

Business Models, Business Strategy and Innovation

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Whenever a business enterprise is established, it either explicitly or implicitly employs a particular business model that describes the design or architecture of the value creation, delivery, and capture mechanisms it employs. The essence of a business model is in defining the manner by which the enterprise delivers value to customers, entices customers to pay for value, and converts those payments to profit. It thus reflects management's hypothesis about what customers want, how they want it, and how the enterprise can organize to best meet those needs, get paid for doing so, and make a profit. The purpose of this article is to understand the significance of business models and explore their connections with business strategy, innovation management, and economic theory.

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Introduction

Developments in the global economy have changed the traditional balance between customer and supplier. New communications and computing technology, and the establishment of reasonably open global trading regimes, mean that customers have more choices, variegated customer needs can find expression, and supply alternatives are more transparent. Businesses therefore need to be more customer-centric, especially since technology has evolved to allow the lower cost provision of information and customer solutions. These developments in turn require businesses to re-evaluate the value propositions they present to customers – in many sectors, the supply side driven logic of the industrial era has become no longer viable.

This new environment has also amplified the need to consider not only how to address customer needs more astutely, but also how to capture value from providing new products and services. Without a well-developed business model, innovators will fail to either deliver – or to capture – value from their innovations. This is particularly true of Internet companies, where the creation of revenue streams is often most perplexing because of customer expectations that basic services should be free.

A business model articulates the logic and provides data and other evidence that demonstrates how a business creates and delivers value to customers. It also outlines the architecture of revenues, costs, and profits associated with the business enterprise delivering that value. The different elements that need to be determined in business model design are listed in Figure 1.

The issues related to good business model design are all interrelated, and lie at the core of the fundamental question asked by business strategists – how does one build a sustainable competitive advantage and turn a super normal profit? In short, a business model defines how the enterprise creates and delivers value to customers, and then converts payments received to profits.¹ To profit from innovation, business pioneers need to excel not only at product innovation but also at business model design, understanding business design options as well as customer needs and technological trajectories. Developing a successful business model is insufficient to assure competitive advantage as imitation is often easy: a differentiated (and hard to imitate) – yet effective and efficient – business model is more likely to yield profits. Business model innovation can itself be a pathway to competitive advantage if the model is sufficiently differentiated and hard to replicate for incumbents and new entrants alike.

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In essence, a business model embodies nothing less than the organizational and financial ‘architecture’ of a business.² It is not a spread sheet or computer model, although a business model might well become embedded in a business plan and in income statements and cash flow projections. But, clearly, the notion refers in the first instance to a conceptual, rather than a financial, model of a business. It makes implicit assumptions about customers, the behavior of revenues and costs, the

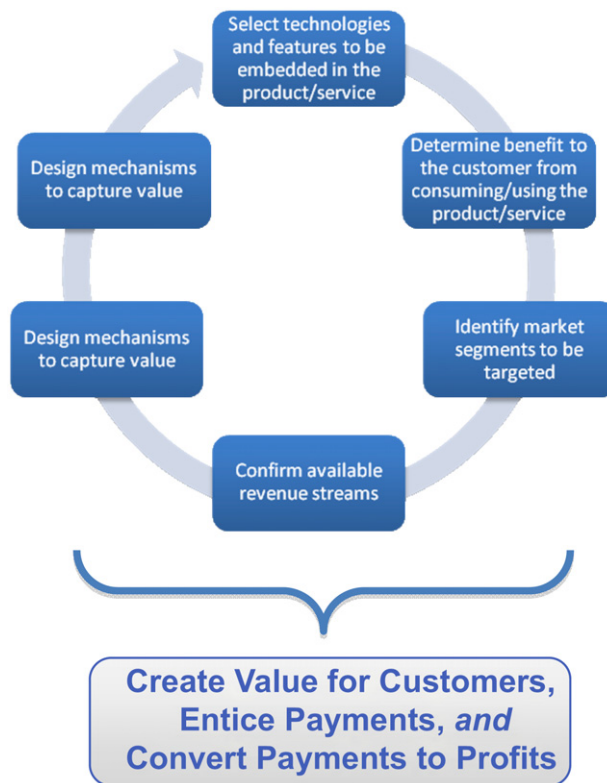


Figure 1. Elements of business model design

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