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Innovations in Retail Business Models

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Abstract

A *retail business model* articulates how a retailer creates value for its customers and appropriates value from the markets. Innovations in business models are increasingly critical for building sustainable advantage in a marketplace defined by unrelenting change, escalating customer expectations, and intense competition. Drawing from extant strategy and retailing research, we propose that innovations in retail business models are best viewed as changes in three design components: (1) the way in which the activities are organized, (2) the type of activities that are executed, and (3) the level of participation of the actors engaged in performing those activities. We propose six major ways in which retailers could innovate their business models to enhance value creation and appropriation beyond the levels afforded by traditional approaches to retailing. We also describe the drivers of business model innovations, the potential consequences of such innovations, and numerous examples from retail practice that highlight our concepts and arguments. In doing so, we provide a starting point for academic research in a domain that is deficient in theoretical and empirical research, and offer retailing managers a framework to guide retail business model innovations for sustainable competitive advantage.
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Globally, retailing is witnessing seismic shifts. The growth of the Internet has powered upheavals in the retail landscape that are revolutionary in scope, and unprecedented in nature. Some firms have created new markets, such as Apple with iTunes, and some have changed existing markets, such as Priceline.com. Today, most large retailers have morphed into multichannel firms, where the same customer visits the retailer via different channels for different purposes (e.g., obtains information online, makes purchases offline, and contacts customer support via telephone). Most have also expanded their focus from selling products to engaging and empowering customers, with the ultimate goal of creating a rewarding customer experience.

As a result, retailing practice is increasingly encompassing a broader range of activities as retailers expand the boundaries of their target markets and develop new ways for interacting with customers and channel partners. For instance, some retailers now use mass customization technologies to provide their customers with “made to order” products instantly (e.g., Build-a-Bear). Others effectively use technology to streamline the supply chain to rapidly align their product assortment with seasonal trends (e.g., Zara’s “fast fashion” approach of releasing five times as many collections per year as the industry average). Some have devised innovative customer interfaces (e.g., Shop24 dispenses over 200 grocery items 24/7 using automated kiosks). Yet another category of retailers simultaneously cater to multiple niche segments and as a result effectively exploit the “long-tail” (e.g., Amazon.com). Finally, in countries like India and China, the opportunity to satisfy the needs and wants of the populations at the “bottom of the pyramid” has spawned numerous retail innovations, such as Project Shakti implemented by Hindustan Lever, which has enabled poor rural women to become distributors of branded products in villages.

This paper focuses on *retail business model (RBM) innovations*. While many retailers continue to adhere to the adage “retail is detail” (a quote attributed to James Gulliver), retailers at the forefront of innovative practices recognize that paying attention to details is not enough because many specialized firms can execute specific retail activities to near perfection on behalf of retailers (e.g., order fulfillment via UPS or FedEx). A new critical capability involves configuring, and when needed recon-

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figuring individual retail activities and processes into a coherent blueprint, their business model, which outlines the innovative logic for competing effectively in their markets.

How should we think systematically about retail business model innovations? Is there a conceptual framework that provides theoretical insights as well as practically useful guidelines? We address these questions in this paper. Specifically, we first discuss the concept of business model in general and highlight its differences from the related concept of business strategy. Next, we conceptualize retailing business model (RBM) in terms of its three core components, namely, retailing format, activities, and governance, with a particular emphasis on interdependencies among these components that define the retailer's coherent theme. We assert that the purpose of RBM is to create and deliver value to customers, and at the same time, appropriate value from the markets for the retailer and its partners. We then propose that a business model innovation is a change beyond current practice with respect to its three core components and their interdependencies. We also propose a classification of RBM innovations along a set of six design themes, each providing a distinct approach to enhancing value creation or appropriation. We then describe the drivers of business model innovations, the potential consequences of such innovations, and highlight our ideas and arguments with numerous examples from retail practice. We conclude with research opportunities and practice guidelines.

Business model: definition and usefulness

There is no commonly accepted definition of business model in the literature. Instead, the literature reveals a wide range of definitions that vary in their emphases and scope (e.g., see the 2010 *Long Range Planning* special issue dedicated to business models). Nevertheless, most authors agree that a business model articulates a firm's value proposition, its sources of revenue, the resources used to extract rents, and the governance mechanism that links firm's stakeholders (Zott and Amit 2010). Drawing from this core idea, we propose a working definition of business models: *A business model is a well-specified system of interdependent structures, activities, and processes*[1] *that serves as a firm's organizing logic for value creation (for its customers) and value appropriation (for itself and its partners).*

The business model represents the firm's distinctive logic for value creation and appropriation (Chesbrough and Rosenbloom 2002; Gambardella and McGahan 2010; Osterwalder and Pigneur 2009; Teece 2010; Zott and Amit 2010).[2] For instance, a business model may outline how the firm creates value for customers via activities related to product development and flexible pricing. A business model may also outline how value is appropriated through, for instance, improved inventory management and changes to governance structures that reduce opportunity costs, increase customers' switching costs, or lower the leverage that various stakeholders exercise on the firm. Articulating the means by which a firm creates and appropriates value allows for a clearer delineation of the sources of its competitive advantage, which, in turn, facilitates updating and strengthening the business model.

A central aspect of our definition of a business model is that it incorporates interdependencies that transform a set of structures, activities, and processes into an integrated system. A business model is not *only* specified by a revenue model, a cost structure, a set of resources, or a value proposition; it is fundamentally about how these pieces of the business "fit together" to create and appropriate value (Magretta 2002). In this context, "fit" refers to multi-layered interdependencies among the elements of a business model such that the "whole" (business model) is not simply the sum of its "parts" (elements). If these interdependencies reflect a high level of complementarity or synergy among the elements of a business model, then the business model is likely to be more cohesive and effective in achieving its purpose (e.g., Porter 1996). Indeed, complementarities have been highlighted in numerous papers as a source of economic rents and competitive advantage (see Ennen and Richter 2010 for a review). For instance, Milgrom and Roberts (1994) found that the total economic value added by combining two or more complementary factors in a production system exceeds the value that would be generated by applying these production factors in isolation. Conversely, if the elements of a business model, however well designed, do not reinforce each other, synergies are less likely to emerge and the risk of failure will increase. In sum, the beneficial interplay of the elements of a business model is pivotal to its successful implementation. Conceptualizing the business model as an interdependent system thus encourages "systemic and holistic thinking" instead of local optimizations or piecemeal decisions (Zott and Amit 2010).

Business model and strategy: similarities and differences

Hambrick and Fredrickson (2005, p. 49) define strategy as "a central, integrated, externally oriented concept of how the business will achieve its objectives". At the same time, business model has been described as the "essence of a firm's strategy" (Gambardella and McGahan 2010) and "a reflection of the firm's realized strategy" (Casadesus-Masanell and Ricart 2010). Although business model and strategy share some common roots, they are different in important ways.[3]

First, strategy articulates a certain goal, whereas the business model details the mechanisms that moves the organization towards that goal. In other words, strategy specifies how the firm aims to differentiate from, or compete with, its rivals to achieve competitive advantage (Magretta 2002). It is focused on the firm's (unique) position in the marketplace (Porter 1996). The business model focuses on the organizing logic of *how*

[1] A process can be defined as "a structured and measured set of activities designed to produce a specific output for a particular customer or market" (Davenport 1993).

[2] Value creation implicitly incorporates a firm's ability to deliver this value to customers.

[3] For a more extensive discussion of the differences between business model and strategy, we direct the reader to Teece (2010).

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