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Innovative business models and crisis management

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Abstract

Nowadays the worldwide and regional increasing competition, increasing demands from customers asking for more sophisticated products and the rapid changing of the environment where the businesses operate, has created the need for innovative business models. From a survey run by IBM in 2008 it was concluded that Chief Executive Officers from many corporations feel the need to adopt their business models and even to undertake larger changes as a result. Most financial analysts or academics take the music industry as a prime example of failure to innovate its core business model, especially in this troubled crisis period. There are many other industries where failure to innovate its core business lead to their decline. One of the biggest calamities of the current recession is the fall of the once highly regarded (and onetime fourth-largest) Wall Street investment firm – Lehman Brothers Holdings, which was forced to file for bankruptcy protection few years ago. Not many years ago another giant WorldCom second biggest long distance phone company in the US filed for bankruptcy burning 107 billion USD of assets. It is claimed that the financial crisis is the reason. But, is the financial crisis the only reason for failure? The reality shows that the business models and crisis management provisions have lost their role. The aim of this article is to present the rationale on the need of investing in innovative business models as the literature tells and run a comparative study using data from two or three big corporations in order to show how innovative business models can help the management to take the right decisions when dealing with crisis situations. The main result and conclusion of this article is to show that the failure of many corporations is not created by the crisis alone, but because the management did not innovate its business model.

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1. Introduction

It should be no surprise that if we ask executives and corporate employees to define the term of business model and to share the company's business model story, we tend to get a lot of blank stares and very different stories from across the organisation. For most, their business model has been in place since the business started, before most employees joined the company. Years ago the basic rules for how a company creates, delivers and capture value were established, fortified by functional archives and sustained by reinforcing company cultures. All energy and resources were focused on scaling business model and beating back competition attempting to do a better job executing the same business model.

At the present time increasing competition, increasing demands from the clients for more sophisticated products, technology and the rapid changing of the environment where the businesses operate, create the need for ground-breaking business models. From a survey run by IBM in 2008[2] it was concluded that Chief Executive Officers from many corporations feel the need to adopt their business models and even to undertake larger changes as a result.

What is a business model? Although there is no generally accepted definition of "business model", practitioners and academics often talk loosely of a business model as "*the way the firm operates to value creation and value capture*[3].

Another definition, by Saul Kaplan (2012), mentions business model as the rationale of how an organization creates, delivers and capture value-economic, social or other value. The importance of business model derives since 1950s where new models came from McDonald's Restaurants and Toyota. Then with the evolution and new dynamics of the markets the business model got innovated such as Wal-Mart and Hypermarkets, FedEx, Blockbuster, Dell Computer. In the last decade with the explosion of Information Technology it was more necessary than ever before to change the business model toward a model that is based on competitive advantage. In other words the focus has been to invest more on business model than on new products and services.

According to a survey run by Economist Intelligence Unit in 2005 for the five coming years, 4018 executives and leading decision-makers around the globe declared that how companies do business will often be more important than what they do[4]. With the last financial and economic crises which started in 2007 in USA and spread worldwide in 2008 and 2009, the said survey proved to be true.

The main theme of this article is to present the rationale on the need of investing in innovative business models as the literature tells and run a comparative study, using data from two or three big corporations in order to show how innovative business models help the management take the right decisions when dealing with crisis situations.

The first section presents the notion of business model. Section 2 provides the link between the business model and the latest financial economic crises illustrated by case studies. In section 3 we present a SWOT analysis. Last section gives conclusions and recommendations.

2. Business Models

As mentioned in the introduction section many define the business model as the way the firm operates to value creation and value capture. A more thorough definition of the business model describes it as a model which consists on the set of choices that a company makes and the set of consequences from those choices5.

Surprisingly, the business model is often studied without explicitly defining the concept. In many business model

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[2] IBM, Global CEO Survey 2008, www-935.ibm.com/services/uk/gbs/pdf/ibm_ceo_study_2008.pdf

[3] Masanell Ramon-Casadeus, Ricart Joan E, Company Strategy: Business Model Reconfiguration for Innovation and Internalization, Working Paper, 2009, pg 2

[4] Economist Intelligence Unit, Business 2010-Embracing the challenge of change, 2005, pg 2

[5] Masanell Ramon-Casadeus, Ricart Joan E, Company Strategy: Business Model Reconfiguration for Innovation and Internalization, Working Paper, 2009, pg 2

publications reviewed, more than one-third do not define the concept at all, taking its meaning more or less for granted. Less than half explicitly define or conceptualize the business model, for example, by enumerating its main components. The remaining publications refer to the work of other scholars in defining the concept. Moreover, existing definitions only partially overlap, giving rise to a multitude of possible interpretations. We have chosen three business models definitions just for illustrating our presentation.

1. *A business model is "a description of the roles and relationships among a firm's consumers, customers, allies, and suppliers that identifies the major flows of product, information, and money, and the major benefits for participants*".
2. *A business model is a "concise representation of how an interrelated set of decision variables in the areas of venture strategy, architecture, and economics are addressed to create sustainable competitive advantage in defined markets". It has six fundamental components: Value proposition, Customer, Internal processes/competencies, External positioning, Economic model, Personal/investor factors.*
3. *Business models "consist of four interlocking elements that, taken together, create and deliver value". These are: Customer value proposition, Profit formula, Key resources, and Key processes.*

2.1 Business models & types – concepts, definitions

In recent years, the business model as a unit of analysis and study has been the focus of extensive attention by both academics and practitioners. Despite the overall flow in the literature on business models, researchers do not agree on what a business model is. We observe that many people frequently adopt individual definitions that fit the purposes of their studies, but that are difficult to reconcile with each other. However we also found some emerging common ground among researchers on definition of business models.

In particular:

a) business models emphasize a system level, a overall approach towards explaining *how firms do business;*
b) the business model is emerging as a new unit of analysis;
c) organizational activities play an important role in the various conceptualizations of business models that have been proposed, and
d) business models seek not only to explain the ways in which value is captured, but also how it is created.

Although business models have been essential to trading and economic behaviour since pre-classical times, the business model concept became prevalent *with the advent of the Internet* in the mid 1990s and it has been gathering thrust since then. From that time on, ideas revolving around the concept have resonated with researchers and business practitioners as documented by the number of publications, including articles, books and book chapters in the business press and scientific journals. The increased availability of electronic means of communication has created opportunities for all kinds of enterprises to make parts of their value offerings available to customers as e-services and thus to change their business models. The advent of the Internet enabled the design and implementation of new ways of doing business, unique value propositions and new mechanisms for creating value that cannot be fully captured by existing theories of value creation.

Due to the fundamentally *different social, economic and cultural environments* which characterize emerging markets, companies need to rethink every step in their supply chains and develop new business models; existing models may have limited applicability and need to be adapted. Thus, enterprises which aim at reaching the bottom of the pyramid which constitute an important source of business model innovation have suggested that visionary companies can play a role in creating new business models that open up new markets and simultaneously expand societal wealth.

A third factor besides technology (Internet) and demography, which might have contributed to the recent surge of interest in the business model, could be the *emergence of organizations heavily relying on post-industrial technologies and operating* according to logics that differ from those of typical industrial organizations. Prof. Markus Perkmann and Andre Spicer (What are Business Models? Developing a Theory of Performative Representations UK, 2010) have recently suggested that post-industrial technologies, such as software, biotechnology and complex material science call for new organizational architectures and governance structures, which differ radically from those typically seen in traditional manufacturing organizations.

According to a survey for a company to be successful the following should be taken into account[6]:

1. The business model has to be revised regularly more than products and services because the last can be easily replicated, while the business model is typical for the company on the way how it operates.
2. The companies have to be quick to the environment changes and adopt innovative business models that fit those changes.
3. The customer needs are becoming crucial to any company's operation. Therefore, it is important that before designing a business model the company knows its customers and invite them at all points of the business cycle from product design to customer service.
4. Nowadays the competition comes more from existing players than from new entrants because the existing players have an experience in offering their products, they know the market they operate and therefore they are faster to recognize the environmental changes. As a result, the company should specialize in what they do best in order to gain a competitive advantage.

3. Innovation in the time of crisis

The fashion these days is to focus on the supply side of innovation: for example, by *encouraging everyone to think big thoughts*. For example 3M, the maker of Post-it notes, expects its workers to spend 15% of their time on their own projects. Google expects them to spend 20%. This approach is attractively democratic: by giving everyone a chance to innovate, it makes everyone feel special. Or so the theory goes. Companies dissolve into a thousand small initiatives rather than focusing on a few big problems. It also produces far too many ideas: managers have to spend weeks sorting through the chaff to find a few grains of wheat.

A second approach *focuses on closing the loop between ideas and results*. Nucor Corporation, a steelmaker, gives its workers bonuses, if they can produce steel more efficiently. Deere & Company, a maker of farm machinery, has produced a detailed playbook on how to design new tractors. We think that this approach is an excellent way of making incremental improvements to existing products and processes, but suggest that it has little chance of producing a big breakthrough.

We need to start by recognizing that innovation is unnatural. Established businesses are built for efficiency, which depends on predictability and repeatability—on breaking tasks down into their component parts and holding employees accountable for hitting their targets. But innovation is by definition unpredictable and uncertain. Bosses may sing a pretty song about innovation being the future. But in practice the heads of operational units will favor the known over the unknown.

Many would-be innovators deal with the trade-off between efficiency and innovation by rejecting traditional management entirely. They repeat mantras about "breaking all the rules" and "asking for forgiveness rather than permission". They set up skunk works (small, autonomous units with a remit to innovate) and mock the boring corporate types who write their pay-cheques.

But again this is counter-productive. Mocking the corporate establishment only encourages it to starve you of resources. And producing ideas in isolated skunk works ignores the basic reason for working for a big company in the first place—to use its superior resources to supercharge what you are doing. Companies need to build dedicated innovation machines. These machines need to be free to recruit people from outside (since big companies tend to attract company men rather than rule-breakers). They also need to be free from some of the measures that prevail in the rest of the company. But they must avoid becoming skunk works.

They need to be integrated with the rest of the company—they must share some staff, for example, and they must tap into the wider company's resources as they turn ideas into products. And they must be tightly managed

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[6] Economist Intelligence Unit, Business 2010-Embracing the challenge of change, 2005, pg 2

according to customized rather than generic rules. For example, they should be held accountable for their ability to learn from mistakes, rather than for their ability to hit their budgets.

Several examples of successful innovation machines:

1. Harley-Davidson, a firm whose customers tend to be fiercely loyal, was struggling to woo new ones. So it created a group to come up with ideas for attracting beginner motorcyclists, such as safety courses and rental programmes.
2. BMW, a carmaker, realized that its established system for producing brakes might be a hindrance when it came to designing brakes for hybrid vehicles (which benefit from capturing wasted energy and putting it back to work). So it set up an innovation team in which battery specialists regularly talked to brake specialists.
3. Allstate, an American insurance company, noted that insurers had come to accept widespread customer dissatisfaction as a fact of life. So, it asked marketers to help risk-adjustment specialists to design car insurance. They came up with industry-changing ideas such as accident forgiveness and cash rewards for good driving.

Innovation machines come in many shapes and sizes. Sometimes it is wiser to buy something than to make it yourself. Unilever, for example, would not have invented "Chubby Hubby" ice-cream if it had not bought Ben & Jerry's. But nonetheless it is right to argue that students of innovation must pay more attention to big companies. They have the muscle to chase big prizes, from alternative fuels to clean drinking water. But, they need to learn how to conquer new territories while continuing to cultivate old ones.

The following section gives two case studies of companies that changed their business models according to the environmental changes.

3.1 Business Model of Mango

Mango, a designer, manufacturer and distributor of clothes and footwear, was born international. The company started importing sophisticated product designs which it manufactured in low cost. The company expanded quickly and moved early into international markets. Mango developed a global brand and a network of exclusive retailers. Thanks to a complex, tailored IT system and innovative human resource practices, Mango was able to manage growth, while keeping costs under control allowing competitive pricing. To summarize the key factor for Mango success were the following:

1. Mango imported its products from low cost countries. Besides that sophisticated human resources practices and IT systems contributed to low cost and efficiency.

2. Mango from the beginning invested in marketing activities to create a global brand and an exclusive network of retailers.

3. Mango experienced the so called Blue Ocean Strategy (Kim and Maubourgne, 2005). The company developed an offering for a large, new market space, through keeping some attributes of the shopping experience that its target customer group valued such as, high end fashion garments at reasonable prices, eliminating attributes not valued much by the target customer segment such as, high quality and adding new attributes that set the company apart from its competitors such as loud, modern music in the stores.

3.2 Business Model of Abertis

Abertis was a company devoted to the management of public infrastructure through public-private partnerships. Initially focused on the toll roads in Catalonia, it grew to be the world's largest operator of toll roads and later diversified into the management of telecoms infrastructure, airports, car parks and logistics centers. By 2009 toll roads were the largest revenue and profit generator for the company.

The company chose to offer a reduced product line in as many regions as possible. This allowed the build-up of a stock of knowledge on how to most efficiently manage infrastructures. Also, by having different businesses in the same geographical area, Abertis developed strong relations with important stakeholders and this resulted in increased likelihood of being awarded new concessions. Abertis approached its relationships with customers as long-term public private partnerships where both sides worked together to create and share value. The case of Abertis once again illustrates that knowledge creation and international expansion go hand in hand.

To summarize these two cases illustrate that technological progress, globalization, demographic change and other forces enabled the creation of new business model. While some companies may focus on local markets, which is the case of traditional business model based on cheap local labour and protected markets will lead to failure.

4. SWOT Analysis

This section provides a SWOT Analysis for the reconfiguration of the business model especially in the period of crises. The rationale for conducting this analysis is to point out the main conclusions we reach through this paper in an analytical way. They are not conclusions by itself, but summarize the key elements that should be taken into consideration.

The main strengths for revising the business model include the following:

- Technological progress. This is considered as one of the strategies applied by many businesses to achieve huge benefits with low cost, which further leads to economies of scale.
- Globalization. Through globalization the environment changes quickly and new interactions are brought into play making the old business models becoming obsolete. The most important changes brought include dwindling of protectionism, development of new technologies, and new focus on marketing activities, which become crucial to competition. As a result, the companies are able to respond effectively to the more intense competitive interaction brought about by foreign firms entering into global market.
- Demographic change. As mentioned above, in order to have a successful business model the companies must know in advance the customer behaviours and include their preferences early on when the business model is designed. Therefore, the demographic change brings a switch in the lifestyle of people and as a result companies must be aware and quick to adapt to new customer behaviour.
- Anticipating crisis occurrence. The reality has always shown that crises of any type are cyclical. Therefore, the companies must be able to anticipate their occurrences to protect them from failure.

The main weaknesses for revising the business model include the following:

- High cost factor. Besides many advantages brought by technological advancement there are also high costs involved to cope with new inventions, because the research and development activities are very expensive.
- Limited technology. Not all the countries are able to adapt to technological progress. This is especially true for middle and low income countries where technology investments are not a priority considering the many deficiencies the economic system faces (we mean here problems with governance, corruption which are of a higher importance).

The main opportunities for revising the business model include the following:

- Building complementary interactions. One of the advantages of globalization is the opportunity the companies have in building complementary interactions with other industry players through partnership model. This approach makes possible sharing of risks and as a result leads to more opportunities.
- Dynamism. Organization goals may change with the changes in the environment posing reconfiguration of the business model. Therefore, the business model is dynamic in the meaning that goal attainment is easier as time goes by. In contrary, a static business model is not appropriate, because it does not respond to changes that may happen and the organization does not achieve its goal.
- New market capture. Another opportunity for companies is new market entrance due to globalization. Those companies that are quick to changes in the environment are the ones that have more opportunities to be competitive and expand their activities.

The main threats for revising the business model include the following:

- Greater competition. As it is true that business models are different it is also true that they are replicated. A company might spend time and money to invest in new business model, while another one might replicate the business model and take advantage to penetrate into market and be more competitive.
- Mass demographic change is a threat especially in developing countries where population tends to move from rural to urban areas creating urban problems. Since the demographic change brings a switch in the lifestyle of people, the companies might get threatened to adapt quickly to new customer behaviour.

5. Conclusions

Identifying sustainable paths to grow in the worldwide increasing competition and the rapid changing of the environment where the businesses operate creates the need for innovative business models. The focus on sustainability almost always translates into search for new products, technologies and awe-inspiring business models. Even though there is no generally accepted definition of "business model", practitioners and academics often talk loosely of a business model as "the way the firm operates to value creation and value capture".

According to a survey run by Economist Intelligence Unit in 2005 for the five coming years, 4018 executives and leading decision-makers around the globe declared that how companies do business will often be more important than what they do. Although business models have been essential to trading and economic behaviour since pre-classical times, the business model concept became prevalent *with the advent of the Internet* in the mid 1990s, and it has been gathering thrust since then. The increased availability of electronic means of communication has created opportunities for all kinds of enterprises to make parts of their value offerings available to customers as e-services and thus to change their business models.

Due to the fundamentally *different social, economic and cultural environments* which characterize emerging markets, companies need to rethink every step in their supply chains and develop new business models; existing models may have limited applicability and need to be adapted. Another factor besides technology (Internet) and demography, which might have contributed to the recent surge of interest in the business model, could be the *emergence of organizations heavily relying on post-industrial technologies and operating* according to logics that differ from those of typical industrial organizations.

In this paper we present many examples of successful business model innovation schemes such as Harley-Davidson, BMW and Allstate. Also, we make a comparative analysis among two business companies namely Mango and Abertis.

Mango, a designer, manufacturer and distributor of clothes and footwear, was born international. The company started importing sophisticated product designs which it manufactured in low cost. The company expanded quickly and moved early into international markets. Mango developed a global brand and a network of exclusive retailers. Thanks to a complex, tailored IT system and innovative human resource practices, Mango was able to manage growth while keeping costs under control allowing competitive pricing

Abertis a company devoted to the management of public infrastructure through public-private partnerships chose to offer a reduced product line in as many regions as possible. This allowed the build-up of a stock of knowledge on how to most efficiently manage infrastructures. Also, by having different businesses in the same geographical area, Abertis developed strong relations with important stakeholders and this resulted in increased likelihood of being awarded new concessions.

These two cases illustrate that technological progress, globalization, demographic change and other forces enabled the creation of new business model. While some companies may focus on local markets, which is the case of traditional business model based on cheap local labour and protected markets will lead to failure.

6. Recommendations

As the paper highlights, companies should not focus on investing on products and services, but on business model innovation. Also, companies should take into account customers needs in the very beginning stage of the business model design.

As technology is the key element to business model innovation, we recommend that developing countries, which are faced with limited technology, should make efforts to allocate more funds to research and development activities. This does not exclude also the developed countries. As the environment changes rapidly because of globalization, business companies should see the opportunity of building complementary interactions with other industry players through partnership model. This approach makes possible sharing of risks and as a result leads to more opportunities.

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