource and competency analysis: Which possible scenarios result from step 2? What are our core competencies and resources – also independently of the current business model?

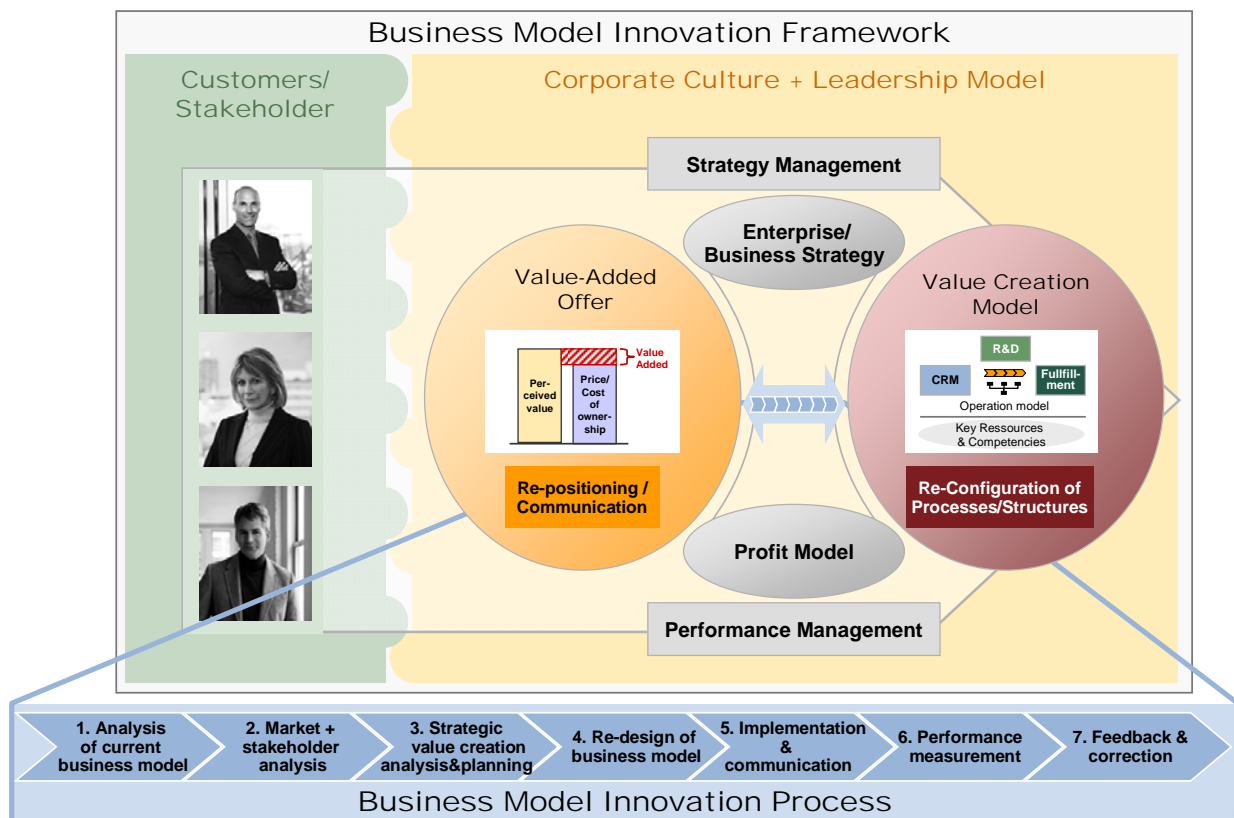
The resulting strategic planning: What strategic options for strengthening our competitive edge and for future growth does this make available to us, considering our corporate philosophy and market position?

Choosing suitable strategic options on the basis of selected efficiency, effectiveness, and compatibility criteria (compatibility of value-added offering, value creation model, and profit model).

4. Redesigning the business model on the basis of the new value-added offering, value creation model, and profit model, as defined by the strategy: What is our future value-

added offering to our customers? How can we communicate this? What are the new core business processes? How do we develop these? What roles/skills of our employees do we need to expand? Which cooperation partners have an important role? How can we shape and develop the cooperation and the underlying business processes? What organizational changes will result from this? What does this mean for our business infrastructure (locations, IT, and so on)? How can we make money with the new business model? (Where does revenue come from, and what costs are generated where?)

5. Implementing and communicating the change: What does the “project scenario” look like? Who is responsible for what measures? What are the goals? Has the reason for the business model innovation and the new business model been made clear to all employees and partners in an understandable way? Are our goals realistic and practicable?
6. Results control and performance measurement: Have we achieved the results/reached the project milestones we aimed for? Are the intended effects of the new business model manifest on the market?
7. Feedback & correction: Where do we need to make changes?



Business model innovation framework and process
(Source: European Business Model Innovation Forum – EBMIF)

Given that any process of business model innovation involves changes throughout the enterprise or across the business unit, one of the essential tasks when institutionalizing the process is to establish it organizationally in the form of clearly defined responsibilities:

Individual process steps should be assigned to an ‘owner’. One way of doing this is by assigning individual process steps to different company departments; each step should be assigned to the department with the greatest possible contribution to the task in question. In this case, you need a

strong, cross-department project management; project management coordination should be in a single hand – for example, in that of the strategic planning department. The other option is assigning project responsibility to a newly created “Program Office Business Model Innovation” function.

In both cases, “change management” also needs to take the informal organization into account. The crucial question is how you can generate sufficient commitment to the new business model among employees and business partners and how you can push the company culture as well as internal, informal communication in the desired direction.

Systematic business model innovation is uncharted territory for most companies – best practices are yet to be developed

Successful business model innovation is set to become the most prominent source of competitive advantage and of sustained, profitable growth and success and, consequently, of shareholder and stakeholder value. This requires a systematic, standardized, and comprehensive process of business model innovation that fits into the complete management system seamlessly.

Developing this process will become one of the most important management tasks in the coming years. This will involve meeting quite a number of challenges. Required is a new, integrated, cross-functional view of normative, strategic, and operative corner-stones in enterprise management that were considered fixtures and as of no particular import previously under the industry’s ‘standard business model’. What is required is nothing less than an architecturally innovative value creation design as a basis for long-term generation of added value for customers, for differentiation on the market and for profitable growth and success. This leads to interdisciplinary forms of cooperation in cross-company networks – it needs the production engineer’s operative attention to detail as well as the investment banker’s perspective on financial strategy as well as the risk manager’s vigilance. Especially the latter has to keep an eye on all risks involved in business model innovation. And this does not apply only - as already mentioned – for the management of strategic risks, but also for identifying, measuring, and controlling infrastructure risks, which could emerge during the implementation of new business models.

How is this possible in day-to-day business? How can the know-how that already exists within the company be consolidated, integrated, and developed? How can the know-how outside the company, that is, of customers, business partners, and other stakeholders, be used to achieve this?

For most companies, this is uncharted territory. There are no generally accepted best practices in this area yet. The European Business Model Innovation Forum founded by the authors has made it its task to develop these; this network brings together professionals from companies from various industries, various business functions, and various European countries in order to:

- jointly develop a guideline for systematic, successful business model innovation
- support its participants in ‘selling’ and implementing the concepts developed by the forum in their own organizations
- exchange experiences and ‘lessons learned’

More information can be obtained from the authors.

About the authors:

Juergen H. Daum is management adviser and chief solution architect of the Business Solution Architects Group at SAP in Walldorf, Germany. In this role he acts for the CFOs and finance professionals of European multinationals as a generator of ideas and stimuli for redesigning and transforming the finance organisation and enterprise performance management. In addition, he is involved in a number of international networks dealing with subjects such as intangible assets, performance management, innovation management, entrepreneurship and sustainability. He has gained more than 25 years of professional experience in management and in advising senior management in business transformation and in finance transformation.

Karl F. Gruber is director of operational risk management at the corporate center of Deutsche Bank AG, Frankfurt. In his previous positions at Deutsche Bank he was responsible for international key projects in organisational development, compliance, controlling, capital and risk management, as well as marketing and communications (such as, restructuring, post-merger integration, cost containment, risk reduction, internal branding, growth initiatives). He has been advising senior management at group, divisional, and regional level for over 20 years.