Capitalizing on Creativity at Work:

Fostering the Implementation of Creative Ideas in Organizations

Designing and implementing innovative business models

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1 Introduction

The concept of business model gained popularity among managers and entrepreneurs during the dot-com boom in the late 90s (Zott, Amit, & Massa, 2011). A key tenet of the concept is that it connects the value creation and value capture sides of a firm's strategy. In other words, the business model must link the activities performed by the firm to create and capture value to outside actors such as customers, partners and complementors (Baden-Fuller & Mangematin, 2013). In doing so, the business model plays three main roles (Spieth, Schneckenberg, & Ricart, 2014): it helps a) to describe the business (i.e. how the firm generates its profit), b) to run the business (in terms of e.g., operational aspects like processes, linkages and structures), and c) to develop the business (i.e. as a support to the management in the strategy process). Besides, entrepreneurs can use the business model to generate and test working hypotheses about how their business creates and delivers value to customers (Eckhardt, 2013).

In this chapter we introduce the concept of business model and business model innovation and provide some guidelines for designing "good" business models. Since this task is generally challenging in that it requires particularly creative reconfigurations, we will also discuss some of the key difficulties that firms may experience when trying to innovate their business model. Reflecting the richness of business model research, we will present three different perspectives. Next, we describe some real-world examples of different business models, and discuss the main reason why incumbents are often slow to react to new business models. We provide two illustrative cases. The first shows how Blockbuster found very difficult to respond to severe disruption in its market created by the innovative business models introduced by new entrants. The second briefly presents the innovative business model of Naked Wines.

2 Designing "good" business models

Business modeling is the managerial equivalent to the scientific method (Magretta, 2002). A working hypothesis (about customers, market, pricing, partners …) is put forward and then tested. If it works, it is adopted and the process is then iteratively repeated ad infinitum. The most powerful business models do not simply shift existing business among companies, but create new demand and with it new markets (Magretta, 2002). One of the primary goals when designing models is to create customer stickiness (in the form of loyalty or lock-in) and barriers to entry for competitors (McGrath, 2011). Business models that create a recurring stream of revenues are more sustainable in the long run than those in which customers buy only once and never come back.

Effective business models have three main characteristics. Firstly, they are aligned with the company's strategy and present a good fit with the industry's competitive landscape. Industry fit does not mean to follow the prevailing view about how "things are done" within the industry, but requires a good dose of critical thinking about how to challenge existing assumptions. Often, innovative business models emerge when the industry environment changes (e.g. a shift in technology or regulation), but most major players remain stuck in old ways of doing things. Second, the choices made within business model design should be self-reinforcing (Casadesus-Masanell & Ricart, 2011). They need to complement each other and seek synergies with feedback effects. These virtuous cycles continually strengthen the business model with network effects like dynamic. For example, Ryanair's low cost business model aims to achieve cost savings through high aircraft utilization. The consequence are low prices that attract even more customers and – to conclude the cycle - high volume of customers enables even higher aircraft utilization. Third, the business model should be robust, and its effectiveness should be sustained over time. This means that the firm should be able to counter four main threats: imitation (the ability of others to copy the business model), holdup (the value is captured by customers, suppliers or other players), slack (organizational complacency) and substitution (could similar value proposition be delivered by other products and services?).

2.1 Business model frameworks

Academics and practitioners alike have still to agree about an exact definition of the business model concept. What is common to most definitions is that the concept encompasses both value creation and value capture sides of a firm's strategy and that it represents a holistic view of the business that outlines the firm's architecture of revenues, costs, and profits (Teece, 2010). Using the language of business models, complex relationships and interdependencies among different activities can be simplified into coherent stories (Arend, 2013).

Business models can be defined both objectively and subjectively (Doz & Kosonen, 2010). From an objective standpoint, they offer descriptions of the logic of the business and of the complex inter-relationships between the firm, its customers, suppliers and other stakeholders. In this respect, the business model concept can be useful to classify what firms do into various taxonomies. However, from a subjective standpoint, the business model represents how a firm's senior management thinks of the complex interdependencies between their business and its environment (Doz & Kosonen, 2010). It thus offers a cognitive structure that provides a theory of how to set the boundaries of the firm, create value and choose the appropriate organization design.

Along the objective-subjective continuum, we can identify three perspectives on business models: 1) The business model canvas (Osterwalder & Pigneur, 2010); 2) Business models as activity systems (Zott & Amit, 2010); and 3) the cognitive perspective (Baden-Fuller & Mangematin, 2013).

Arguably the most used framework in consultancy, the *business model canvas* (Osterwalder & Pigneur, 2010), divides business models into nine building blocks: value proposition, customer segments, channels, customer relationships, revenue streams, key resources, key activities, key partnerships and cost structure. Among these building blocks, the value proposition is the most central because it is tightly connected to customer segments. This framework is deeply enrooted in design thinking and its main purpose is to provide a powerful visualization tool that may aid the process of business model design. The business model canvas is often used in conjunction with the lean startup process (Ries, 2011) as the hypotheses related to each different building block need to be tested based on feedback from potential customers. This framework suggests that firms should engage in an iterative process in which each block of the business model is tweaked and changed until a suitable level of fit with the external environment is reached.

A well-known alternative is that of the business model as an activity system. According to this view, an activity system is "a set of interdependent organizational activities centered on a focal firm, including those conducted by the focal firm, its partners, vendors or customers" (Zott & Amit, 2010). It is thus not limited just to the focal firm, but spans its boundaries to include external partners as value co-creators. This line of thinking echoes Porter's (1996) view on strategy, who suggested that the real sources of a firm's competitive advantage lie in its choices and configuration of activities. It suggests that business model innovation is primarily about innovating on the content, structure and governance of the activity system (Amit & Zott, 2012). The content includes the set of activities that are performed within the business model and innovation might thus include the addition of new activities or the abandonment of old ones. The structure of an activity system describes instead how the activities are linked (Amit & Zott, 2012), The governance of an activity system defines who performs which activity. In this respect, value can be created (and captured!) not only by the focal firm, but by multiple firms within a given activity system. This view also argues that there are four fundamental value drivers of business models: novelty (the degree of innovation within a given business model), efficiency (the potential for cost savings through a given activity system), lock-in (customers' level of ability and willingness to transfer to another activity system) and complementarities (the level of value-related interdependencies across activities within the system). Innovating the activity system requires therefore systemic and holistic thinking as the goal is to optimize the whole activity system and not just a particular activity.

Finally, Baden-Fuller and Haefliger (2013) see business models as cognitive devices. Their purpose is to make better business decisions by facilitating the explication of ideas in entrepreneurs' and managers' mind thus allowing for an easier detection of potential inconsistencies (Abraham, 2013). According to this view, the business model does not describe "reality", but it is independent of context and captures how the firm sees the world. In other words, rather than being a complete description of everything that the firm does, it offers a concise depiction of the cause-effect relationships between customers, the focal firm, outside partners and money (Baden-Fuller & Mangematin, 2013). Proponents of this perspective suggest that the business model can be analyzed along found basic dimensions: customer identification (who the customer groups are and which groups of customers actually pays for the product or service), customer engagement (often divided into "taxi" – tailored approach and "bus" – scale-based approach with limited ability to offer flexibility in satisfying customer needs), value delivery and linkages (how value is delivered and who actually delivers it; this may not be the focal company but one of its partners) and monetization (which goes beyond just pricing and includes systems for collecting revenue and timings of payment).

2.2 Some examples of business models

Arguably the longest-existing types of business models are those involving the manufacturing of products (e.g. food, clothing, cars) or the delivery of services (e.g. cleaning, legal advice) for which the company is paid a certain price. This type includes for example the "no-frills" or "low-cost" business models that provide products and services stripped down to essentials for low price. The essence of this model is to run an extremely efficient operation with low margins and make it up on volume. The most famous exemplars are no-frills airlines (e.g. Ryanair, Southwest Airlines) and discount retailers (e.g. Aldi).

The razor-blade business model is another classic type that involves pricing razors cheaply while earning a profit on the high-margin consumables (i.e. razor blades) (Teece, 2010). A famous exemplar of a firm employing this business model is – of course – Gillette (razor – razor blades).

Platforms (sometimes also called two-sided markets) are unique in the sense that the platform provider connects two different customer groups. Credit cards (e.g. MasterCard), which connect merchants with individual buyers, are common exemplars. Platform providers have two different customers groups to serve and have to decide whether they will charge both groups or have one group subsidize the other.

Free platform models normally mean that users get the service for free but some other party pays for them. This other party are most often advertisers. Good instances of companies employing this type of model are various types of online services and media (e.g. Google search, Huffington post).

Freemium (free + premium) business models provide instead part of the service for free while charging for more advanced parts of service that customers are willing to pay for. The logic behind freemium model is that the free offer serves as a loss-leader for the premium offer where revenues are made. Dropbox is a prime exemplar of a freemium model. The company provides a service of storing digital files for free up to a certain limit, above which it charges a monthly subscription fee. Freemium business models are very popular but can also be very dangerous as the cost of supporting (perhaps millions) of free users may prove a very expensive marketing mechanism over time.

Internet retailing enabled so-called “long-tail” business models. Physical stores have limited shelf space meaning that each of the products needs to bring in large amount of revenue. Long-tail model makes profit by selling lots of different items just very few times each, but aggregated revenue still brings in respectable profit. Online retailers (e.g. Amazon) often employ this model to a certain degree.

2.3 Why incumbents fail to react to disruptive business models

When presented by consultants, business model innovation sounds simple. However, it has been proven difficult for incumbents (i.e. companies with established powerful position at a certain market) to react to new, potentially disruptive business models.

The problem is that established companies often find new business models unattractive (Markides, 2008). The market around new business model might be initially small and insignificant compared to the company's core customer groups already served by the existing model. Besides, the success factors and the resources and capabilities critical to be successful in the new market could be different than in the existing one and may often conflict. Finally, new markets need time to grow and this is often at odd with the expectations of immediate results so common in today's corporate world. Indeed, successful new businesses normally revise their business models several times before reaching profitability (Johnson, Christensen, & Kagermann, 2008) and this might prove too challenging for existing incumbents that might also suffer from a special kind of myopia (Tripsas & Gavetti, 2000). In other words, as Chesbrough & Rosenbloom (2002) demonstrated so aptly on the case of Xerox, existing business models limit the search for alternative models that differ from the current way of thinking within company. New business models tend therefore to be evaluated through the lens of existing business model, severely limiting the possibilities for innovation.

2.4 Change is difficult: Blockbuster

The mini-case of Blockbuster will show how difficult it is for established companies to engage in business model innovation. The consequence of this fact was Blockbuster's bankruptcy.

Blockbuster was a video rental company established in 1985 in Dallas, Texas, whose main business was renting movies through its network of neighborhood stores. In 1988 Blockbuster became the top video retailer in the US with more than 500 stores. Blockbuster had a very simple pricing scheme: $2.99 for two-day rental of new releases and same price for five-day rental of old movies (Girotra, Netessine, & Coluccio, 2010). An important part of their revenues was derived from fees charged to customers who were late to return the movies. Blockbuster continued to grow both organically and through acquisitions. In 1994 it was acquired by Viacom.

Its business model was innovative at the time because it enabled the customization of the offerings to the demographic characteristics of the neighborhood where the store was located. It also used then novel computer technology and applied big data insights into its customer base well before the term big data was even invented. At the height of its fortunes it owned 5,000 retail stores and employed 60,000 people.

However, in 1997 the Blockbuster found itself in crisis. At the time, inventory purchases of movies were the company's largest single cost and amounted to 36% of Blockbuster's revenue. With these payments Blockbuster contributed more revenue to the movie studios than they got through movie releases in theatres (Girotra et al.,

2010) but failed to make adequate return on capital itself. Blockbuster's top management then negotiated a new revenue sharing deal with movie studios. Under this agreement Blockbuster would pay only $6-7 per movie (before $65) and split the revenue 60/40 with studios in the favor of Blockbuster. With these changes, interests of movie studios and Blockbuster became better aligned. Blockbuster increased its market share and went public in 1999. Revenue-sharing model saved Blockbuster, but not for long since a number of Internet and mail subscription services emerged in just a few years challenging Blockbuster's store network model. The best known competitor was Netflix that started as DVD-by-mail subscription service in 1997. Initially, Netflix had several tiers of rental plans that allowed customers to keep 1-5 videos as long as they wanted without paying late fees. It also developed a personal recommendation system that was based on user ratings and reviews, which increased the number of times each video was rented (Girotra et al., 2010). DVD-by-mail model evolved into internet streaming subscription model that is the dominant model used today with Netflix having the largest market share.

Even though Blockbuster soon launched its own version of the DVD subscription model, it was held back by concerns that this new service would cannibalize its brick-and-mortar operations (Teece, 2010). Patent protection also prevented Blockbuster from fully copying some important features of Netflix service. Netflix was thus able to enjoy a long period without a full blown competitive response. Only in 2004 Blockbuster launched its Blockbuster Online initiative that was then extended in 2006 with Blockbuster Total Access service, based on a combination of a subscription delivery model with its retail stores. At this point. Blockbuster was imitating most of the Netflix business model and was able to offer some services that Netflix couldn't match. However, maintaining the commitment to its costly retail network proved fatal for Blockbuster.

Blockbuster was unable to fully change its business model from brick-and-mortar stores to a lean internet approach. The company applied for Chapter 11 bankruptcy in 2010 and was subsequently acquired by Dish networks. The last of Blockbuster stores closed in 2013.

2.5 How to innovate on business models?

Business model innovation can be defined as the company's search for an improved business model in essentially the same business and market. We can speak of business model innovation every time a company changes one of its business model dimensions. However, sometimes just small reconfigurations of existing models are not enough, but the design of a completely new model is required. This "new" business model could be new to the company or new to the industry and could commercialize a new product for a previously unmet need or find new ways of selling of existing offerings (Magretta, 2002).

New technologies are generally commercialized through innovative business models (Chesbrough, 2010; Tracogna, Balboni, & Bortoluzzi, 2016) because the technologies have no economic value themselves, unless the value is created and delivered through appropriate models. In this context, the business model is seen as the connection between a firm's (innovative) technology and customer needs (Zott et al., 2011). On the other hand, technology can be the enabler of novel business models. The business models could therefore be seen either as a vehicle for (technological) innovation or a subject of (business model) innovation.

There are three types of strategies for business model innovation (Giesen, Berman, Bell, & Blitz, 2007). First, business model innovation at the industry level involves innovating the "industry value chain". This could be done by bringing an existing business model from one industry to another (like Virgin uses its customer management expertise to enter new industries, e.g. financial services and telecommunications), or by redefining existing industries (like Apple established the category of smart-phones with the iPhone which then completely transformed the mobile phone industry). The most extreme version of this type of strategy develops entirely new industries or industry segments (e.g. Google and other search engines).

A second type revolves instead on producing innovations in how firms generate revenues or by using new pricing models. A good example of this type of revenue-based innovation is the above-mentioned razor-model that was then adopted by computer printers such as HP or Epson, to sell printers cheaply and make it up with expensive ink cartridges.

The third type of innovation is the enterprise model, which creatively changes the structure of the enterprise and its value chains. The focus is on redefining organizational boundaries. A case in point is the clothing retailer Zara, that introduced a novel information system with feedback loops to enable information flows from local stores to the headquarter and used local suppliers to cut delivery times for newly designed merchandise (Giesen et al., 2007). Thanks to these choices, Zara has been consistently able to react to changing customer demands very quickly.

2.6 Innovative business model: Naked wines

A second case will show the innovative business model of a UK firm Naked Wines[1]. The model revolves around an online platform which links (a) quality independent winemakers around the world with limited production capabilities and b) end-customers seeking to explore and enjoy a broad variety of quality wines at a much lower price than from existing brick-and-mortar retailers. The key element of the model is that customers can sign up as ‘angel’ investors by prepaying at least £20 on a monthly basis. The company then uses this money to fund independent winemakers in advance so that they can afford the risk of producing larger than usual quantities. In this way, and by selling directly with no other intermediaries, Naked Wines can enjoy heavy discounts which are passed onto end-customers with discounts ranging between 25-50% on the full retailing price, on the top of being able to redeem all the money previously prepaid. The complementary aspects of the model include: a) close monitoring of customer preferences via a detailed feedback system which can predict future purchases; 2) effective cash flow management since the company mainly invest money on the behalf of end-customers; 3) a pure marketplace section in which demand for new winemakers is tested with limited quantities and a bidding system until stock lasts.

The business model represented by Naked Wines mainly serves two groups of customers. A minority of customers are not subscribers of the ‘angel’ system based on monthly payments and simply use the website to source good wines when needed (without additional discounts). Through a recent fine bond emission, Naked Wines is also testing the possibility to appeal to customers more interested in traditional investment opportunities rather than wines a mere products.

The value proposition is twofold. On the one hand, Naked Wines offers customers interested in quality wines the possibility to buy from a large number of independent winemakers around the world with home delivery and at a substantial discount. Customer engagement is also achieved via the above mentioned crowd-funding mechanism which makes customers feel as they are proactively supporting independent winemakers, with characteristics similar to a degree to fair-trade

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certifications. These customers also enjoy a sense of exclusivity – i.e. the same wine is not available elsewhere, - and of being part of a creating winemaking process – i.e. each customer can interact with winemakers and provide feedback online, - within a like-minded community. On the other hand, it offers these independent winemakers crowd-funded investments (generally in the region of £50,000) to reduce the risk of increasing their production volumes in exchange of very low prices which are then partly passed onto end-customers. Winemakers can also enjoy the possibility of being connected to their customers – an important aspect for small producers in this sector.

To keep delivery time fast, Naked Wines uses a network of warehouses throughout the UK (and the US/Australia). Winemakers thus ship to these warehouses and then Naked Wines delivers them to the final customer. In this way, the company can also use its stock to create pre-mixed cases thus increasing product rotation and keeping inventory costs down. Its standard delivery is £4.99 for next business day (£6.99 for Saturday deliveries) to almost everywhere in the UK if an order is placed before 5pm. However, delivery is also free to most UK postcodes for orders above £80. From spring 2014, the company has been testing a same-day delivery service in London for £14.99.

The latest financial information about the company suggests that Naked Wines closed 2013 with around £50 million in revenues and additional funding from investors. The fine wine bond emission in Autumn 2013 was also successful: the company hoped to raise at least £1 million, set an upper limit of £5 million and received offers for £6.2 million, with two-third of subscribers opting for the 10% return in wine credit. Although the company does not disclose its marginality, information released to the public for the bond emission suggests it enjoyed between approx. 30% gross profit on wine purchases, with selling/distribution costs amounting to 13-16% and other operating expenses between 11-13%, for a total pre-tax profits in the region of 4-6%. At the beginning of 2015, Naked Wines was acquired by Majestic Wines, the UK's largest wine distributor, for £70 million. Naked Wines' Founder and CEO Rowan Gormley has been appointed at the helm of both companies to facilitate backend integration while keeping the two customer-facing value propositions independent.

3 Conclusion

Business models encourage systemic and holistic thinking (Amit & Zott, 2012). Entrepreneurs and managers should thus consider particular choices in the context of the overarching business model. The business model concept provides a common language that enables entrepreneurs and managers to focus on the forest, rather than individual trees. The core guiding principles common to most definitions of business models focus on both value creation and value capture. They emphasize the inter-dependencies between different parts of each business model and provide a framework to relate the activities performed within a firm to its outside environment.

While technological innovation is championed in advanced economies, much less attention is given to business model innovation. Nevertheless, the true potential of technological inventions often needs to be released through proper commercialization strategies. To be achieved, these strategies require the design of appropriate business models. Creative ideas in the form of innovative business models are then the primary vehicles for the diffusion of novel products and services. Finding the right combination of business model parts is the crucial task of true innovators and needs to be completed over time, again and again.

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