THE VALUE CREATION POTENTIAL OF NEW BUSINESS MODELS

A business model is composed of three elements. These describe a generic way of **creating value** and identify the maximum **potential value** of that model for customers[1]. The elements of a business model are the "job to be done" for the customer; the asset configuration, or set of resources and capabilities, required to deliver the product or service to the customer; and the revenue (or monetization) model. An example would be ride sharing: "providing immediate transportation services through a mobile platform that utilizes other people's vehicles, by charging a demand driven transaction fee".

All companies will have some business model. But any number of firms can adopt a given business model - think Lyft and Uber in ride sharing. Similarly, firms pursuing different business models can compete for the same customer – as taxis compete with ride sharing companies. This recalls the earlier notion of "strategic groups" as fundamentally different ways of competing within the same industry. A private label manufacturer is in a different "strategic group" from, or competes with a different "business model", than a branded CPG company.

In contrast, no two firms should have the same strategy. What determines the relative success of those pursuing the same business model, such as Lyft and Uber, is their specific "classic" strategy - how they translate the business model into their target product/customer (scope), and value proposition and activity set (competitive advantage) – and how effective they are at implementing the strategy to realise value over time ie the other two elements of the Complete Strategy Landscape.

Job to be done:

Clay Christensen's use of the old term "job to be done" highlights that this element of the business model focuses on the customer. What underlying customer need is satisfied by the use of this product or service? I do not need to revisit classic examples – it is not a hammer and nail the householder wants, but the picture hanging on the wall – but reiterate that the framing is absolutely from the consumer perspective. "Strategy begins and ends with the customer," and when discussing value creation potential, nothing can be truer. If the product or service does not satisfy a customer need, it cannot create value. More importantly, the amount of value created for a consumer depends on **"willingness to pay":** how much more valuable is the product or service than available alternatives.

The target customer need not be identified in the business model because customer scope is a strategic choice. One way to see that is to recognize that an invalid choice of customer – women for ride sharing – can ruin a strategy, as Safr found out - but does not invalidate the business model per se.

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[1] Johnson, M, C. Christensen, and H. Kagermann. "Reinventing your Business Model." *Harvard Business Review* vol.86 #12 (2008) p.57-68. Pisano, G. "You Need an Innovation Strategy." *Harvard Business Review* vol. 93 #6 (2015) p.44-54. Eisenmann T. "Business Model Analysis for Entrepreneurs" Harvard Business School Note 812-096 (2014). Baden-Fuller C., and S. Haefliger. "Business Models and Technological Innovation." *Long Range Planning* vol. 46 #6 (2013) p. 419-426. Gassmann, O. Karolin F., and M. Csik. "The St. Gallen Business Model Navigator." (2013). Casadesus-Masanell, R. and JE. Ricart. "How to Design a Winning Business Model." *Harvard Business Review* # 89 vol.1/2 (2011) p. 100-107

Strategy is where the choice of scope clarifies exactly who the "job" is to be done for, and so identifies the size of the opportunity and the addressable market. [2]

Critically, "job to be done" focuses attention on the **function** that the product or service fulfills, **not the specific form** of how it is delivered. This separates the customer need that is being satisfied from the means by which it is delivered (the asset configuration element of the business model). This harks back to the seminal insight of Ted Levitt when he asked, "what business are you in?" to demonstrate the railroads, which dominated the Dow Jones until the 1920's, failed because they defined their business to be railroads rather than transportation - so missing out on the trucking and airline businesses[3]. A contemporary example would be Blockbuster, which went bankrupt four years after having accumulated 5,000 video stores (so that 70% of the population was within a twenty minute drive of a store), by defining itself as a bricks and mortar DVD rental store rather than as providing personal video entertainment – so losing out, first, to Netflix's mail delivery of the DVD and later to online streaming.

Asset configuration:

The asset configuration element of a business model describes the set of assets required to deliver the product or service to the end consumer. This includes, among others, manufacturing assets (if any), technologies employed, as well as distribution channels and customer relationships. While Uber and Lyft satisfy the same 'job to be done" as taxis – immediate transportation – they have an entirely different asset configuration. Uber and Lyft are asset light versions of the taxi business with vehicles owned by drivers, not by the company itself, and with their investment being in the technology platform.

It is important to realise that assets extend beyond the obvious physical assets. It is better to think of this as the **stock of resources and capabilities** that are involved in the fulfillment of the job to be done[4]. This might include a brand name – which distinguishes the branded CPG business model from the private label version; or distribution channels – which distinguishes a company like chain saw manufacturer Stihl that only distributes through servicing dealers, from a competitor, like Homelite, that distributes through all channels including mass retailers; or the mastery of product management in the online space – a very different skill than merchandising within a physical store.

Revenue Model:

In the past, little thought was given to revenue models. Today, how a product or service is monetized, is a vital question.

Companies used to simply charge for each transaction. There were surely debates about how much to charge as "value pricing" and "demand elasticity" determined how to extract the maximum revenue from a customer (which highlights that this aspect of pricing concerns value capture). But there was little debate around **how** the customer was charged. Today there is enormous attention paid to the

[2] Volume * (Willingness to pay minus cost) is the total value created.

[3] Ted Levitt, "Marketing Myopia, Harvard Business Review, 38 (July-August 1960), pp. 24-47

[4] See the later note on Resources for the course, and Collis, D. and C. Montgomery. "Competing on Resources: Strategy in the 1990s." *Harvard Business Review* (2008) p. 25-40

monetization method and how that, in turn, affects customer value creation. This is not about choosing where along the demand curve to price, but the prior question of the method of charging that determines the shape of the demand curve itself.

And there are at least two hundred permutations possible to consider! (see Box) Consider a mobile phone game. Applying the traditional way of generating revenue, the customer would be charged when the app was downloaded. But will more value be created by drawing in millions of users with free downloads, and then charging for in-game purchases? Or by offering a premium version for a fee after the user has, hopefully, become addicted to the game (the "freemium" approach)? Perhaps no one should be charged for using the product or service, rather value can be extracted by selling data gained in the transaction to a third party?

REVENUE MODELS

The traditional way to monetize a product or service is a one-time fee paid at the time of the transaction by the user - $2 for a bar of chocolate, $30 for a taxi ride. However, there are myriad ways to generate revenue from the provision of a product or service.

One dimension to consider is the structure of the charge – the **way** you are charging. The choice is an absolute sum ($2), or a percentage of the value provided (5% real estate commission); fixed and/or variable components, as with the rate structure of a utility that has a lump sum for access and an additional per KwH charge; and whether to bundle the charge into one figure, or deconstruct it into an a la carte offering – the way the airlines today charge you for the ticket, the better seat, luggage, meals…..

The second dimension is **what** to charge for? Or the unit that generates the fee. This can range from paying for the product or transaction (each apple); a subscription for a period of time ($x dollars per month for Netflix or Amazon Prime); a one-time lump sum (country club membership fee); or a rental fee for the actual useage of the object (GE charging for each hour a jet engine is in the air).

The third, and certainly most interesting in terms of recent changes, is the dimension of **who** pays. While historically the direct beneficiary of the product or service was charged, today there are many other participants in the ecosystem who can contribute to monetization. The service might be free to the user because another party is charged for access to the user - as the Google search engine is paid for by the advertiser. Indeed any platform provider has to decide which side of the platform should pay. Should I charge men to list on a dating site, but let women join for free? Charge both equally? The product or service can be free for initial users and only paid for by those who buy additional features ("freemium"), or items (as in in-game purchases, or the paywall that hits once a user has visited a newspaper site a set number of times). Or it might be free because the private information generated by the user is sold on to third parties as data - the model of most internet platform companies, such as Facebook, and of a new coffee shop chain, Shiru Cafe, which offers free coffee to students in return for access to their data.

As you can see, the alternatives quickly expand (and I suspect I have not classified all the possible monetization schemes that creative minds can envisage) and have a dramatic impact on value

creation and how to build a competitive advantage. Particularly when developing a new business model, the choice of monetisation scheme can have a radical effect on the viability of the opportunity.

The three elements of a business model define the maximum potential value created by the opportunity. How high is customer willingness to pay for the "job to be done"? What is the cost structure of the assets required to deliver that "job to be done", and how will the product or service be monetized? Combined, these elements shape the underlying structure of the business. In simple economic terms, the asset configuration determines the supply curve, the "job to be done" and monetization scheme together determine customer willingness to pay and the shape of the demand curve. These elements also underpin the competitive market outcome, such as whether returns will be concentrated on a few winners because of scale economies or network effects, and appropriate strategies, such as whether being a first mover is important. The business model therefore determines the opportunity's value creation potential, and suggests how the resulting value might be distributed among participants pursuing that model.

Business Models and Value Creation

Merely describing the elements of a business model, does not help strategists. Insights come from how the elements of job to be done and asset configuration interact to create differing strategic prescriptions (Figure 1).

FIGURE 1

Job to be done

Assets	Different	Better	Same	Inferior
New	RADICAL INNOVATION Polaroid, Amazon	PC, Netflix	DISRUPTION Uber, Airbnb	Nucor, Coursera
Same	ONGOING OPTIMISATION Cirque du Soleil "Blue Ocean"	Dishwasher iPhone (after 2007)	DON'T GO THERE X	X

Simplifying, the "job to de done" dimension in the figure ranges from inferior through better to "different", while the asset configuration dimension ranges from similar to novel combination of assets. Note that a "better job" could either be a lower cost version of the same product or service (as in the case of VOD streaming replacing video rentals), or a "higher willingness to pay" created through an improvement to the satisfaction of customer needs as in the latest, and most expensive, version of the i-phone[5].

[5] The continuum along the two axes are intentionally ambiguous. A "better" job is increasing the pixels, and hence the resolution of a smartphone camera. But is adding a new feature, such as photo-shopping a snap, making that

RADICAL INNOVATION

The top left is the space of radical "innovation" and historic breakthrough business models that leverage, typically, a new technology to create a wonderful and completely novel product. The Polaroid instant camera had enormous impact because it delivered something that did not previously exist from a new technology. Amazon uses a completely different asset configuration than brick and mortar retailers by selling online with a logistics system based on fulfillment centres and vans to pick and deliver individual items to the home. The success of both business models demonstrates the value created by performing a better job with novel assets.

Radical innovation is the obvious way to create enormous value, even though its rarity shows how difficult it is to achieve in practice. Stories that the predicted total worldwide demand for computers would only ever be for five units[6], illustrate just how inconceivable such a product was on its first appearance. Less dramatic are examples of employing different assets to deliver a better product as, for example, the personal computer combined the tasks of a calculator and typewriter.

Importantly, all incumbents usually pay attention to this avenue of improvement (even Walmart launched its version of online retailing just four years after Amazon started selling books online), typically by crafting product development portfolios that allocate adequate investment to Horizon 3 opportunities[7], and will embrace the market when it appears – if they can actually master the new technology themselves. Walmart, for example, has taken nearly twenty years to get its act together in online retailing.

DON'T GO THERE

The bottom right quadrant is a null set. Developments here will almost certainly be unsuccessful. Offering an inferior product from the same asset base, is a recipe for disaster (not that this has stopped many companies trying this approach in the past!). There is no value created for customers, and the me-too asset configuration means the entrant has no conceivable advantage over incumbents. When you build a worse metal and wood mousetrap, no one will beat a path to your door!

ONGOING OPTIMISATION

The lower left is the domain of incremental innovation within existing business models. Quality improvements to an existing product create small increments in value over the long term – think of how the i-phone is qualitatively better than the original i-phone in camera quality, size, etc. Similarly, the major appliance industry has reduced the real price of a dishwasher or washing machine by 2% pa for the last forty years as it drives what Porter calls "operational efficiency".

Innovations here do create value, even if only slowly and steadily as incumbents try to push the frontiers of their product or service in the twin directions of improving performance and lowering cost. Both are aspects of the challenges faced each and every day, and which constitute 80% of the management task. Without the perennial drive for continuous quality improvements matched by

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phone different or better? Similarly, while nearly all the technology was existing prior to the i-phone, some specific aspects of the phone did use novel technologies.

[6] Reputed statement by Thomas Watson, President of IBM in 1943

[7] Govindarajan, Vijay. *The three-box solution: A strategy for leading innovation*. Harvard Business Review Press, (2016). Sharpe, Bill. *Three Horizons*. Triarchy Press, (2013).

operational attention to cost, a firm is condemned to failure, and yet achieving them is merely a sine qua non of staying in business. This is the red queen problem – running hard to stay in place – because all others with the same business model are also relentlessly driving improvements on both dimensions.

More creative, but still employing the existing business model to create value, is the far lower left quadrant. This is the domain of Blue Ocean strategy[8]. Rather than trying to outperform existing products or services on criteria that are well known and demanded by customers, the business model seeks to introduce novel criteria that have previously been downplayed, underprovided, or undiscovered in the old "job to be done". In this regard, Blue Ocean primarily operates within the space of "job to be done" for the customer rather than exploiting a novel asset base.

Indeed, Blue Ocean has been widely embraced because it does not require a firm to master a new asset configuration, technology or build new capabilities, rather it just requires the rearranging of existing assets in a different combination. The degree of difficulty in achieving a breakthrough is thereby reduced. Unfortunately, the fact that it does not capitalize on new assets, means that it is vulnerable to imitation by competitors, as Yellowtail wine (one of the much touted Blue Ocean successes) found to its detriment. The breakthrough that led to its success was putting an animal label on a bottle of sweetened wine. While temporarily successful (mainly because of a US distribution deal), other Australian vineyards could, and did, quickly introduce their own "critter" labels, leading Yellowtail into bankruptcy.

DISRUPTION

To the top right, we have the notion of disruption as defined by Clay Christensen[9]. His insight was that you can win with a seemingly inferior offering. That was the surprise, and ignoring such business models was the underlying reason for the failure of entrenched incumbents and the explanation for the success of insurgents like Nucor, Netflix.... etc.

Note that the new offering cannot be universally inferior on every customer purchase criterion. If it was, no one would purchase it! Rather, Christensen identified that even if the offering is inferior on some dimensions, it will succeed if superior on some dimensions of importance to customers who have never bought the old offering, or to existing customers who are buying something that currently overshoots their performance requirements. In either case, the "inferior" offering is actually better for the customer on at least one critical dimension. For Nucor's structural steel customers the appeal, relative to integrated steel producers, was the lower cost of an inferior quality steel that was adequate for their needs. For minicomputer and then personal computer manufacturers, the appeal was the small physical size of the disk even if the technical specifications of the disk were inferior to larger disks. In both cases, the rank order of customer purchase criteria by the "low end" customer placed less weight on technical criteria on which the new offering underperformed, than on other criteria on which it outperformed.

This explanation of disruption is really just an extension of "blue ocean strategy". Find a set of purchase criteria that are currently over-satisfied and remove or reduce them (quality and speed to read in the two examples above) and/or find a few purchase criteria that are currently under-satisfied for a

[8] Kim, W. Chan and Mauborgne R.*Blue Ocean Strategy* Harvard Business School Press (2004).
[9] Christensen C. *The Innovators Dilemma* Harvard Business School Press (1997).

set of customers and add them into the offering (cost and size in the examples). Disruption makes the point that removing, minimizing, or failing to satisfy the needs of most existing customers is not the death knell of a new business model. If it is a superior offering in some ways to some customers, it can still be successful.

The novel contribution of disruption is the introduction of dynamics. The real threat of the low end entrant is not the small set of previously unserved customers that it initially wins by rejigging the value proposition. It is that the performance improvement trajectory of the new business model is faster than the old business model. The potential for learning and scale improvements is, by definition, greater for a novel way of doing things than a mature approach. How much better can a professor standing in front of a blackboard become after ten centuries, as opposed to the rate of improvement for online learning after the covid pandemic?

Thus it is a novel asset configuration that represents the "existential" threat to incumbents. Lost in the attention paid to disruption has been the classic way to supercede established competitors by exploiting a radical asset architecture. If this occurs, it is not only organizational inertia that prevents the incumbent offering low end versions of its product, but also its struggle to build or acquire the novel set of capabilities and technologies. In that case the incumbent with the current business model literally becomes an entrant into the new model and likely fails as often as other entrants.

I therefore disagree with Christensen, who argues that Lyft is not a disruptive threat to taxis because it does not offer an inferior service – his strict definition of disruption. Semantics ultimately don't matter, but exploiting different assets is actually more "disruptive" to incumbents than offering an inferior product that appeals to a different customer group. It is replication of the novel asset base that is hard, not the inferior product offering! Offering an equivalent product or service, but from a different asset configuration can be a real threat, as the taxi industry has learnt to its cost.

Business Model Competition

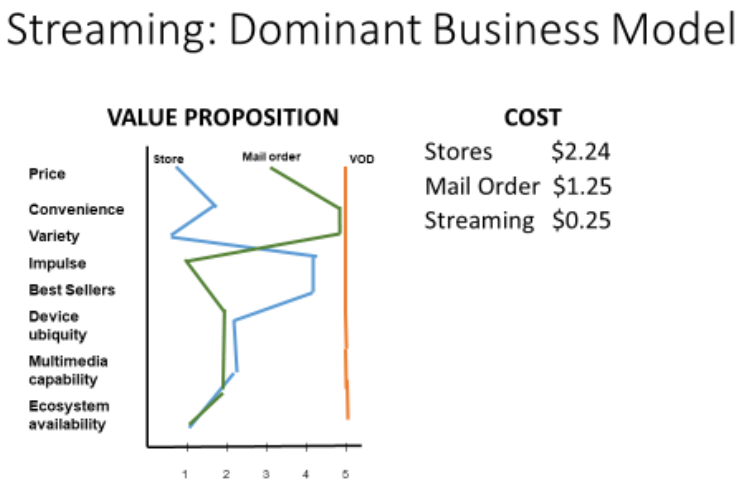
No incumbent should respond to any and every new business model – that would simply be playing whack-a-mole. Instead you must know whether or not to pursue a new model by **predicting the outcome of business model competition.** Understanding which model delivers a superior value proposition to customers and which asset base generates the lower cost ie which has the larger value gap, is the logical way to approach the problem.

Consider why video on demand (VOD or streaming) replaced the red envelope mail order delivery of a DVD and the old-fashioned video store. In contrast, why will Amazon's online business model never fully displace Walmart's bricks and mortar business model?

The value proposition for the "job to be done" of "delivering personal video entertainment" [10] reveals the absolute dominance of streaming (Figure 2). Regardless of what purchase criteria matters - convenience, impulse purchase, access to recent best sellers, or a large back catalog … VOD is better than either of the earlier business models.

[10] Note the definition of the business refers not to the *form* in which the service is delivered – bricks and mortar stores, mail order delivery, or online streaming – but by the "job to be done" for the customer – its *function*.

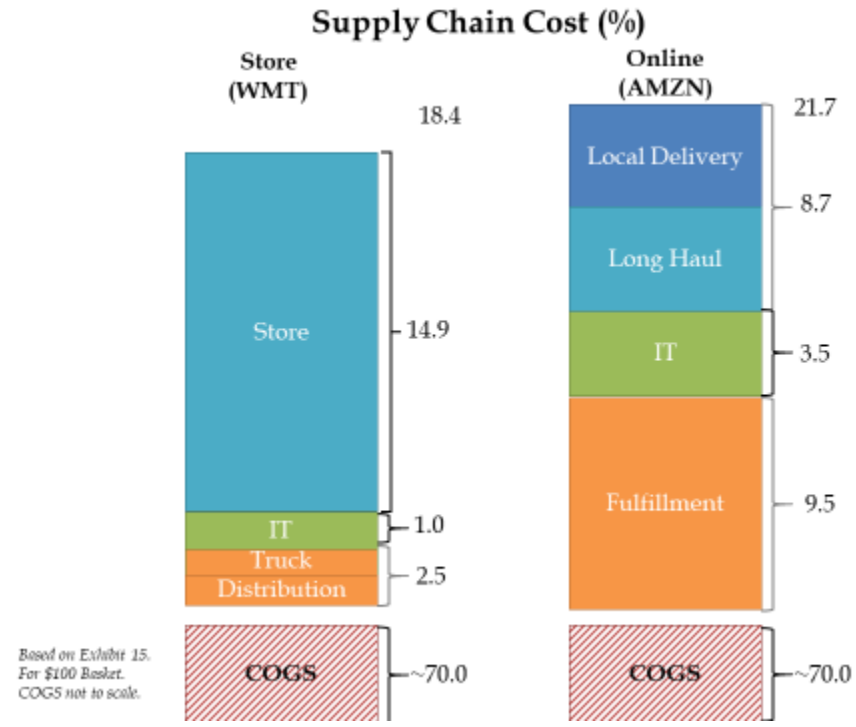
Figure 2



If that is not enough, the new business model is simply lower cost when digital delivery over the internet substitutes for the physical asset infrastructure of stores or the logistics of mail order. Put the demand and the supply side of the new business model together, and is it any wonder that we all are all now paying a monthly subscription to stream our video content?

In the battle between the two retailing goliaths – Amazon and Walmart – we can predict a different outcome. Online retailing delivered through a logistics network based on a limited number of fulfillment centres, will not dominate the traditional bricks and mortar stores supplied by a national network of distribution centres. Both will survive, which is why both are rushing to replicate the other's asset base and combine them in an omni-channel business model. (Figure 3).

Figure 3



With regard to the "job to be done", Amazon's business model works for home delivery of a very broad range of items (hundreds of millions available online), while Walmart's is better for immediate availability at low cost of a more limited set of items (about one hundred thousand in the

store). Each business model has a distinctive value proposition that appeals to different customers on different occasions for different products.

The same is true for the cost position of the different asset bases. Walmart's logistics system is low cost for everyday items and when the consumer picks up in-store or in rural locations. Amazon's cost structure is better for the long tail and for home delivery in dense geographies. Again, neither business model dominates. As a result, both are replicating the other's business model, acknowledging that each has advantages in different cases.

A Strategic Approach

We can now posit a strategic mandate for mastering business model evolution produced by changes in the opportunity set. First, every firm must strive to continuously improve by optimizing opportunities in the bottom left quadrant, whether these are ongoing cost reductions, or value improvements or recombinations – the sine qua non of competition. In fact, actions here are the projects required to continually adapt the existing business model and strategy to the ever changing environment. This is where most strategic action actually happens and is vital to the ongoing realization of value.

Second, adequate investment has to be made to address possible threats in the upper left quadrant. While there are no simple answers, the portfolio approach of Three Horizons is valuable in allocating resources to achieve the right balance between commitment and flexibility to hedge the risk of the "existential' threat from the new combination of assets.

Third, the bottom right quadrant should be avoided!

And finally, and this is the contribution of Christensen, the potential for innovation in the "inferior but different" quadrant cannot be ignored. When Intel CEO, Andy Grove, wrote "Only the Paranoid survive" it was this quadrant that he had in mind! Here the strategic mandate from Christensen is to adopt skunk works and support new ventures to override the inherent conservative tendencies of successful organizations. However, alternative organizational prescriptions, such as "incubate then integrate" abound, whose choice can depend on the **Borrow/Forget** ratio of the new business model compared to the old business model.