

**Creating New Business Models:
Approaches, Techniques and Measurement for
Strategic Leadership and Management**

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DECLARATION

I, the undersigned, hereby declare that the work contained in this assignment is my own original work and that I have not previously in its entirety or in part submitted it at any university for a degree.

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ABSTRACT

Given the increased uncertainty and unpredictability prevalent in the business environment, there is heightened pressure for organizations to become radically innovative and to constantly reinvent themselves, and ultimately change the rules of the game in their industry. The concept of new business models is relatively new to business literature. However, its significance cannot be underestimated where operating in a turbulent competitive landscape has made the traditional way of doing business ineffective, and consequently has changed the nature of competitive advantage. Despite the obvious importance of creating new business models, there seems to be inadequate understanding and definition of the term “business model”, thereby hindering the understanding of the nature of new business models and the approaches needed for creating new business models.

This paper initially investigated the concept of “business model” and its core dimensions, which revealed that the term lacks an adequate and comprehensive definition. In response to this, a comprehensive working definition for the concept was formulated after an analysis of the various definitions proposed in the business literature. Since the key elements of a business model are important sources of competitive advantage, this definition has been used to illustrate how organizations can create new business models by manipulating the basic aspects of the business model. Approaches and techniques that enable organizations to create new business models and to become radically innovative have been selected from those put forward by Govindarajan and Gupta (2001) and Amit and Zott (2001). Finally, an analysis was made of the performance measurement tools for new business models. This revealed a lack of such an evaluation tool and this study has proposed a framework from which its dimensions can be used to expand and develop a measurement instrument for proposed business models and/or industries.

UITTREKSEL

Gegee die verhoogde onsekerheid en onvoorspelbaarheid wat teenwoordig is in die besigheidsomgewing, is daar meer druk op organisasies om radikaal innoverend te word, om hulself konstant te herontdek en uiteindelik om die reels van die spel in hulle bedryf te verander. Die konsep van nuwe besigheidsmodelle is relatief nuut in die besigheidsliteratuur, maar die belangrikheid van die konsep kan nie onderskat word nie, waar die tradisionele besigheidsbenaderings ondoeltreffend geword het binne 'n fluktuerende mededingende omgewing. As gevolg hiervan, het die hele wese van mededingende voorsprong verander. Ten spyte van die duidelike behoefte aan die skep van nuwe besigheidsmodelle, blyk daar ook om onvoldoende begrip en definisie van die term "besigheidsmodel" te wees. Dit belemmer die begrip van die oorsprong van nuwe besigheidsmodelle en die benaderings benodig vir die skep van nuwe besigheidsmodelle.

Hierdie skripsie het eerstens die konsep "besigheidsmodel" en sy kerndimensies ondersoek, wat aan die lig gebring het dat die term ontbreek aan 'n voldoende en volledige definisie. Nadat die verskeie definisies in die besigheids-literatuur is, is 'n volledige gangbare definisie vir die konsep geformuleer. Aangesien die sleutelemente van 'n besigheidsmodel belangrike bronne van mededingende voorsprong bied, is die definisie gebruik om te illustreer hoe organisasies nuwe besigheidsmodelle kan skep deur die basiese aspekte van die besigheidsmodel te manipuleer. Benaderings en tegnieke wat organisasies in staat stel om nuwe besigheidsmodelle te skep en om radikaal innoverend te word, is geselekteer vanuit die voorgestel deur Govindarajan en Gupta (2001) en Amit en Zott (2001). Ten slotte, is 'n ontleding gedoen van die instrumente wat gebruik word om die prestasie van nuwe besigheidsmodelle te meet. Dit het aan die lig gebring dat daar nie so 'n evalueringinstrument is nie, en hierdie studie het dus 'n raamwerk voorgestel waarvan die dimensies gebruik kan word om 'n meetinstrument vir voorgestelde besigheidsmodelle en/of industrieë uit te brei en ontwikkel.

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CHAPTER 1

INTRODUCTION

1.1 Background of the Study

New technology often has a disruptive effect upon business practices, as traditional forms of sustainable advantages are weakened and new ones emerge. The Internet has had such an effect. It is not only technology but also global competition and deregulation that are driving major shifts in almost every industry, and also across industries (Campbell, 2000; Rometty, 1999; Fiorina, 2000).

We have entered the “new economy”, as described by Tapscott (1997), with themes such as digitization, knowledge, virtualization, integration/internetworking, disintermediation, convergence, prosumption, and so forth. This new economy triggers the challenge for companies to change their business models (which include their products, markets, distribution channels, organizational structures, cultures – simply stated, the way they do their business). And also as explained by Tucker (2001), no matter how strong and seemingly durable a firm’s current business model is, it will be imitated, diluted and commoditized. But most importantly, it will be challenged by new business models.

The concept of “business models” is not as clear and specific as one would imagine in view of the many publications which recognize their relevance to organizations’ existence. Recent publications in books and journals illustrate concern over firms’ difficulty in achieving sustainable competitive advantage in the competitive landscape. Furthermore, there is a growing interest in how firms can use non-linear innovation and “first mover” strategies, i.e. being first to market a product or service, in order to survive and be competitive in a fast changing environment. However, authors often do not give adequate definition to the term

“business model.” Therefore, a consistent definition and framework is lacking and there is ambiguity and confusion in the use of the concept.

Approaches to strategies, such as “resource based view”, knowledge management, leveraging dynamic capabilities, and strategic networks continue to govern business thinking. But with disruptive technologies and the increased rate of change in the competitive landscape, experimenting with novel and unconventional ideas to produce “revolutionary innovations” has brought about the development of new business models. With discontinuous changes taking place in every industry, businesses are facing not only shorter product life cycles but also shorter strategy life cycles (Hamel, 1998). Therefore, an organization should constantly attempt to discover new business models if it hopes to survive and grow.

Hamel (2001) explains how newcomers, in practically every industry, are responsible for most of the wealth created over the last decade with their unconventional thinking and imagination. In this “age of revolution”, defined by Hamel (2000, p. 4) as “age of upheaval, of tumult, of fortunes made and unmade at head snapping speed”, the most effective means of creating new wealth is radical innovation as opposed to reengineering, continuous improvement and incrementalism. A useful distinction between reengineering and reinvention is made by Fiorina (2000, p. 5) - while restructuring and reengineering have the aim of “wringing out” all the inefficiencies and maximizing profitability, reinvention, on the other hand, requires new skills, new business models, new behaviours, new ways of selling products and services, marketing, doing business, and using new technology “to make life better and to make life at work better.”

In the past few years, significant interest has been focused on the conditions and prerequisites crucial for creating new business models. However, it is evident that there is lack of consensus about managerial approaches and techniques on the development of new business models. Some authors have offered different approaches for developing new business models,

the major ones being suggestions put forward by Govindarajan and Gupta (2001), Hamel (1998), Amit and Zott (2001), and Youngblood (1997). The importance of such generic approaches is observed in the increased interest given to new value creation and non-linear innovation to be competitive - and even survive - in a fast changing environment.

Therefore, with the increasing rate of change in the external environment, strategic life cycles getting shorter, and the impossibility of operating with a single business model for decades by merely improving it, organizations have to redefine the way they do business through radical innovation.

1.2 Statement of the Problem

Business models seem to be one of the most discussed but least understood aspects of organizations. There are several discussions concerning how technology and the “new economy” have changed traditional business models, but there is little evidence of what exactly this means. Simply put, a business model is the way of doing business so that a company can profitably sustain itself (Rappa, 2002). However, the term “business model” is often used ambiguously by both academic literature and various publications, resulting in contradictions and misinterpretations of the concept. Although the relevance of sound business models seem to be undisputed there is almost no discussion of the term as such, and there is little evidence of a precise definition that clarifies the dimensions and core issues of business models.

In addition, a number of authors have proposed various approaches for creating new business models. Although there is considerable similarity among these approaches, there seems to be lack of generic managerial techniques for the development of new business models and measurement dimensions for their evaluation. Such generic approaches and measurement

techniques are important for companies to enable them to be competitive in a rapidly changing environment.

1.3 Objective of the Study

The primary objective of the study is to investigate the concept of “new business models” for clarity of *definition* and *scope*, and to identify the critical *components* (or *dimensions*) of business models.

The secondary objectives of the study are:

- a) To investigate the different approaches and techniques in *creating* new business models. A number of authors have offered different approaches on how organizations can change “the rules of the game” in their industry. The existing definitions and approaches will be analyzed to arrive at an understanding in creating new business models.
- b) To examine the various *measurement* (or *evaluation*) dimensions, if any, that could be proposed for new business models.

1.4 Method of the Study

For the purpose of this research, literature from academic and popular literature sources in strategic management have been used. These consist of books, articles, Internet sources, and research papers. Information has been collated and evaluated to establish a working definition of business models, generic managerial suggestions have been analyzed in the creation and implementation of new business models, and measurement dimensions for new business models have been investigated.

1.5 Structure of the Study

Chapter 1 consists of this introduction.

Chapter 2 presents a variety of extant business model definitions, and the contexts and dimensions involved in these business models. The definitions have been used for analytical purposes and to provide insight into the basic nature of business models.

Chapter 3 describes the turbulence and uncertainty in the business environment of the “new economy” due to changes in technology and globalization, and the relevance of these for organizations to create new business models.

Chapter 4 illustrates the different approaches and techniques used for developing new business models, and the problems faced by established companies in challenging past and present business practices.

Chapter 5 analyzes methods based on recent research that could be employed in the evaluation and measurement of new business models.

Chapter 6 presents summary, conclusions and recommendations.

1.6 Conclusion

Even though the significance of sound business models appears to be evident, there is almost no discussion in the literature of what exactly the term means. The term “business model” is often used ambiguously and there is no clear and complete picture describing the different dimensions and perspectives of the concept.

Nevertheless, the relevance of creating new business models has become imperative in an environment filled with uncertainty due to disruptive technology, globalization, deregulation,

and shorter strategy life cycles. There are many opportunities in such uncertainty. However, simply downsizing, reengineering, outsourcing non-core activities, process improvement and efficiency programs do not guarantee sustainable competitive advantage. Instead, organizations should be able to bring about “non-linear innovations” to change the “rules of the game” (Hamel, 1998) not only in their organizations but also in their industry.

However, coming up with breakthrough innovation, or being a “first mover”, once only does not ensure being a long-term winner in the new economy. It is important to constantly bring about radical changes in the way business is done. With generic pointers for creating new business models, organizations could be enabled to avoid head-to-head competition with their rivals and gain great returns from doing business differently.

CHAPTER 2

BUSINESS MODELS: NATURE, COMPONENTS AND WORKING DEFINITION

2.1 Introduction

To define and understand the concept of new business models, it is important to understand exactly what a business model implies and means. There are several discussions on how traditional business models have changed, or need to be changed, due to changes in technology and globalization. The term “business model” is often used, but there is no consistent definition or framework for the concept.

Business models are perhaps the most discussed and least understood of terms, although as indicated by Schmid *et al.* (2001) and Ethiraj *et al.* (2000), at first glance, there seems to be a broad understanding regarding business models. The term is widely used in both academia and practice. Its importance is usually regarded as high since a sound business model seems to influence the revenues, or potential revenues, and the future success of a business initiative. Much debate also revolves around how traditional business models are being changed and around the future of e-based business models.

However, despite a widespread intuitive understanding, an analysis by Schmid *et al.* (2001) reveals a confusing and incomplete picture of the dimensions, perspectives, and core issues of these business models. The results disclose that there are hardly any explicit references to business models, that an understanding of business models often remains unspecific and implicit, and that consensus on the elements of business models is lacking. They also illustrate that many definitions merely refer to the transition from the industrial age to the information age, and to the fact that the introduction of a business model often consists of increased networking among multiple partners.

This chapter consists of an analysis of the nature and components of business models, and provides a working definition of the concept.

2.2 Business Models in Literature

In the most basic sense, a business model is the method of doing business by which a company can sustain itself - that is, generate revenue. The business model depicts how a company thrives by specifying where it is positioned in the value chain (Rappa, 2002).

Regarding the Internet, an e-business model is simply the approach a company takes to become a profitable business on the Internet. There are many terminologies that define aspects of electronic business, and there are subgroups as well, such as content providers, auction sites and Internet retailers in the business-to-consumer space (Trombly, 2000).

Timmers (1998, p. 4) provides a definition of a business model as:

- an architecture for the product, service and information flows, including a description of the various business actors and their roles;
- a description of the potential benefits for the various business actors; and
- a description of the sources of revenues.

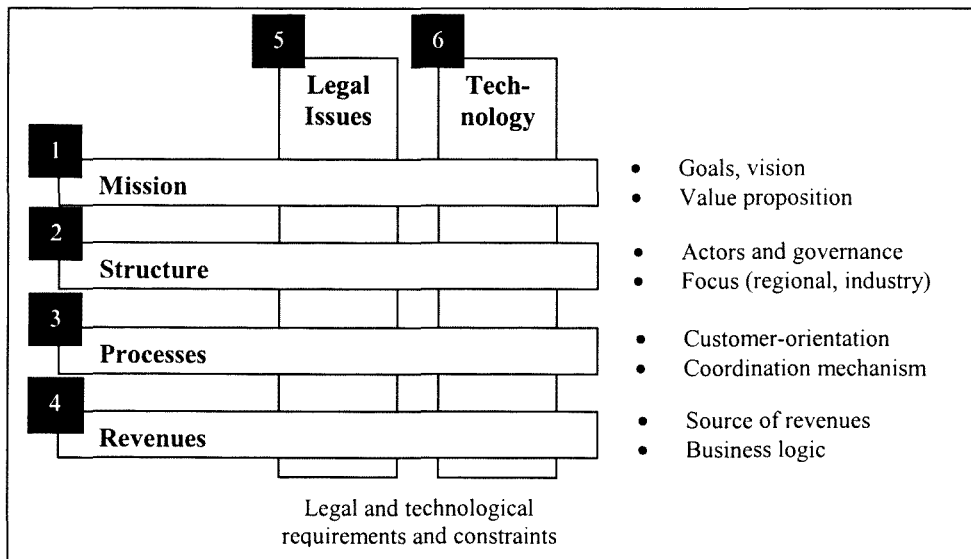
On the basis of a general understanding of what business models seem to be, the following sections proceed to describe a variety of established business model definitions as presented by four different publications. These definitions are used to provide the various components, dimensions, and frameworks of business models.

2.2.1 Schmid *et al.*'s Six Generic Elements

In order to bring together the various lines of thought and to establish a common denominator for the business model discussion, Schmid *et al.* (2001) have distinguished six generic

elements of a business model: mission, structure, processes, revenues, legal issues, and technology (see Figure 2.1). When designing a business model and applying the framework, the authors emphasize that all six generic elements and the dynamics of the respective elements have to be considered.

Figure 2.1: Generic Elements of Business Models



Source: Schmid *et al.* (2001). Business Models. *Electronic Markets*, 11(1).

- a) **Mission:** One of the most critical elements of the business model is developing a high-level understanding of the overall vision, strategic goals and the customer value proposition, including the basic product or service features.
- b) **Structure:** determines which roles and agents constitute and comprise a specific business community (be it a value chain or value web) as well as the focus on industry, customers and products.
- c) **Processes:** provide a more detailed view on the mission and the structure of the business model. They show the elements of the value creation process.
- d) **Revenues:** are the “bottom line” of a business model. Sources of revenue and necessary investments need to be carefully analyzed from a short- and mid-term perspective.

- e) **Legal issues:** have to be considered with all dimensions of business models. For instance, legal issues may influence the general vision, as in the banking industry where most markets are still regulated in some respect.
- f) **Technology:** is both an enabler and a constraint for IT-based business models. It is important to take into account the ongoing technological developments and their impact on the business model design. Thus, technological issues affect all aspects of business models, the overall mission, as well as structures, processes, and revenue models.

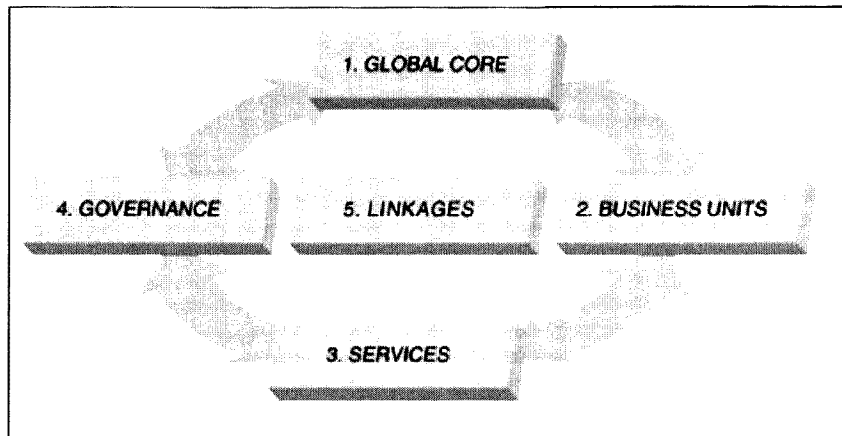
2.2.2 Viscio and Paternack's Five Elements

According to Viscio and Paternack (1996), a firm's business model comprises five elements: global core, business units, services, governance, and linkages (see Figure 2.2). This model defines the elements individually as well as collectively, i.e., the model must generate a "system" value in addition to the value from the individual parts. This system value establishes what should be inside and what should be outside the corporation. It also helps set the standards for performance expectations from each of the elements.

- a) **Global core:** It is global in the sense that it is responsible for key vision and mission across the corporation. It is a core because it is meant to add value to all of the other elements of the model. It is not a centre because execution of its mission is distributed across the corporation. The global nature of business makes it imperative that companies perform many core activities close to where they are needed. Technology enables this.

The global core has five key missions: identity, strategic leadership, capabilities, capital and control.

Figure 2.2: The New Business Model



Source: Viscio & Paternack (1996). Toward a New Business Model. Strategy & Business.

- *Identity*: this is based on a shared vision and value system. It adds value to the corporation across a wide set of constituents, including governments, public interest groups and customers.
 - *Strategic leadership*: provides the overall context for growth, helps develop the overall business portfolio, and assists in fostering key alliances.
 - *Capabilities*: are the fundamental building blocks of competitive advantage. The core's role is to ensure that the corporation has access to "world-class" capabilities and that they are allocated across the firm in the best possible way.
 - *Control mission*: is to define targets, monitor performance, meet legal and fiduciary requirements and comply with regulations. It must also manage the overall business risks across the company's operations, for example, falling short of shareholder expectations.
 - *Capital mission*: is to ensure access to lowest-cost funding to support growth and to manage the financial risks of the corporation.
- b) *Business units* should be worth more as part of the firm than they would be outside of it, thus creating systemic value. This enhanced value may come from one or more

sources, such as the core, interactions with other business units in such activities as best-practice exchanges, knowledge sharing and capabilities transfers.

To capture some of the potential value, the boundaries separating business units must be permeable and flexible, and greater interaction should be encouraged among the units. Thus, the predominant measure for the corporation will be the performance of the whole, and not the sum of the parts.

- c) ***Service delivery*** can be from several sources, but central services out of the corporate centre should not be one of them. Activities that show economies of scale and are either too critical to outsource or for which the outsourcing market is not efficient can be put into a shared-service division. The principle of voluntary exchange is one of the key attributes distinguishing shared services from centralized functions. Another important dimension to shared-service delivery is to support sub-scale business activities in remote locations. Sharing can be among business units or initiated by corporate to provide the support needed for growth.
- d) ***Governance*** is taking on a larger role in corporations. Four forces are driving this change. First, a push for performance is creating more active boards with greater CEO accountability. Second, expansion of capital markets and the need to access new capital are especially important as family-owned businesses look to obtain financing or companies seek out capital in emerging markets. Third, regulatory actions are forcing boards to become more pro-active to deal with everything from privatization issues to taxes on “excessive” CEO compensation. And lastly, alliances, especially international and cross-cultural ones, are requiring adjustments in how ventures are governed.
- e) ***Linkages*** tie the corporation together and cover issues such as organization, management processes and communications. Some linkages are corporate-wide, while others cover only certain elements of the business. Linkages are needed between and

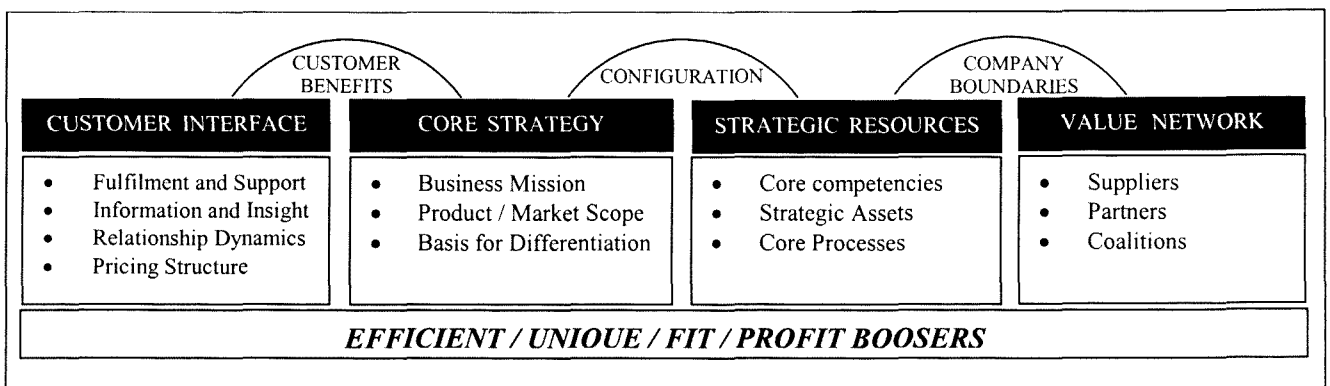
among the five elements of the business model and within each. Many of the linkages are related to the firm's knowledge structure and people processes.

2.2.3 Hamel's Business Concept

Hamel (2000, p. 66) states that the building blocks of a business concept and a business model are the same – a business model is simply a business concept that has been put into practice.

A business concept comprises four major components: core strategy, strategic resources, customer interface, and value network (see Figure 2.3).

Figure 2.3: Deconstructing the Business Model



Source: Hamel (2000, p. 94). *Leading the Revolution*. Boston: Harvard Business School Press.

a) **Core Strategy:** It is the essence of how the firm chooses to compete. Its elements include:

- *The Business Mission:* which captures the overall objective of the strategy – i.e. what the business model is designed to accomplish or deliver. It implies a sense of direction and a set of criteria against which to measure progress.
- *Product/Market Scope:* this captures the essence of where the firm competes (which customers, which geographies, and what product segment) and where, by implication, it doesn't compete.

- *Basis for Differentiation*: this captures the essence of how the firm competes and, in particular, how it competes differently than its competitors.

b) **Strategic Resources**: These include:

- *Core competencies*: this is what the firm knows. It encompasses skills and unique capabilities.
- *Strategic Assets*: these are what the firm owns. They are things, rather than know-how, which can include brands, patents, infrastructure, proprietary standards, customer data, and anything else that is both rare and valuable.
- *Core Processes*: this is what people in the firm actually do. They are methodologies and routines used in transforming inputs into outputs. Core processes are activities, rather than “assets” or “skills”. They are used in translating competencies, assets, and other inputs into value for customers.

Configuration: Intermediates between a company’s *core strategy* and its *strategic resources* (see Figure 2.3). Configuration refers to the unique way in which competencies, assets, and processes are combined and interrelated in support of a particular strategy. The concept of configuration recognizes that successful business models depend on a distinctive combination of competencies, assets and processes.

c) **Customer Interface**: The components are:

- *Fulfilment and Support*: refers to the way the firm “goes to market”, i.e., how it actually reaches customers – which channels it uses, what kind of customer support it offers, and what level of service it provides.
- *Information and Insight*: this refers to all the knowledge that is collected from and utilized on behalf of customers – the information content of the customer interface.

It also refers to the ability of a company to extract insights from this information that can help it do new things for customers.

- *Relationship Dynamics*: refers to the nature of the interaction between the producer and the customer. The notion of relationship dynamics acknowledges that there are emotional, as well as transactional, elements in the interaction of producers and consumers, and that these can be the basis for a highly differentiated business concept.
- *Pricing Structure*: there are several choices in what firms charge for, such as, charging customers directly or indirectly through a third party, bundling components or pricing them separately, charging a flat rate or charging for time or distance. Each of these choices offers the chance for business concept innovation, depending on the traditions of the firm's industry.

Customer Benefits: Intermediating between the core strategy and the customer interface is another component - the particular bundle of benefits that is actually being offered to the customer (see Figure 2.3). Benefits are what link the core strategy to the needs of the customer. An important component of any business concept is the decision as to which benefits are or aren't going to be followed.

d) **Value Network**: The fourth component of a business model is the value network that surrounds the firm, and which complements and strengthens the firm's own resources. Today many of the resources that are critical to a firm's success lie outside its direct control. Elements of value network include:

- *Suppliers*: suppliers typically reside "up the value chain" from the producer.
- *Partners*: Partners supply critical "complements" to a final product or "solution". Their relationship with producers is more horizontal and less vertical than that of suppliers.

- *Coalitions*: Often a company is required to join together with other, similar competitors in a coalition. This is especially likely in cases where investment or technology obstacles are high. Coalition members are more than partners since they share directly in the risk and rewards.

Company Boundaries: Intermediating between a company's *strategic resources* and its *value network* are the firm's boundaries (see Figure 2.3). This component refers to the decisions that have been made about what the firm does and what it contracts out to the value network. Again, an important aspect of any business model is the choice of what the firm will do for itself and what it will outsource to suppliers, partners, or coalition members.

2.2.4 Ethiraj et al.'s E-Business Models

Ethiraj et al. (2000) define a business model as a "unique configuration of elements comprising the organization's goals, strategies, processes, technologies, and structure, conceived to create value for the customers and thus compete successfully in a particular market" (2000, p. 19). The business model is manifest in: the core value proposition; the sources of revenue; how the revenue is generated; the costs involved in generating this revenue; and the plan and trajectory of growth. The strategically relevant aspect of a business model is in the value proposition that it implies. Consequently, business models are differentiated by classifying them based on the opportunity for value creation they express or imply.

Rappa (2002) suggests that business models can be categorized in a variety of ways and any given firm may combine different models as part of its web business strategy. These models also tend to evolve rapidly with new variations in the future. Accordingly, there is no single, comprehensive and cogent taxonomy of web business models one can identify.

Ethiraj *et al.* (2000), however, discuss e-business models as those oriented toward the use of Internet and other electronic technologies to create and/or deliver value. Two important factors affect the creation of an e-business model. These include:

- The convergence of traditionally disparate industries such as telecommunication, entertainment, media, and computing which has resulted in highly interconnected business and markets. Consequently, competition is not merely competing with others in the industry but with several competitors in related markets.
- The largely information-based feature of products and services. Information possesses unique characteristics: it is costly to produce but almost costless to reproduce; its indivisibility makes partial sharing impossible; it is non-rivalrous in use; and it does not allow the selective exclusion of users from access to the informational asset since any single user with access can replicate and diffuse it among others.

These two characteristics suggest four important elements of business models based on electronic technologies: scalability, complementary resources and capabilities, relation-specific assets, and knowledge sharing routines.

- a) **Scalability:** E-businesses leverage the Internet and associated electronic technologies in unique ways. Informational assets, unlike physical assets, are not subject to scale-related barriers. The term “capability scalability” is used by Ethiraj *et al.* (2000) to illustrate the ability of the business model to handle large volumes of a similar kind of transaction (exploit economies of scale), and also the extension or scalability of the business model across geographic markets, products, or customer segments (i.e. the ability to extend the business model’s unique advantages along the value chain).
- b) **Complementary resources and capabilities:** Complementary assets assist firms to cope with disruptive technological change. As a technology matures and knowledge of

its use and implementation gets relatively standardized, sustainability of competitive advantage from it may become increasingly difficult. Moreover, competitive advantages on informational assets are harder to protect from imitation. For this reason, the sustainability of competitive advantage in business models is likely to depend on the effective leverage of complementary physical assets, which are harder to imitate than are informational assets, especially if they are accumulated and integrated over a long period of time. A new entrant wishing to duplicate them would be faced with considerable entry barriers, including high capital cost, scale economies, and learning.

- c) ***Relation-specific assets***: E-businesses thrive in a networked world of relationships and ties. Competitive advantage in this arena often accrues from managing the right collaborative relationships with other constituents in the network (such as suppliers, customers, complementors, competitors). When e-businesses' environments are undergoing rapid and unpredictable changes, strategic alliances are one way to procure assets, competencies or capabilities not readily available in competitive factor markets. Consequently, firms cooperate with one another so as to collectively cope with the heightened uncertainty. These relation-specific assets at the boundaries of the value chain may provide access to customers and/or markets, new technologies, knowledge assets, complementary assets, and new opportunity.
- d) ***Knowledge sharing routines***: Creating value to exploit complementary resources and capabilities and develop relation-specific assets suggests that collaborating firms develop the knowledge-sharing routines necessary to ensure efficient utilization of each other's capabilities. Knowledge sharing routines permit the transfer, recombination, or creation of relation-specific assets. Electronic technologies are increasingly established to store, access and process information, making it possible for partners to more easily access and exploit each others' resources and capabilities.

The tacitness and complexity of knowledge and know-how makes it difficult for competition to imitate such knowledge. This suggests that partner-specific knowledge sharing routines can be a source of competitive advantage.

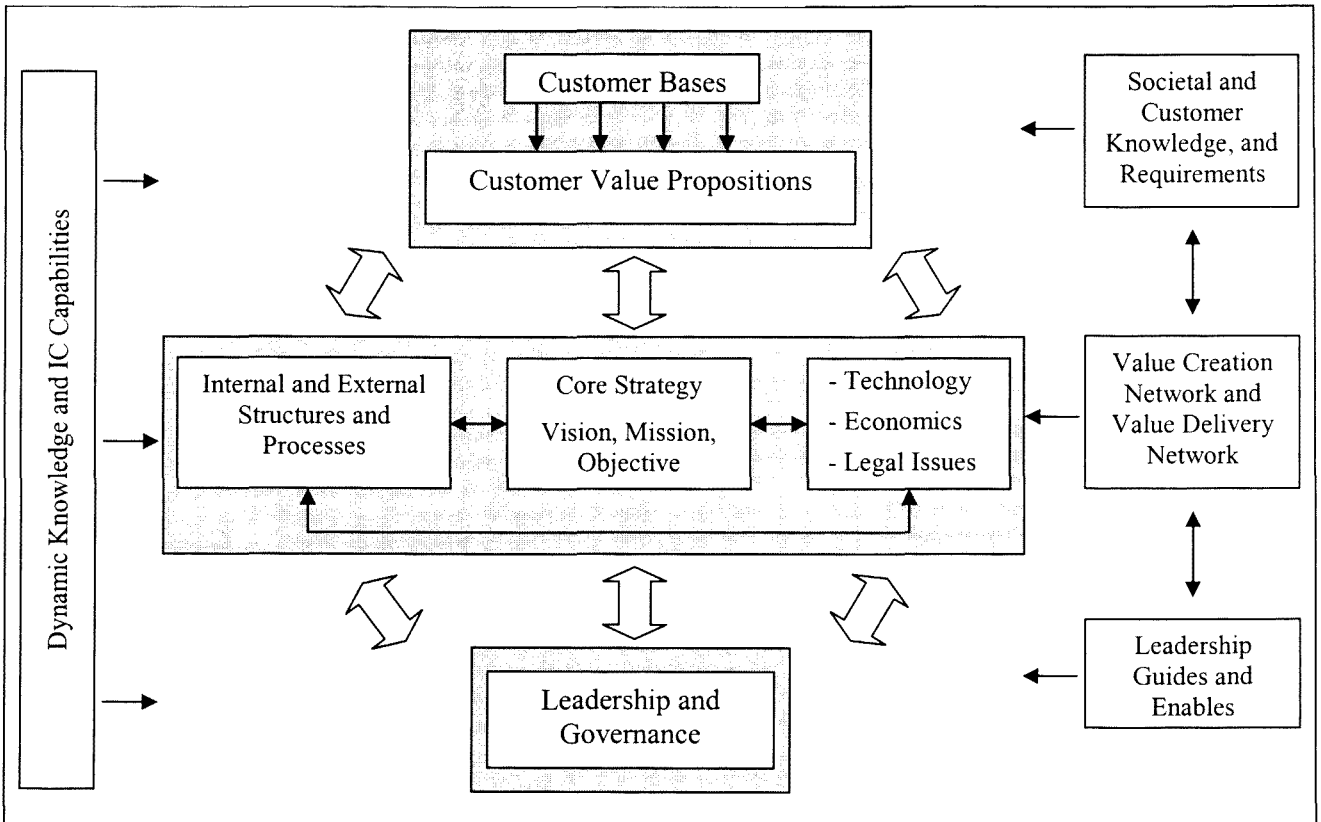
2.3 Integration of Extant Approaches and a Working Definition of a Business Model

As can be seen from the previous section, there are overlapping and common elements among the components and dimensions of business models suggested by the various authors. This section extracts the central theme from these definitions and attempts to give a generic framework of business models.

As previously noted, business models consist of many dimensions and there isn't a single set of business model that applies to all companies and to all industries (Schmid *et al.*, 2001). And also as stated by Viscio and Paternack (1996) the model must generate a total "system" value that is higher than the sum total value from its individual parts. This system enables the creation of value for the various participants in its value chain.

From the above analysis of various generic elements of a business model, the term "business model" can be defined for purpose of this study as follows (see Figure 2.4):

The particular business concept (or "way of doing business") as reflected by the business's *core value proposition for customers*, its *configured value network* to provide that value, consisting of *own* strategic capabilities as well as *other* (e.g. outsourced/allianced) value networks, and its *leadership and governance enabling capabilities* to continually sustain and reinvent itself to satisfy the multiple objectives of its various stakeholders (including shareholders).

Figure 2.4: Key Elements of a Business Model

2.4 Summary

The term “business model” is often used ambiguously, resulting in contradictions and misinterpretations of the concept. While business models are one of the most discussed subjects both in academia and practice, they often remain undefined and a consensus on the elements of business models is lacking.

This chapter has depicted the elements and dimensions of business models provided by various authors. Their shared and common characteristics have been used to establish a working definition of business models that can assist in the better understanding of the term.

Therefore, for the purpose of this study, the term business model is defined as the way of doing business that allows a company to create and deliver value to its customers through value networks and effective governance in order to repetitively sustain itself.

CHAPTER 3

THE “NEW ECONOMY” AND NEW BUSINESS MODELS

3.1 Introduction

Where the industrial era’s environment was relatively simple, companies today are operating in an environment of enormous and continuous change. Hamel has termed it “the age of revolution” – where change is no longer additive, but “discontinuous, abrupt, seditious” (2000, pp. 4-5). Prahalad and Oosterveld (1999, p. 32) also use the term “competitive discontinuity”, and define discontinuity as an abrupt change.

This change, mainly driven by advanced technology and globalization, has created a competitive landscape with substantial uncertainty and unpredictability. The resulting new economic environment is one that challenges the essence of the business models firms use to achieve their various goals. This chapter discusses the driving forces behind the change occurring in the competitive environment, the “new economy” and its implications, and the importance of developing new business models in this new economy.

3.2 Driving Forces

Global competition, deregulation and technology are driving major shifts in almost every industry and across industries (Rometty, 1999). Forces such as improvements in public services, telecommunication and transportation; privatization of major industries; lowering of international trade barriers, global customers demanding global products, and global exploitation of cost advantages have brought about major changes to the competitive landscape (Zahra, 1999; Tapscott, 1997). The major driving forces behind the rapid and unpredictable change in the business environment are discussed in the following subsections.

3.2.1 Deregulation and Privatization

Although the pace and timing vary in different parts of the world, many countries have undergone deregulation and privatization. Industries such as financial services, power, telecommunications, water, and broadcasting have been deregulated and privatized. The process of deregulation and privatization removes local monopolies and allows companies to exploit global opportunities in industries that have been mostly local (Prahalad and Oosterveld, 1999). These newly privatized industries collaborate with companies outside their home country to gain access to capital, technology, skills, innovative capabilities, and other resources (Zahra, 1999).

3.2.2 Technological Change

Great improvements in the areas of communication and information technology have resulted in increased connectivity, facilitated transmission of large amounts of information, and low cost in processing information. This technological change prompts a wide array of options for businesses in terms of how, where and when to find and seize opportunities. As a result, technological innovations create new market opportunities (Viscio and Paternack, 1996).

New technology often has a disruptive effect upon business practices as well. Taking the Internet as an example, it makes the geographic, temporal, and proprietary boundaries insignificant (Campbell, 2000). With computers and communication technology being utilized throughout the world, there is indication of a gradual displacement in the economy of materials by information (Kelly, 1998). That is, pervasive connectivity separates the flow of information from the flow of physical things, allowing each to follow its own economics (Evans and Wurster, 2000).

3.2.3 Globalization

Globalization has created substantial uncertainty in the competitive landscape (Hitt *et al.*, 2001) by bringing about fundamental changes in the traditional boundaries of nations, industries, and companies. And these changes challenge the traditional rules of competition (Zahra, 1999).

Globalization is both driven by and driving new technology. Network technology allows companies to provide 24-hour service and enables firms to collaborate with each other regardless of where they are in the world. In short, technology has eliminated the “place” in workplace. Globalization, similarly, drives technology. Global businesses need to be able to link with customers, suppliers, employees, and partners throughout the world. These companies, variously termed as “transnational enterprises”, “boundaryless firms”, “global organizations”, and “international enterprises”, encourage technology to come up with new and sophisticated means of linking and connecting on a global scale (Tapscott, 1997).

3.3 The New Economy

Global markets, technological advances and changing competitive relationships have significantly altered the economy that the competitive landscape has undergone a fundamental change. These forces have removed the certainty and stability in the economic environment from almost every industry.

This newly emerged economy has three distinguishing characteristics: it is vastly globalized, it favours intangible things (ideas, information, relationships, knowledge), and it is intensely interlinked within deep, ubiquitous electronic networks (Kelly, 1998). These three attributes produce a new type of marketplace and society often termed the “New Economy”, “Information Economy”, or “Networked Economy” (Tapscott, 1997). As a result, the

evolution of the “new economy” has shifted the nature of competitive advantage. As discussed in the following subsections, to be successful in this emerging economy, companies have to be innovative, fast and responsive.

Implications of the New Economy

There are overlapping themes that differentiate the new economy from the old. Discontinuities arise from various sources and understanding these themes is essential and a precondition for transforming businesses for success. The next sections describe these themes.

3.3.1 Knowledge

With the “new economy” becoming a global economy “knowledge knows no boundaries”. Knowledge permeates through people, products, and organizations. In this economy, the majority of the workforce are people who work with their minds rather than their hands. It is an economy based on human capital and networks, which shows a shift from the industrial-based economy to a knowledge- and information-based economy (Tapscott, 1997).

Consequently, knowledge workers have become the key form of capital. This is because an economy that is driven by knowledge and relationships relies more on intellectual (intangible) assets and less on the physical (tangible) assets that were important to the industrial age (Tapscott, 1997).

Therefore, knowledge has become the primary building block of a company’s capabilities. It is focused on adding to the company’s competence by enabling the firm to create something significantly better than others. It is central to the firm’s competitive advantage and creates real value for the company. Accordingly, it is crucial to ensure that the company’s most

important assets - its knowledge and people - are “world-class” through attracting and developing people with specialized skills (Viscio and Paternack, 1996).

3.3.2 Digitization

The “new economy” is a digital economy, with information increasingly becoming digital in form. Networks and digitized information make it possible for copious amounts of information to be compressed, stored, retrieved and transmitted instantly from around the world (Tapscott, 1997). This results in the availability, and easy accessibility, of information across the world and gives everyone instant access to each other (Viscio and Paternack, 1996).

Electronic networks also enable companies to communicate and exchange data quickly and cost effectively, thereby making the process of conducting business better, faster, and more efficient (Hagel and Singer, 1999).

3.3.3 Virtualization

Universal and low-cost communication makes distance and time irrelevant. Although place is still important (real-time face-to-face meetings retain their value), the “new economy” operates in a “space” rather than a place, where more and more economic transactions are taking place (Kelly, 1998).

Kelly defines space as “an electronically created environment ... where more and more of the economy happens. Unlike place, space has unlimited dimensions. Entities (people, objects, agents, bits, nodes, etc.) can be adjacent in a thousand different ways and a thousand different directions. Spaces are not bound by proximity” (1998, p. 95). He describes the advantage of

spaces as their unlimited ability to connect all kinds of dimensions, relationships, and interactions – and not necessarily those that are physically close to one another.

As information shifts from analog to digital, physical things can become virtual. Technologies such as the Internet enable people to shop in virtual malls, join in informal communications with anyone around the world, work and participate without being physically present in the workplace (Tapscott, 1997).

3.3.4 Deconstruction

In the “new economy” the traditional, command-and-control hierarchy is inadequate to respond to the new business needs. Hence, the industrial hierarchy is giving way to structures that are more responsive, flatter, and team-based (Tapscott, 1997). In conventional hierarchies, members are positioned in privilege relative to one another. Conversely, in networks, as reliable information becomes commonly available, there is a peer-like relationship among the members of the organization, and close relationship between the organization and its customers, suppliers, and competitors (Kelly, 1998).

Evans and Wurster (2000) define deconstruction as the “dismantling and reformulation of traditional business structures” resulting from two forces: “the separation of the economics of information from the economics of things, and the blow up (within the economics of information) of the trade-off between richness and reach” (2000, p. 39). Traditional business structures include organizations and value chains. When the trade-off between richness and reach is removed and the traditional link between the economics of information and the economics of things breaks, there is no longer a need for the components of these business structures to be integrated. These deconstructed pieces fragment into multiple businesses that have separated sources of competitive advantage, or recombine to form new business

structures. Therefore, this process of deconstruction challenges the competitive advantages that depended on traditional business structures (Evans and Wurster, 2000).

3.3.5 Integration / Networking

The “new economy” is a networked economy. The new organization is a web of relationships in which the boundaries inside and outside are permeable and fluid. Network technology enables all kinds of companies to achieve economies of scale and access to resources, and at the same time avoid rigid hierarchies and bureaucratic processes that hinder flexibility to changing market needs. As companies collaborate and work well together, they gain the advantages of independence, speed, and flexibility (Tapscott, 1997).

Tapscott’s (1997) “Internetworked Business” is an extension of the virtual corporation – with access to external partners, constant reconfiguration of business relationships, and a great deal of outsourcing. Each participating company collaborates and the total effort is greater than the sum of the parts. Such networks break down the traditional boundaries that existed among companies and their suppliers, customers, and competitors.

As also indicated by Evans and Wurster (2000), in the network economy, there is increased outsourcing because reach to the best suppliers is greater and mutual dependency is minimized by the availability of alternatives. Self-organization of employees to group and regroup across organization boundaries also increases as companies exploit richness and reach of information to collaborate with each other. Similarly, corporations compete and collaborate with each other at the same time by forming alliances in pooling together complementary competencies and sharing risks. As a result, the traditional distinction between internal hierarchy and external markets becomes blurred.

3.3.6 Prosumerism

In many industries, consumers are actively getting involved in the production process, blurring the gap that existed between consumers and producers. This is known as prosumption (Prahalad and Oosterveld, 1999; Kelly, 1998; Tapscott, 1997). In such situations, the company and its customers “cocreate” products and services. An important aspect of prosuming is that since customers are involved in the creation of the product they are more likely to be satisfied with the final result. And the firm, in turn, has customers who are in a much stronger relationship with them than before. Therefore, in this process, both organizations and customers rely on the relationship they develop and maintain in creating products and/or services (Kelly, 1998).

Using the Internet as an example, it has fundamentally changed customers’ expectations about convenience, speed, comparability, price and service (Flower, 1999), and prosumerism can be seen most clearly online, where a product/service is produced by the people who consume it (Kelly, 1998).

3.3.7 Immediacy / Zero Cycles

Discontinuity is creating an era of near “zero cycles” where the life cycles of products and services have become considerably shorter (Prahalad and Oosterveld, 1999). The pace of business has also increased with rising customer expectations and new products entering the market at a much faster rate (Viscio and Paternack, 1996).

Therefore, immediacy has become a key driver and variable in business success. This immediacy imposes new demands on organizations to continuously and instantly adjust to changing business conditions (Tapscott, 1997; Prahalad and Oosterveld, 1999). Succeeding to operate at this rapid pace becomes a source of competitive advantage.

3.3.8 Disintermediation

Traditional value chains were filled with intermediaries (wholesalers, dealers, and distributors) who distributed a completed product or service. However, as more commercial activities shift toward knowledge and information, and as networks connect everybody to everybody else, the economy undergoes disintermediation (Kelly, 1998). As pointed out in section 3.3.4, with the deconstruction of traditional organizational boundaries (assisted by advances in network technology and communication), companies are able to deal directly with end users. This helps organizations to gain sophisticated knowledge about consumers and learn more about how to better serve them (Prahalad and Oosterveld, 1999). When buyers and sellers can deal with each other directly, intermediaries often become unnecessary. This process of disintermediation threatens to challenge a number of established distributors and agents (Evans and Wurster, 2000).

However, the “reintermediation” opportunities are much greater than the disintermediation threats (Tapscott, 1997). Kelly (1998) argues that the anticipation that the network economy favours disintermediation is inaccurate. On the contrary, network technologies do not eliminate intermediaries, but rather generate them. “By definition, every node on a network is a node between other nodes. The more connections there are between members in a net, the more intermediary nodes there can be. Everything in a network is intermediating something else. Thus, all nodes in a network are intermediaries” (1998, p. 100). Hence, disintermediation can create opportunities for new and different middlemen.

3.3.9 Convergence

Traditional industry boundaries are rapidly disappearing, with pressures to converge reshaping every industry. Consequently, convergence has resulted in industry structures that

are fundamentally different from traditional ones (Prahalad and Oosterveld, 1999). The convergence in industries such as in computing, telecommunications, and consumer electronics and also in investment, insurance, and banking industries are changing the way companies do their business (Tapscott, 1997). These changes suggest that the business models developed to compete in a traditional industry structure become irrelevant in the new, evolving industries (Prahalad and Oosterveld, 1999).

3.3.10 Innovation

The “new economy” is an innovation-based economy and human imagination is a main source of value. Given the increased pace of change and complexity in the business environment, there is a need to constantly innovate to keep ahead of imitating competitors (Tapscott, 1997).

Additionally, each innovation is a platform from which other innovations can be created. A well-placed innovation can generate other innovations in the future. It is this expanding and limitless characteristic of innovations that prompts wealth creation in the new economy (Kelly, 1998).

Therefore, managing and fostering these innovations is essential in every part of the firm’s operations, culture and organization (Zahra, 1999). The key managerial challenge is to create a climate where innovation is prized, rewarded, and encouraged. “The organization needs a deep-seated and pervasive comprehension of emerging technologies, ... and a climate where risk-taking is not punished, where creativity can flourish, and where human imagination can soar” (Tapscott, 1997, p. 12).

3.4 Relevance of New Business Models for the New Economy

Govindarajan and Gupta (2001) offer three main reasons why every company must develop a bias for changing the rules within its industry:

- Major discontinuities in the external environment: sometimes incrementally (e.g. the aging population) and sometimes in a radical and discontinuous fashion (e.g. emergence of the Internet).
- Proactive reshaping of the industry structure: large and small firms alike can proactively reshape the external environment.
- Need to break out of the competitive pack: head-to-head competition for diminishing gains leaves an organization vulnerable to pre-emption by more innovative competitors.

Hamel (2000) highlights that in nearly every industry, strategies cluster around certain industry orthodoxy. Strategies converge when “everyone defines the industry in the same way, uses the same segmentation criteria, sells through the same channels” (2000, p. 49). In short, strategies converge when companies operate with the same business model.

Viscio and Paternack (1996), Hamel (2000) and Tucker (2001) point out it is getting increasingly difficult for most companies to have their existing business models generate sustainable profit for an unlimited period of time. The key reasons include major and unpredictable changes in the business environment and the increasing importance placed on innovation as a value-creating attribute that must be found more frequently than before. Therefore, the accelerating pace of the business environment and the need for constant innovation create a challenge in sustaining the efficacy of existing business models.

Hamel (1998) describes how strategy life cycles are getting shorter due to the increasing rate of change in the competitive landscape. The ability to operate with one business model for a

decade or more, slowly improving it, is no longer feasible (Flower, 1999). This has significant implications for a company that seeks to be successful. A company should increasingly be able to become adept and quick in its ability to adjust to changing times, and “more creative in how it competes and more customized in what it delivers” (Viscio and Paternack, 1996).

Today, a company should be capable of reinventing its strategy not when it is in the midst of a crisis, but continuously (Hamel, 2000). No matter how successful and superior a company’s current business model is, it will be imitated by others and challenged by new business models. Therefore, organizations should constantly attempt to create new business models if they hope to survive and grow in a turbulent and competitive environment (Tucker, 2001). As vividly expressed by Flower (1999, p. 14), “the capacity to invent new industries and reinvent old ones is a prerequisite for getting to the future first, and a precondition for staying out in front.”

The following subsections briefly explain the significance of changing the rules of the game in the “new economy.” These include being persistently innovative and imaginative in differentiating own and industry strategy (or business model), reinventing existing business models or creating new ones instead of simply improving or optimizing current business models, and the competitive advantage found in proactively restructuring the industry’s environment through a first-mover mind-set.

3.4.1 Non-linear Innovation

Hamel (1998) explains the challenge today is to become the “architect of industry revolution”. This means to be the creator of the kinds of fundamental change in business models that transform industries. And the way to achieve this is through non-linear innovation. In his *Leading the Revolution* (2000) Hamel states that in a nonlinear world, only nonlinear ideas will create new wealth. Radical, nonlinear innovation is one of the ways to break out of the

hyper-competition experienced in many industries. This innovation requires a company to let go of the constraints of industrial conventions and come up with entirely new solutions to customer needs.

To give an example of how new solutions deliver value to customer, Christensen (1997) illustrates two types of technology changes: sustaining technological changes and disruptive technological changes. Sustaining technologies (whether discontinuous/radical or incremental in character) improve performance of established products. Disruptive technologies, on the other hand, bring to a market a different value proposition than had been available previously. Products based on disruptive technologies are “cheaper, simpler, smaller, and frequently, more convenient to use” (1997, p. xv) However, it is these kind of changes that have brought down industry leaders.

Hamel (1998) categorizes two kinds of innovation. The first is innovation with respect to the firm’s historic strategy (change own strategy). The second is innovation with respect to the firm’s industry and its competitors (proactively reinvent the industry). Succeeding at both kinds of innovation is not easy and few companies are skilful enough to do both. This also applies to many start-ups that are capable of creating radical business models but do not exist long enough to discover another strategy (Hamel, 1998; Youngblood, 2000).

Govindarajan and Gupta (2001) support this view. They advise that the pursuit of changing the rules of the game should be a perpetual process, since, with time, every innovation will eventually be imitated by competitors. Hence, before the current competitive advantages are fully exhausted, companies should already be exploiting new opportunities in the external environment and/or changing industry dynamics. The real challenge for most firms is not whether the rules of the game will change (because they will); rather, it is will they take the initiative to do so.

“Business concept innovation is the capacity to imagine dramatically different business concepts or dramatically new ways of differentiating existing business models” (Hamel, 2000, p.65). Hamel describes business concept innovation as the key to creating new wealth, a way for newcomers to succeed despite resource disadvantages, and for established companies to restore their previous success and remain competitive.

Basically, one way to break away from head-to-head competition is to develop a business model different from what has been created before. Strategy should be a “quest for variety in all components of the business model” (Hamel, 2000, p. 69). This results in companies with highly differentiated strategies that have “unique capabilities, unique assets, unique value propositions, and unique market positioning” (2000, p. 50).

3.4.2 Efficiency versus New Business Models

The business environment is increasingly divided into two kinds of organizations: those that seemingly cannot move beyond continuous improvement/innovation, and those who have moved forward to radical innovation (Hamel, 2000; Murtagh, 2001).

As described in the previous section, in a discontinuous competitive landscape, business models do not survive for long. When they begin to lose their economic value, the response of most companies is to spend human energy, capital, and other resources on improving the efficiency of the existing business model. Means of optimizing existing business models include: downsizing, outsourcing non-core activities, process improvement and efficiency programs (Hamel, 2000; Flower, 1999).

Hamel (2000) explains that every business model reaches the point of diminishing returns. This is when competitors’ strategies become almost similar and top management’s attention is

focused solely on improving internal process and systems. This leaves the company susceptible to unconventional innovators.

Prahalad and Oosterveld (1999) also discuss what they call “old remedies and new problems”. At the first signs of competitive difficulty, managers assume that cost cutting and other forms of improving efficiency (portfolio adjustment, reengineering, and downsizing) will revitalize them. By means of restructuring activities, managers are then able to reduce inefficiencies that have accumulated over the years, but this does not solve competitiveness problems because managers keep applying old solutions to new problems.

Established firms assume that loss of market share, profit declines, and new competitors are the result of inefficiencies rather than the result of the rapidly changing competitive environment. Thus, their first reaction to discontinuities is to “work harder” when what they need to do is “work differently”. Competitive challenges in the new economy demand an “out of the box” strategy, an attempt to operate in the “zone of opportunity”. Yet organizations make “in the box” operational improvements, attempts to stay in the “zone of comfort” (Prahalad and Oosterveld, 1999).

As previously discussed, companies have tried to deal with growing competition (new problems) by introducing improvement programs into every function and process (old remedies). But the competitive pressures keep on getting more intense, the pace of change keeps accelerating, and companies keep expending energy and resources in search of ever higher levels of quality, service, and overall business agility. Even though companies work harder to improve themselves, results improve slowly or not at all (Pascale and Millemann, 1997).

Therefore, it should not be a question of “fine-tuning, or improving, or realigning organizations,” but reinventing business in fundamental ways (Fiorina, 2000, p. 5). Most

companies should come to recognize that reengineering, as the main tool for improving corporate performance and competitiveness, is an inadequate approach to success (Tapscott, 1997). They have to move beyond improving efficiencies to fundamentally changing their current business models. Thus, the challenge is not whether the company can reengineer its processes, but whether it can reinvent its entire industry model. And in the new economy, reinvention of business models is essential for all organizations to survive and remain competitive in an increasingly complex business environment (Fiorina, 2000).

3.4.3 First-Mover Advantage

In addition to exogenous changes taking place in the business environment, such as technology and the global landscape, firms often have the ability to proactively reshape the boundaries, structure, and dynamics of their industry's environment.

First movers are the first to introduce new goods or services. In doing so, first movers earn "monopoly profits" until competitors imitate their innovations. Therefore, early and fast movers can achieve the highest returns (Hitt *et al.*, 2001, p. 484). Being a first mover in responding to environmental change, or being a pioneer in actively initiating change in one's environment, can give a firm a major competitive advantage (Govindarajan and Gupta, 2001).

Kelly (1998) explains since the network economy favours the "nimble and quick", those companies and technologies that grow gradually and slowly will not be able to compete with early starters. And because of the law of increasing returns, not only will they find it difficult to catch up with first movers but may find it difficult to compete at all.

However, Bartlett and Ghoshal (2000) explain there are instances where being a late mover is a source of competitive advantage rather than a disadvantage. By benchmarking and adapting competitors' business models, late movers can learn from the demands, opportunities and

challenges faced by their competitors and benefit by discovering niches overlooked by competitors or adopting different business models from that of competitors.

Thus, although some distinct advantages accrue to early movers, in some instances, the early movers merely bear the “pioneering costs” while the advantages go to those who learn from their early mistakes (Bradley and Nolan, 1998; Boulding and Christen, 2001).

3.5 Summary

Globalization, deregulation, advanced technological improvements, and the rapidly changing business environment have created both major opportunities and threats for businesses. Companies’ capacity to survive and sustain competitive advantage depends on their ability to meet competitive challenges and to take advantage of the emerging opportunities. In a nutshell, survival and sustainability in the new economy can be regarded as a series of reinventing strategies.

The substantial effect of the new economy and its underlying forces has major implications for companies in all kinds of industries and sectors. With the increased pace of change and competition in the business environment, merely improving the efficiency of outdated business models has proved to be ineffective, inadequate, and ultimately unproductive. This is because new wealth is created from innovation, and not optimization.

Therefore, in order to avoid head-to-head competition and converging strategies, companies should focus on imagination and innovation in continually reinventing their business model. Additionally, they should also be able to proactively redesign their industry strategy. This involves developing new business models or reinventing existing ones by becoming unconventional and doing business in a non-traditional and unorthodox way.

CHAPTER 4

CREATING NEW BUSINESS MODELS: APPROACHES AND TECHNIQUES

4.1 Introduction

As discussed in the previous chapter, in order for organizations to survive and be competitive in the rapidly changing business environment, they should continuously reinvent their existing business models. The new business model should enable the firm to respond flexibly to its environment and capture opportunities quickly and profitably. A company also needs to create a radical model that sets it apart from competitors and that encourages the creation of value for customers.

Developing new business models requires discarding conventional beliefs and established ways of doing business. However, the challenge for top management is to let go of industry orthodoxy and lead their companies into constantly developing new business models. But once they have successfully overcome this drawback, it increases the companies' prospects of becoming the drivers of their industries.

Prior to discussing the approaches and techniques for the development of new business models, it is useful to recognize the dilemmas and challenges faced by established companies in competing in the "new economy". This is discussed in the next section, followed by the approaches and techniques for creating new business models put forward by Govindarajan and Gupta (2001), Amit and Zott (2001), Hamel (1998), and Youngblood (1997), and concluded by a summary of this chapter.

4.2 Challenges to Incumbent Companies

The term “incumbent” is used to describe companies that are already established in an industry, or those that have been market leaders at some point. The word “insurgent” is used to describe start-ups and new entrants or competitors in an industry.

“The most venerable can prove to be the most vulnerable” – this is how Evans and Wurster (2000, p. 4) describe industry incumbents’ susceptibility in the new economy. Murtagh (2001) cautions that one of the major mistakes that established companies can make is to assume that their only competitors are their historic rivals. Hamel (2000) also cautions that for most businesses, the newest and most aggressive competitors are usually companies that were not in the same business before.

Changes in the environment, such as new technologies, can also suddenly obliterate brands and businesses that have been established for many years. Managers’ conventional “cognitive maps” of the industry make it difficult for them to see emerging changes in their markets. These cognitive maps influence and shape managerial decisions, especially in terms of selecting the competitive arena and the competitors with which the firm competes (Zahra, 1999).

In a highly competitive business environment, Useem (1999) explains that incumbents face two choices: either to protect still profitable technologies and models, or to pre-emptively destroy them, even if it means terminating the very revenue sources upon which the company is founded. The second alternative is the kind of dilemma incumbents are faced with since it entails embracing new technologies that will destroy the value of past investments. In short, it means, doing things that infringe the conventional way of doing business.

In general, large organizations resist disruptive change partly because the kind of change being required is radical and challenging. This is because it is no longer a matter of

incremental change, but realizing a discontinuous transformation in both organization and industry (Pascale and Millemann, 1997).

The following sections describe some of the difficulties incumbents face in the new competitive landscape.

4.2.1 “Good” Management

Useem (1999) maintains that incumbents are bound to lose their market share to new entrants when faced with disruptive technologies that make existing ones obsolete. This is because corporate managers disregard important new technologies and markets precisely because they are “good managers”. They have what he refers to as “excess of rationality”. But these rational instincts serve well only when it is a matter of incrementally improving existing offerings. Christensen (1997) also cites that many of what are now widely established principles of good management are only situationally appropriate.

What Christensen calls one of the “innovator’s dilemmas” is that “blindly following the maxim that good managers should keep close to their customers” (1997, p. 4) can prove to be a serious mistake. “There are times at which it is right not to listen to customers, right to invest in developing lower-performance products that promise lower margins, and right to aggressively pursue small, rather than substantial, markets” (1997, p. xii).

However, Evans and Wurster (2000) point out that it is difficult for established companies to downsize assets that have high fixed costs, to cannibalize current profits, to discard core competencies that were built over a long period of time, to destroy the business when many customers still prefer the current business model, and to cut-off long-term relationships and obligations with partners and distributors.

In suggesting reasons why good managers become paralyzed when faced with disruptions, Christensen, *et al.* (2001) propose the following points:

- Because disruptive technologies perform significantly worse than mainstream products in the beginning, the leading companies' most attractive customers will not use them. The more carefully companies listen to their best customers, therefore, the less they will recognize that the disruption is important.
- Such companies carefully measure the size of markets and their growth rates to understand their customers better. But disruptive technologies foster new products and services with a market impact that cannot be easily predicted.
- Good managers focus on investing where returns are the highest. Disruptive innovations, however, usually translate into cheaper products with lower profit margins.
- As companies become successful and grow, their managers are compelled to pursue large markets and maintain their growth rates. But the emerging markets for disruptive innovations are much smaller at first than mainstream markets and cannot provide the enormous volumes of new business that keep a large company growing.

4.2.2 Limited Perspectives of Top Management

Success of a company tends to block its broader view of opportunities available in the new economy as a whole. This is often a problem with top management having too little perspective (Kelly, 1998). One reason for this is the history and the shared values that define a strong corporate culture and that can prevent top managers from considering “events that do not fit into their collective mental framework” (Evans and Wurster, 2000, p. 4).

Sull (1999) and Youngblood (2000) explain most leading businesses start off with an innovative competitive model that sets them apart from their competitors. This encourages top

management to focus its energies and resources on refining and extending the existing business model. Consequently, the creative thinking that brought about the company's initial success is often replaced by a devotion to the status quo. And when changes occur in the business environment, this rigidity brings failure to the company. Sull (1999) terms this as "active inertia"- the inability to take appropriate action. In particular, the following four occur:

- *Strategic frames become blinders*: Strategic frames are the mind-sets that shape how managers see the business environment. Managers' attention focusing repeatedly only on certain things prevents them from noticing new options and opportunities.
- *Processes harden into routines*: Once a company has found a way that works particularly well in carrying out a certain activity, it becomes a strong incentive to lock in the chosen process and there is no desire to search for alternatives. People in the organization follow the processes not because they are effective or efficient but because they are well known and comfortable.
- *Relationships become shackles*: Companies need to build and maintain strong relationships with customers, employees, suppliers, investors, and distributors to become successful. However, when conditions in the environment shift, these relationships can hinder companies in developing new products or focusing on new markets.
- *Values harden into dogmas*: A company's values are the set of deeply held beliefs that unify and inspire its people. As companies mature, however, their values often harden into rigid rules and regulations simply because they are "enshrined in precedent."

Prahalad and Oosterveld (1999) discuss the zone of comfort versus the zone of opportunity. The more successful a firm gets, the more entrenched its managerial routines become. Moreover, senior executives are usually promoted from within. As a result, all senior

managers have strong social ties and may not have the necessary experience for a different approach of managing. Therefore, when discontinuities challenge the established social order within the company, the zone of comfort (the familiar) often wins over the zone of opportunity (the unfamiliar). However, managers should move out from their zone of familiarity to the zone of opportunity by identifying discontinuities, determining their impact on the market, and developing new business models.

According to Hamel (2000, p. 121), it is not the information technology, processes, or facilities that distinguish industry revolutionaries from incumbents, but rather, it is their ability to “escape the stranglehold of the familiar.” This is because ultimately the business landscape has considerably changed to assume that industry boundaries and business models could remain the same.

4.2.3 The Difficulties in Cannibalizing Oneself

A new entrant’s biggest competitive advantage is the “unwillingness of the incumbent to fight on a deconstructed definition of the business” (Evans and Wurster, 2000, p. 67). Incumbents can easily become inept because of their reluctance to cannibalize their established business model, and this hesitation becomes the greatest competitive advantage for new competitors.

Competing in the new competitive environment requires cannibalizing assets, such as sales and distribution systems, brands and core competencies, and terminating long-term relationships with suppliers and customers. Incumbents hesitate to do this, especially if the existing business has positive margins (Evans and Wurster, 2000). However, when it comes to radical and disruptive innovation, not cannibalizing oneself can mean becoming susceptible to competitors’ attack (Useem, 1999). And as also discussed in section 3.3.4, companies have to pre-emptively deconstruct their own businesses to remain competitive. Although this point

may be easy to grasp intellectually, it is profoundly difficult in practice for established companies (Evans and Wurster, 2000).

This is paradoxical because for companies to survive and remain competitive in the “new economy”, they have to cannibalize their existing business models and at the same time develop innovative and new business models while still benefiting from the existing ones. Even so, incumbents should allow Schumpeter’s “creative destruction”. It is insufficient to merely try to improve existing business. To really thrive, companies should constantly destroy established businesses while at the same time creating new products and services. The paradox of perfecting (improving, making efficient) products and services only to destroy (cannibalizing, reinventing) them is a challenge for managers (Harari, 1996). Nevertheless, it is important to realize that if incumbents are to defend themselves against competitors, they should play the role of both creator and attacker of their own business models (Useem, 1999).

4.2.4 Unlearning the Past

In established companies, senior executives usually get promoted from within and the organizational pyramid becomes a “hierarchy of experience”. And often changes in the organization do not occur unless it is on the verge of collapsing. However, today the competitive terrain is changing so fast that experience alone has become irrelevant, and the organization has to learn how to compete in this new environment (Hamel, 2000). Managers should put aside old competitive beliefs and compete according to new rules of doing business. This includes making decisions at a faster speed, acquiring totally new technical and entrepreneurial skills, and managing for maximal opportunity (and not minimum risk) (Evans and Wurster, 2000).

Kieff (2000) maintains that in order to learn, one must “unlearn”. Unlearning is the essential capacity for new learning. Generally, past success becomes a barrier to innovation and future

success because the positive reinforcement created by success develops into a strong incentive to repeating past behaviour. Unlearning is also difficult because it means giving up all that the organization has been building up over the years. Moreover, Kieff (2000) explains that if individuals experience difficulty in unlearning, it is even more difficult to engage groups (organizations) in unlearning their collective norms and collective behaviour. However, firms should persist in the process of unlearning if they are to survive and compete in the rapidly changing business landscape.

4.3 New Business Models and Approaches

Taking into consideration the challenges faced by incumbents in cannibalizing themselves and operating in unorthodox and unconventional ways, a number of authors have suggested ways to enable both new entrants and established companies to innovate new business models, or reinvent existing ones, in their company and industry. As Govindarajan and Gupta (2001) illustrate “competitive advantage is not just a function of how well a company plays by the existing rules of the game. More important, it depends on the firm’s ability to radically change those rules. This is true of a newcomer ... as it is of an established player” (2001, p. 3).

The following subsections present four approaches and techniques in creating new business models put forward by different authors:

- Extended Value Chain Management
- Drivers of Customer Value Creation
- Revolutionary Thinking Approaches
- Complexity Management Approaches

Although these approaches assist in creating new business models or reinventing existing ones, they will have little significance if they do not offer new customer value proposition. Therefore, offering new customer value is the basis from which viable and successful business models can be created.

4.3.1 Extended Value Chain Management

According to Govindarajan and Gupta (2001) the business model involves the areas of customer definition, customer value identification, and value creation process design. Accordingly, there are three arenas in which the rules of the game can be changed into successful rules from the customers' viewpoint (see Figure 4.1):

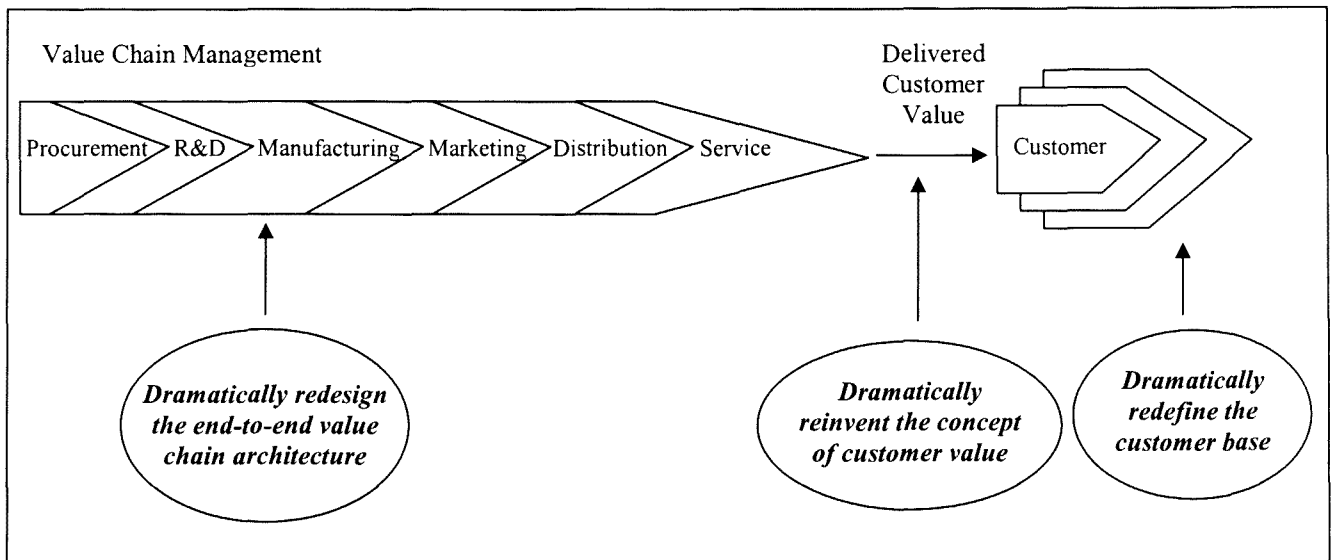
- Dramatic redesign of the end-to-end value chain architecture: make the value chain more effective.
- Dramatic reinvention of the concept of customer value: transforming the value customers receive.
- Dramatic redefinition of the customer base: expanding the market size.

These three arenas are highly interconnected in that changes in any one of them will have implications for the other two, thus, changing the rules of the game.

a) Redesigning the End-to-End Value Chain

A value chain is the linked set of value-creating activities all the way through from basic raw material sources to the ultimate end-product delivered into final customer's hands. Superior value chain architecture is one that, from the customer's point of view, has reduced costs and/or greatly enhanced value.

Figure 4.1: Three Arenas for Changing the Rules of the Game



Source: Govindarajan and Gupta (2001, p. 4). Strategic Innovation: A Conceptual Road Map. Business Horizons, 44(4).

The firm should be able to detect whether the new architecture allows it to target customers much more effectively and efficiently, and whether it has the flexibility to switch to a superior architecture in the future.

There are three principles that should guide the redesigning of the end-to-end value chain architecture. The new value chain should:

- redesign the set of activities that comprise the new value chain and the interfaces across the activities;
- create dramatic gains in one or more of three areas: cost structure, asset investment, and speed of responsiveness to external changes; and
- enable the company to scale up its business model to ensure growth in market share, swift globalization, and expansion into related products and services.

Case 1: Dell - The world's largest "direct sales" personal computer company

How Dell Redesigned the Value Chain

The traditional value chain in the personal computer industry could be characterized as “build-to-stock”. PC manufacturers designed and built their products with preconfigured options based on market forecasts. The products were first stored in company warehouses and later dispatched to resellers, retailers, and other intermediaries, who typically added a 20 to 30 percent markup before selling to their customers. Manufacturers controlled the upstream part of the value chain, leaving the downstream part for middlemen. Retailers justified their margins by providing several benefits to customers: easily accessed locations; selection across multiple brands; the opportunity to see and test products before purchasing; and knowledgeable salespeople who could educate customers regarding their choices.

Two trends in the 1980s allowed Dell to radically reengineer the value chain. First, corporate customers were becoming more sophisticated and experienced technology users and no longer required intense personal selling by salespeople. Second, the different components of a PC (monitor, keyboard, software, and so on) became standard modules, permitting mass customization in system configuration.

When Dell developed its “direct” model, it dramatically transformed the value chain architecture by departing from the industry’s historical rules on several fronts:

- It outsourced all components, but performed assembly.
- It eliminated retailers and shipped directly from its factories to end customers.
- It took customized orders for hardware and software over the phone or via the Internet.
- It designed an integrated supply chain linking its suppliers closely to its assembly factories and the order-intake system.

Dell created a “virtuous” cycle by rewriting the rules of the PC industry, custom-configuring PCs through direct dealings with end users. Customer intimacy gave Dell superior forecasting ability, which allowed it to pursue JIT manufacturing with very low levels of finished goods and components inventory and little risk of stock-outs. Radical reductions in inventory lowered costs and also enabled Dell to be first to market with the latest products. The net result was that Dell had the dominant share of the PC market, which in turn led to more customer contacts - thereby starting the cycle all over again.

The new value chain architecture also enabled Dell to globalize faster and more profitably than its competitors for two reasons. First, Dell’s direct model yielded the same benefits in non-U.S. markets as it did at home. Second, because of its direct channel, Dell did not require access to local distribution channels and so faced lower entry barriers into foreign markets.

IBM, Compaq, and Hewlett-Packard probably found it difficult to imitate and neutralize Dell’s direct model for fear of alienating their dealers. The bulk of these companies’ sales came through third-party dealers. If they set up direct channels, their distributors, retailers, and resellers would be upset at the loss of market share, and the companies could not run the risk of angering their critical constituency.

Source: Govindarajan and Gupta (2001, pp. 5-6). Strategic Innovation: A Conceptual Road Map. *Business Horizons*, 44(4).

b) Reinventing the Concept of Customer Value

For reinventing the customer value proposition, opportunity lies in shifting from selling discrete products and services to providing a comprehensive customer solution and offering an integrated bundle of products and services to address a generic underlying need. This strengthens the firm’s relationships with its customers.

Customers' dependence on the company increases considerably when a company redefines its value proposition from selling discrete products to selling an integrated system of products and services. However, customers generally do not like to rely on a single source because the provider could choose to exploit the resulting bargaining power. Therefore, from the customer's standpoint, offering total solutions will be a successful value proposition if all of the following three conditions are in place:

- The firm is "best-in-class" in every product it offers. Otherwise, customers can obtain that product from another better source.
- The integrated solution is truly superior to the alternative of customers buying discrete products and services and bundling them on their own.
- The firm offers the integrated bundle at a lower price than what customers would pay to assemble the individual products from separate providers. This way, the resulting gains are shared between the firm and its customers.

c) Redefining the Customer Base

Redefining the customer base means discovering and serving a previously hidden customer segment large enough to uncover a large customer base. Such redefinition provides the innovator with a large, profitable, and undefended marketplace and challenges the incumbent in its own market.

An approach of a firm that discovers a hidden customer segment and builds the capabilities to serve it can alter the rules of the game in the following ways:

- The discovery of a new segment dramatically increases the size and growth rate of the overall marketplace, thereby changing the value potential of the industry.

- Solutions designed for the new segment begin to replace the previous solutions of the original segment.
- The capabilities accumulated in the process of discovering and dominating the new segment can be leveraged to overturn established companies.

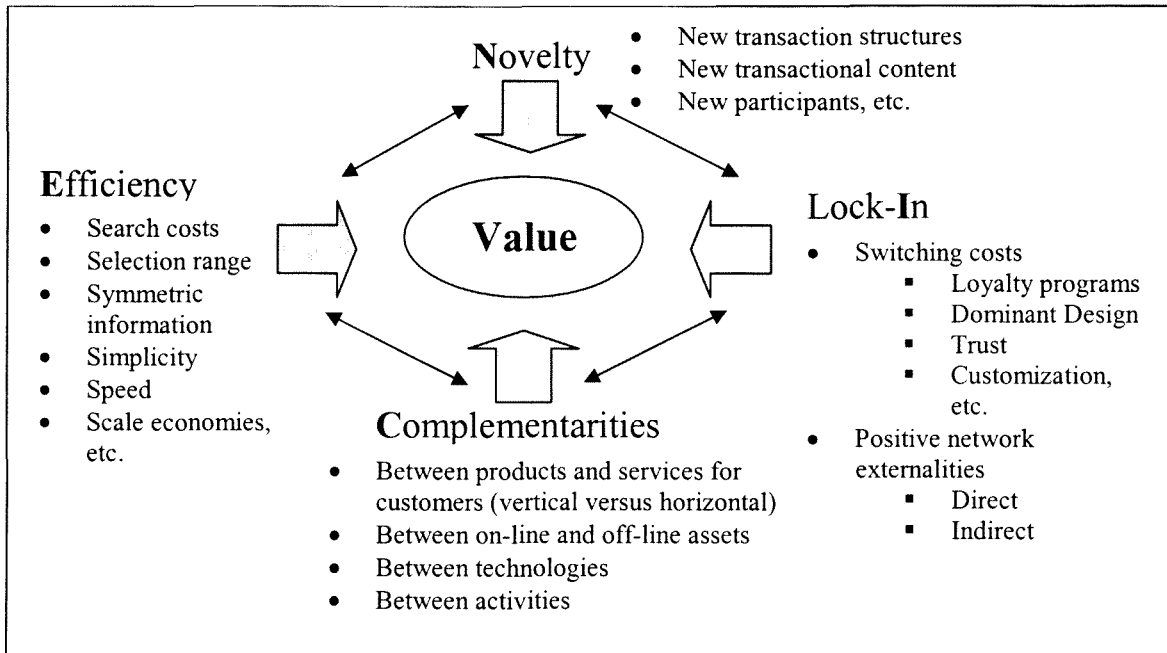
4.3.2 Drivers of Customer Value Creation

Amit and Zott (2001) propose four sources of value creation in e-business. They define the term “value” as “the total value created in e-business transaction regardless of whether it is the firm, the customer, or any other participant in the transaction who appropriates the value” (2001, p. 503). The authors suggest that each of the four major value drivers and the linkages among them enhance the value-creation potential of e-business. The drivers of value creation are (see Figure 4.2):

- Efficiency: by making the purchase made by customers more efficient (e.g. providing information to customers so they can make informed decisions)
- Complementaries: offering complementary services to customers as an integrated bundle of services.
- Lock-in: using strong incentives to obtain repeat business, thereby creating high switching costs.
- Novelty: the service provided is unique and recognized to be pioneering, thus creating previously unrecognized value.

Hitt *et al.* (2001) point out that these four concepts of value creation are not limited only to e-businesses but to all business operations as well.

Figure 4.2: Sources of Value Creation in E-Business



Source: Amit and Zott (2001, p. 504). Value creation in E-business. *Strategic Management Journal*, 22(6/7).

a) Efficiency

Transaction efficiency is one of the primary value drivers for business. The costs per transaction decreases whenever transaction efficiency increases, hence making the business more valuable.

Efficiency enhancements can be realized in the following ways:

- Reducing information asymmetries between buyers and sellers through supplying up-to-date and comprehensive information. This improved information can reduce customers' search and bargaining costs.
- Enabling faster and more informed decision-making by leveraging inter-connectivity of virtual markets.
- Streamlining the value chain to make it effective and efficient, thereby benefiting both vendors and customers.

- Increasing the number of transactions that flow through the business platform, i.e. scalability.

Therefore, increased information flows and reduced asymmetries of information (with the aid of advanced information technology), among other factors, are important in increasing efficiency and reducing the potential transaction costs.

b) Complementarities

Complementarities are a bundle of goods providing more value than the total value of having each of the goods separately. Complementarities increase value by enabling revenue increases.

Businesses can leverage the potential for value creation by offering bundles of complementary products and services to customers. The complementarities are often directly related to a core transaction enabled by the firm, thus the services enhance the value of the firm's core products. But it may also be desirable to offer complementary goods that may not be directly related to the core transactions. Offline assets can additionally complement online offerings. Customers who buy products over the Internet value the possibility of getting after-sales service or returning/exchanging merchandise to "bricks-and-mortar retail" outlets.

Businesses can create value by capitalizing on complementarities among activities thereby uncovering hidden value, such as supply-chain integration and complementarities among technologies.

Interdependency between Efficiency and Complementarities

Efficiency gains made possible by information technology make way for the exploitation of complementarities in business. Bringing together resources and capabilities of distinct firms is

economically compelling when transaction costs, and hence the threat of opportunism, are low. Conversely, when customers have access to products and services that are complementary, efficiency may be enhanced through reduced search costs and improved decision-making.

c) Lock-In

The value-creating potential of a business is enhanced by the extent to which customers are motivated to engage in repeat transactions (which tends to increase transaction volume), and by the extent to which strategic partners have incentives to maintain and improve their associations (which may result in both increased willingness of customers to pay and lower opportunity costs for firms). These value-creating attributes can be achieved through “lock-in”. Lock-in helps in preventing customers and strategic partners from going to competitors, thus creating value.

Customer retention can be enhanced in the following ways:

- Establishing loyalty programs that reward repeat customers with special bonuses.
- Developing dominant design proprietary standards for business processes, products and services.
- Establishing trustful relationships with customers. To the extent that customers develop trust in a company, they are more likely to remain loyal to the business rather than switch to a competitor.
- Opportunities for customization and personalization can be exploited. Businesses can enhance lock-in by enabling customers to customize products, services, or information to their individual needs.

Firms can use data-mining methods (e.g., submitted customer information and past purchases) to personalize products, information, and services. With such mechanisms the more the customer interacts with the firm, the higher the probability that customers will have the incentives to return to the firm. This creates a positive feedback loop.

Interdependency between Efficiency, Complementarities, and Lock-In

The potential value of a business depends on the combined effects of lock-in, efficiency, and complementarities. Efficiency and complementarities as sources of value creation can be helpful in fostering lock-in. The efficiency features and complementary product and service offerings of a business may serve to attract and retain customers and partners. Conversely, when a business creates lock-in, this can also have positive effects on its efficiency and on the degree to which it provides for complementarities. Moreover, a strong potential for lock-in provides an incentive for prominent partners to contribute complementary products and services because of the promise of high-volume (repeat) business.

d) Novelty

Businesses can be innovative in the ways they do business. This could be done by introducing new ways of conducting and aligning business transactions: create value by connecting previously unconnected parties, eliminating inefficiencies in the buying and selling processes through adopting innovating transaction methods, capturing latent consumer needs, and/or by creating entirely new markets.

There can be substantial first-mover advantages for business innovators. Being the first to market with a novel business method makes it easier to create switching costs by developing brand awareness and reputation. Additionally, innovators can gain by learning and accumulating proprietary knowledge, and by pre-empting scarce resources.

Interdependency between Efficiency, Complementarities, Lock-In, and Novelty

Novelty and lock-in are linked in two important ways. First, innovators have an advantage in attracting and retaining customers, especially in conjunction with a strong brand. Second, being first to market is an essential prerequisite to being successful in markets that area characterized by increasing returns. In “winner-takes-most” markets, it is crucial to enter a new market first.

Novelty is also linked with complementarities. The main innovation of some businesses resides in their complementary elements, such as the resources and capabilities they combine.

Lastly, in the relationship between novelty and efficiency, certain efficiency features of businesses may be because of novel assets that can be created and exploited in the context of virtual markets.

Each of the identified sources of value creation demands equal consideration, and, as discussed above, the presence of each value driver can enhance the effectiveness of any of the other drivers. Therefore, there is interdependence of the sources of value in the value-creation for business.

4.3.3 Revolutionary Thinking Approaches

According to Hamel (1998) if companies want to succeed in the new economy, they should think about innovation in the following ways:

- move beyond incrementalism to embrace non-linear innovation;
- understand innovation at the level of an entire business system as well as innovation at the level of an individual product or service;

- move beyond a view of innovation as the outcome of “lone visionaries”, and learn how to exploit the innovative ideas of “activists” throughout their organizations;
- develop approaches to innovation that combine diversity of ideas with a coherent viewpoint about the future of the entire enterprise; and
- make innovation a systemic capability.

a) Incrementalism Vs Non-linear Innovation

As discussed in section 3.4.2, incrementalism is no longer sufficient in a rapidly changing business environment. In nearly every industry today, companies’ strategies are converging and are reaching the end of incrementalism. This is seen in industries where organizations are working harder to improve efficiency and achieving less in competitive differentiation and real wealth creation. Therefore, in a “non-linear world”, only “non-linear strategies” will create new wealth.

Thus, for people in a company to understand the future and to become innovative, top management should encourage the process of experiential learning at all levels of the organization. This means that senior management should ensure that the organization is learning as fast as the changing environment.

b) Innovation of the Business Model

It is essential that companies shift from a product-centric view of innovation to a systemic view of innovation. That is, companies should be able to think about new business models in their entirety as opposed to seeing innovation as a technology or product issue. It is all about a fundamentally different business model.

c) Activists not Visionaries

Companies should rethink their perception that innovation originates with “visionaries” rather than “activists”. There is a long-held belief that change, strategic thinking, and new strategies originate from top management. Essentially, however, most companies are not run by visionaries but by lower level managers and employees who deal directly with the daily business. Therefore, it is important that each person in the company should be able to feel they have a responsibility in contributing to innovation and value creation for the organization.

To help “revolutionary strategies” emerge, companies should involve three constituencies that do not have a large share of voice in the strategy making process: young people or those with youthful perspective; people at the geographic periphery of the organization; and newcomers with experience in other industries and who have not yet had corporate training.

d) Diversity but Coherence in Strategy

Although diversity is usually emphasized in innovation, coherence in strategy is equally important. Unregulated innovation may result in fragmentation, with no structure that unites individuals to common causes. At the other extreme, coherence may become authoritarianism and the uniformity it results in may repress a company’s ability to experiment and adapt.

A diverse, yet coherent strategy conversation can be achieved by developing non-conventional strategic options (e.g. challenging orthodoxies). But at the same time, there is the need to re-converge by looking across all the ideas and options and finding themes that broadly bind the scope of innovation in the firm.

The challenge for senior management, therefore, is to establish the strategic boundaries that will give coherence and consistency to innovation. But these should be derived from a creative process that widely involves people at all levels of the organization.

e) Innovation as a Systematic Capability

Innovation is often viewed as the result of a chance happening. But success in the new competitive landscape depends on constant innovation, and consequently it has become imperative to learn how to make innovation a corporate-wide capability.

As pointed out in section 3.4.1, non-linear innovation holds a competitive advantage for companies operating in the new economy. Therefore, if the goal of the company is to constantly create new wealth-generating strategies, then it should incorporate innovation and imagination of all the people in the company in the strategy-making process.

4.3.4 Complexity Management Approaches

Youngblood (1997; 2000) explains that it is at the “edge of chaos” that living systems are most flexible and have the greatest potential for novelty and creativity. The edge of chaos is when organizations operate far from equilibrium but have not collapsed into chaos. Here they creatively “self-organize” into higher levels of order that are both more complex and more stable. This “bounded instability” provides clear boundaries (vision, objectives, and guiding principles) that gives the company shape and direction, but within those boundaries there is freedom to act quickly and responsively in the company’s best interest.

Leaders can create an environment where the organization can renew itself as needed in order to achieve the strategic vision. The role of leaders, then, shifts to activities that promote an environment where self-organization can occur.

Youngblood (1997) offers three broad categories of activities for which the “new leader” is mainly responsible: establishing context, disturbing the system, and cultivating the organization.

a) Establishing Context

Creativity and self-organization in living systems are dependent on having a clear identity. In organizations, this identity is established through a shared vision of purpose, principles, strategy, and culture. A strong, well-understood, core ideology is vital, because it is through shared beliefs and intentions that people are able to act autonomously and remain in harmony with the whole - thus significantly reducing the need for external controls.

Responsibilities for the new leaders in this regard are: clarifying a shared vision and connecting the people in the organization to it through active participation and extensive dialogue; developing organizational alignment around a collectively shared purpose, strategy, and guiding principles; and assisting the organization in understanding and interpreting information and events in the context of the organization’s shared vision.

b) Disturbing the System

Living systems have the most vitality and creativity when they are experiencing disturbance. Therefore, instead of creating stability, the new leader ensures that the organization is sufficiently “*de-stabilized*”. Some of the actions that new leaders take are: creating compelling goals that are audacious and inspiring; helping the organization obtain accurate and useful information and feedback from the ecosystem in which they are operating; developing organizations that truly value, rather than fear, different viewpoints; and helping employees use their anxiety, caused by change and disturbance, to stimulate their creativity.

c) *Cultivating the Organization*

Creativity and self-organization in living systems are contingent on having a clear identity, a high degree of autonomy among the systems agents, and openness (the free flow of information, interactions between agents, and diverse viewpoints). The new leaders should understand that the organization does not need to be controlled, but that it will generate its own order and respond creatively to the environment once these conditions are met.

The new leader's responsibility in assisting the organization in creating these conditions is: attempt to create the conditions where people can feel ownership for both their work and their company; actively promote collaboration, cooperation, and mutual enrichment; promote the diffusion of learning within the company and encourage diverse ideas and viewpoints; and seek ways to channel employees' vitality and creativity into positive and productive directions.

"Leadership" is not a position, nor something that is limited to certain people. It is a process in which every person in the organization participates. In such organizations, the goal is to hand over decision-making authority and power to individual employees. This will enable them to operate independently and creatively.

Case 2: BRL Hardy's New Business Model in the Global Wine Industry

Reinventing the Industry and Company

Among the companies studied in the wine industry, the one that took advantage of others' inflexibilities the best was BRL Hardy, an Australian wine company that defied many of the well-entrenched traditions of international wine production, trading, and distribution – despite the fact that its home country produces only 2% of the world's wine.

From a 1991 base of \$31 million in export sales – much of it bulk for private labels and the rest a potpourri of bottled products sold through distributors – Hardy built its foreign sales to \$178 million in 1998, almost all of it directly marketed as branded products. The insight that triggered this turnaround was the realization that for a lot of historical reasons, the wine business – unlike the soft-drinks or packaged-foods industries – had very few true multinational companies and therefore very few true global brands. This was a great opportunity waiting to be seized.

The inflexibility of the European practice could be attributed to labelling wines by region, subregion, and even village. A vineyard could be further categorized according to its historical quality classification. The resulting complexity not only confuses consumers but also fragments producers, whose small scale prevents them from building brand strength or distribution capability. This created an opportunity for major retailers to overcome consumers' confusion, and capture more value themselves, by buying in bulk and selling under the store's own label.

For decades, BRL Hardy's international business was caught in this trap. It distributed its Hardy label wines to retailers through local agents and sold bulk wine directly for private labels. But the company's insight, and its willingness to change the rules of the game on both the demand and supply sides, gave it a way out. First, new staff was appointed and new resources allocated to upgrade overseas sales offices. Instead of simply supporting the sales activities of distributing agents, they took direct control of the full sales, distribution, and marketing. Their primary objective was to establish Hardy as a viable global brand. The company's supply-side decision was even more significant. In order to exploit the growing marketing expertise of these overseas units, Hardy encouraged them to supplement their Australian product line by sourcing wine from around the world. Not only did Hardy offset the vintage uncertainties and currency risks of sourcing from a single country, it also gained clout in its dealings with retailers. By breaking the tradition of selling only its own wine, Hardy was able to build the scale necessary for creating strong brands and negotiating with retail stores.

The advantages have been clear and powerful. The company's range of wines – from Australia as well as France, Italy, and Chile – responds to supermarkets' needs to deal with a few broad line suppliers. At the same time, the scale of operation has supported the brand development so vital to pulling products out of the commodity range. Results have been outstanding. In Europe, the volume of Hardy's brands has increased 12-fold in seven years, making it the leading Australian wine brand in the huge UK market, and number two overall to Gallo in the United Kingdom. And branded products from other countries have grown to represent about a quarter of its European volume. Hardy has evolved from an Australian wine exporter to a truly global wine company.

Source: Bartlett & Ghoshal (2000, pp. 139-140). *Going Global: Lessons from Late Movers. Harvard Business Review*, 78(2).

4.4 An Overview of New Business Models Approaches and Techniques

The approaches for creating new business models discussed in the previous section are not meant to be exhaustive. However, they assist in creating an understanding and awareness of how companies can become adept in constantly reinventing their business models.

Both the Extended Value Chain Management (Govindarajan and Gupta, 2001) and Drivers of Customer Value Creation (Amit and Zott, 2001) place emphasis on creating value for customers in their approaches in developing new business models. This is the starting point they use from which competitive and successful business models can be created. These two approaches provide guidelines for companies in designing efficient and effective value chain architecture, increasing customer value by offering a comprehensive and integrated bundle of products and services, striving to be imaginative and innovative in finding new and unique ways of doing business, and locking-in a substantial share of the market. Accomplishing these will increase customer value proposition, and this in turn intensifies the firm's ability to reinvent itself and to change the rules of the game in its industry.

Revolutionary Thinking Approaches (Hamel, 1998) and Complexity Management Approaches (Youngblood, 1997) are techniques that encourage organizations to establish a setting where new business models can take place. These include, firstly, making innovation an outcome of a company-wide capability that combines a diverse and cohesive set of ideas and viewpoints from people throughout the organization. And secondly, creating an environment where the organization can self-organize and remain competitive by establishing a shared vision/identity, creating disorder that motivates creativity, and encouraging learning and promoting risk-taking.

In reviewing the above approaches in creating new business models, it is evident that Govindarajan and Gupta (2001) and Amit and Zott's (2001) approaches provide particular frameworks and dimensions for reinventing new business models. Hamel (1998) and Youngblood's (1997) approaches, on the other hand, provide ways for constructing a suitable environment or thinking that enable new business models to arise.

4.5 Summary

The need for innovation and creativity has become stronger in a competitive landscape where business models have shorter life cycles. Yet there is reluctance and hesitation in established organizations to let go of traditional ways of doing their business. Incumbents tend to follow established patterns of thinking and working despite dramatic environmental changes. However, it is critical for companies to acknowledge that the way to survive and thrive in this "new economy" is through unorthodox and unconventional methods.

This chapter discusses the obstacles established firms face by resisting changes. The traditional way of doing business and the limited perspectives of top management lead companies to falter in an era where constantly creating new business models is essential to becoming successful in a rapidly changing business environment.

A number of established approaches have been published on how companies and individuals can be creative and innovative, and this chapter has discussed some of the methods put forward by different authors in developing new business models, namely, Govindarajan and Gupta's (2001) approach to exploring the opportunities for changing the rules, Amit and Zott's (2001) four drivers for value creation, Hamel's (1998) "revolutionary thinking" about innovation, and Youngblood's (1997) approach to complexity management.

While these approaches are not meant to be comprehensive, they provide the frameworks and guidelines for creating new business models and the techniques for developing an environment conducive to innovation and imaginativeness.

CHAPTER 5

EVALUATION AND MEASUREMENT OF NEW BUSINESS MODELS

5.1 Introduction

A key question that arises is how organizations evaluate, or should evaluate, the relevancy of their existing business model and that of proposed business models.

Traditionally, the “fitness” of an organization was measured in various ways, e.g. profitability such as Return On Investment - ROI (McCrory and Gerstberger, 1992; Suutari, 2000/2001; Parks, 1993), Economic Value Added - EVA (Weaver, 2001; Dodd and Johns, 1999; McLaren, 1999; Brewer and Chandra, 1999), Balanced Scorecard (Kaplan and Norton, 1996; Allee, 1999; Stivers, 2000), and Increasing Intellectual Capital - ICI (Knight, 1999; Usoff *et al.*, 2002). These were mostly used for existing business models and applied in a historic, i.e. “after the fact”, context. This implies that historical measures are obtained to make after-the-fact inferences. The challenge that arises is how to measure – and evaluate – proposed new business models.

Pre-1990, the traditional way of doing business consisted of an organization doing a SWOT (Strength, Weakness, Opportunities, Threats) or Value Chain Analysis (Porter, 1985) and adjusting accordingly to the business environment. After 1990, however, with uncertainty, unpredictability, and rapid change in the business environment, there was a need for a dynamic tool. Thus, the Balanced Scorecard (Kaplan and Norton, 1996) is discussed in this study since this tool considers the changes that should take place in the organizational strategies, structures and processes as the result of changes in the new competitive business landscape.

This chapter illustrates firstly the relevancy of the Balanced Scorecard as one of the currently accepted business model fitness tools, and then suggests a new framework for measuring the relevancy of innovative (proposed) business models.

5.2 The Balanced Scorecard (BSC) as a Measurement Tool for New Business Models

In the “new economy”, businesses are confronted with new rules of competition and faced with the need to be fast and responsive to changes in the business environment. As discussed in section 3.3.1, competitive success in the new environment is achieved through acquiring and leveraging intangible assets (Stivers and Joyce, 2000). These include customer relationships; innovative products and services; responsive operating processes, skills and knowledge of the workforce; information technology that supports the workforce and links the firm to its customers and suppliers; and an organizational climate that encourages innovation, problem-solving, and improvement (Kaplan and Norton, 2001). Complementary to these changes is the realization that many performance measurement systems that performed well in the past are not effective in this new competitive environment (Stivers and Joyce, 2000; Kaplan and Norton, 1992; 2001).

One example is financial measurements. Kaplan and Norton (2001) put forward reasons why balance sheets do not provide a valid valuation of intangible assets. Firstly, assets such as knowledge and technology rarely have a direct impact on revenue and profit. Improvements in intangible assets affect financial outcomes through chains of cause-and-effect relationships involving intermediate stages. Secondly, the value from intangible assets cannot be separated from that of the organizational processes that bring about customer and financial outcomes. The balance sheet is a linear, additive model that records the value of each class of asset separately and adds up each asset to get a total amount. In contrast, the value created from investing in individual intangible assets is neither linear nor additive.

Accordingly, Kaplan and Norton introduced the Balanced Scorecard (BSC) as means of describing value-creating strategies that link intangible and tangible assets (1992; 1996; 2001).

5.2.1 Nature of the BSC

Kaplan and Norton's (1996) BSC supplements traditional financial measures with criteria that measure performance from three additional perspectives - those of customers, internal business processes, and learning and growth. This enables companies to measure financial results while at the same time monitoring progress in building the capabilities and acquiring the intangible assets required for future growth.

- ***Financial Perspective:*** This is the growth, profitability, and risk viewed from the perspective of the shareholder. The general purpose of profit-seeking companies is a significant increase in shareholder value. Companies increase economic value through revenue growth (revenue from new markets, products, and customers; and increased sales to existing customers) and productivity (improved cost structure and utilizing assets more efficiently).
- ***Customer Perspective:*** This is the strategy for creating value and differentiation from the perspective of the customer. It defines how the organization differentiates itself from competitors in attracting, retaining, and deepening relationships with targeted customers. Companies differentiate their offerings by selecting from among operational excellence, customer intimacy, and product and service leadership. Identifying value proposition helps a company to know which classes and types of customers to target.

The customer perspective also identifies the intended outcomes from delivering a differentiated value proposition. These would include market share in targeted

customer segments, account share with targeted customers, acquisition and retention of customers in the targeted segments, and customer profitability.

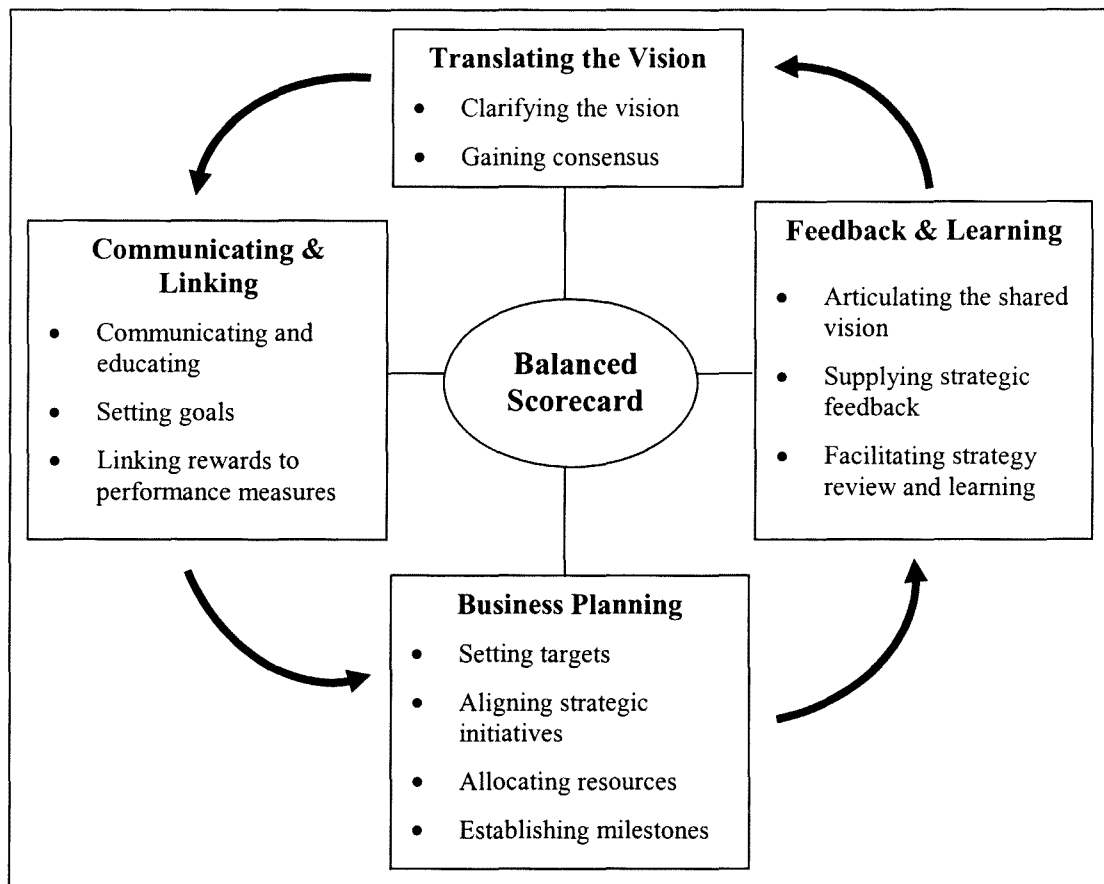
- ***Internal Business Processes Perspective:*** Once an organization has a clear picture of its customer and financial perspectives, it can determine the means by which it will achieve the differentiated value proposition for customers and the productivity improvements for the financial objectives. The scorecard usually identifies entirely new processes that an organization must possess to meet its financial and customer objectives.

The financial benefits from improvements to the different business processes typically occur in stages. Cost savings from increases in operational efficiencies and process improvements deliver short-term benefits. Revenue growth from enhancing customer relationships accrues in the intermediate term. Increased innovation generally produces long-term revenue and margin improvements. Thus, a complete strategy should generate returns from all three internal processes.

- ***Learning and Growth Perspective:*** This concerns the creation of an environment that supports organizational change, innovation, and growth. The other three perspectives reveal gaps between a firm's existing capabilities and those that it needs to achieve long-term growth and improvement. In the learning and growth perspective, managers define the employee capabilities and skills, technology, and corporate climate needed to support a strategy. These objectives enable a company to align its human resources and information technology with the strategic requirements from its critical internal business processes, differentiated value proposition, and customer relationships. After addressing the learning and growth perspective, companies have a complete "strategy map" with linkages across the four major perspectives.

When companies put emphasis on short-term financial measures, they leave a gap between the development of a strategy and its implementation. The BSC helps to introduce four new management processes that, separately and in combination, contribute to linking long-term strategic objectives with short-term actions (Kaplan and Norton, 1996). These are: translating the vision, communicating and linking, business planning, and feedback and learning (see Figure 5.1).

Figure 5.1: Four Processes in Managing Strategy



Source: Kaplan and Norton (1996, p. 77). Using the balanced scorecard as a strategic management system. *Harvard Business Review*, 74(1).

- ***Translating the Vision***: helps managers build a consensus around the organization's vision and strategy. Mission statements from the top do not easily translate into operational terms that provide useful guides for appropriate actions at lower levels. Vision and strategy statements, therefore, should be expressed as an integrated set of objectives and measures, agreed upon by all senior executives, that describe the long-

term drivers of success, and translated in a way that has meaning to the people who would accomplish the vision.

- ***Communicating and Linking:*** lets managers communicate their strategy throughout the organization and link it to departmental and individual objectives. Traditionally, departments are evaluated by their financial performance and individual incentives are tied to short-term financial goals. The BSC, however, gives managers a way of ensuring that all levels of the organization understand the long-term strategy and that both departmental and individual objectives are aligned with it.
- ***Business Planning:*** enables companies to integrate their business and financial plans. When organizations implement a variety of initiatives to achieve their strategic goals, managers often find it difficult to integrate these diverse change programs and ultimately reach unsatisfactory end results. The BSC measures can be used as the basis for allocating resources and setting priorities, and undertake and coordinate only those initiatives that contribute toward the company's long-term strategic objectives.
- ***Feedback and Learning:*** gives companies the capacity for strategic learning. Feedback and review processes focus on whether the company has met its budgeted financial goal. With the BSC, a company can monitor short-term results from the non-financial indicators (customers, internal business processes, and learning and growth) and evaluate strategy with regards to recent performance. The BSC thus enables companies to modify strategies to reflect real-time learning.

5.2.2 Relevancy of BSC

Most existing performance measurement systems have been designed by financial experts, and senior managers rarely get involved. However, the BSC ensures the involvement of

senior managers since they are the ones who have the most complete picture of the company's vision and priorities. Hence, the BSC helps to put strategy, and not control, at the centre (Kaplan and Norton, 1992).

Additionally, by translating their strategy into a "strategy map", organizations create a common and understandable course of action for all organizational units and employees (Kaplan and Norton, 2001). By putting strategy and vision at the centre, the BSC establishes goals but permits employees to adopt the required behaviours and actions necessary to attain those goals. Because of the constantly changing environment, the measures are intended to pull employees towards the overall vision, and not to control how they go about achieving the desired results (Kaplan and Norton, 1992).

A feature of the BSC is its dynamic nature. As long as the system is constantly reviewed and updated, the scorecard provides guidance to individuals in ensuring that their actions are consistent with the strategic goals of the organization (Stivers and Joyce, 2000). Information systems play an important role in BSC. By developing a responsive information system, the BSC information is timely and the measures can easily be linked to managers and employees at lower levels of the organization (Kaplan and Norton, 1992).

Another important aspect of the BSC is that it recognizes the impact of innovation and human capital to organizational success in the new business landscape and includes innovation, productivity, customer service, and employee involvement as critical measures. For instance, measurement of skill may identify a gap between future needs and existing competencies. This helps companies to invest in systems that help employees acquire the necessary skills and accurate and timely information about customers (Stivers and Joyce, 2000).

An additional attribute of the BSC is its double-loop learning that facilitates the reassessment of the strategy, or the techniques used to execute it, by taking into account the changing

conditions in the turbulent business environment. With double-loop feedback, it is possible to evaluate and determine whether the planned strategy is still viable in the continually changing environment or whether it needs to be changed. Therefore, the company not only requires single-loop learning to know if strategy is being implemented as planned but also a feedback as to whether the planned strategy is still appropriate and successful in light of emerging opportunities and threats that constantly arise in the business landscape. This may result in the formulation of an entirely new strategy (Kaplan and Norton, 1996).

Generally, the BSC is more than a performance measurement system. It is a management system that clarifies and translates organization vision and strategy; communicates and links strategic objectives and measures; focuses the efforts of all employees towards achieving strategic objectives; gives feedback on current performance so as to adapt priorities towards value improvement; and offers feedback on the key drivers of long-term future performance (Stivers and Joyce, 2000).

5.3.3 Limitations of the BSC

Currently, the BSC is a prevailing and widely accepted framework for defining performance measures and communicating objectives and vision throughout the organization. However, there are a number of limitations that hinder the BSC from properly measuring new business models. These are:

a) Focus on profitability

Even though the BSC has increased the awareness of intangible performance measurement, it seems that the financial perspective is given more weight. It takes into consideration customer's perspective, internal business processes, and innovation and learning, but ultimately it is focused on increasing profitability.

As mentioned in section 5.2, the value that develops from intangible assets has an indirect impact on profit and cannot be separated from the organizational processes that result in financial outcomes. A reason for top management to focus on financial results could be because it is difficult to understand and conceptualize the combined effects of intangible assets, such as satisfied customers or employee competence, while on the other hand, an account of the profit or loss of the organization is easy to prepare and comprehend. Therefore, with lack of guidelines and objectivity in measuring intangible assets, performance measures often favour financial measures.

b) Focus on customer satisfaction and not new customer value proposition

The BSC's "customer perspective" aims at redefining the organization's process to satisfy and match customers' expectations. Rometty (1999), however, describes that the value proposition customers are willing to pay has expanded in several important ways. The scope of offerings has spread out to include new bundled products and services, often from multiple parties (such as the customer, manufacturer, distributor) and discovering innovative products and services. Additionally, products themselves are becoming less important while product and complementary information are becoming more valuable.

To have sustainable competitive advantage, a firm's business model should enable the company to build and use its resources to offer its customers better value than its competitors. Therefore, instead of organizations merely attempting to achieve customer satisfaction, the new business environment demands that they discover and offer new ways of creating value for customers.

c) Focus on existing industry

Allee (1999) explains that the BSC has emerged in response to a need to measure and understand more of a company's dynamics other than through financial measures alone.

However, it still does not fully capture the essential nature of the “new economy” because it is too focused on an enterprise with traditional boundaries. Traditional thinking assumes the organization to be a relatively closed system except for very specific supplier inputs and outputs where there is direct revenue exchange with the customer. Conversely, a dynamic, whole-system view of the enterprise extends beyond the boundaries of the company to include dynamic exchanges with the larger society. The BSC begins to expand this view, but only in a limited way.

Boundaries in most industries have disappeared, or are in the process of disappearing, because of globalization, deregulation, and technological development (Ashkenas, 1999). Consequently, competition is no longer vertical and industry-specific, but horizontal and open to competitors outside the industry. That is, the company has to become “boundaryless” in the sense that it should make hierarchical and functional boundaries more permeable, and collaborate with customers, suppliers, competitors, and other important stakeholders. In general, in the global economy, companies no longer abide by or respect traditional industry paradigms and partitions (Oliver, 2002).

In order to have sustainable competitive advantage in the rapidly changing and unpredictable business environment, companies have to be quickly adaptable and easily flexible. To accomplish this they have to overturn business and industry models and create increasingly permeable boundaries (Moore and Curry, 1996). Moore (1993) uses the term “business ecosystem” to refer to a company that operates across a variety of industries, and therefore, should not be viewed as a member of a single industry but as part of a business ecosystem where companies work cooperatively and competitively.

According to Bradley and Nolan (1998), radical improvement in communication and technology enable companies to exchange information and coordinate activities in an effortless and cost-effective way. With this development, multimedia and networking

technologies make possible the creation and capturing of value in entirely new industries and are rapidly restructuring many existing industries by creating new sources of competitive advantage and devaluing existing ones.

The BSC framework fails to take into consideration the blurring of boundaries that has taken place, and is taking place, among industries in the globally competitive business environment. For global companies, therefore, performance measurements should cross organizational boundaries and take collaboration (inside and outside the organization) into account.

d) Focus on processes and not value chain configuration

The BSC encourages companies to identify, measure, and excel at the processes and competencies needed to be competitive in the rapidly changing environment. The measures link top management's decision about key internal processes and competencies to the actions taken by individuals that affect overall corporate objectives. This linkage ensures that employees at lower levels in the organization have clear targets for actions, decisions, and improvement activities that will contribute to the company's overall mission (Kaplan and Norton, 1992).

The BSC does not, however, take into account the growing importance of satisfying stakeholder requirements – as shareholders still remain the most important stakeholder. All relevant stakeholders such as investors, customers, employees, suppliers, government entities, and so on should be incorporated into the BSC. In identifying the key stakeholders of the organization and their requirements, it would be necessary to consider whether the organization has the strategies in place to address the needs of all the relevant stakeholders.

Amit and Zott (2001) also point out that scholars of strategic management increasingly recognize that the source of value creation lies in networks of firms. Business models may thus cross over industry and firm boundaries, with a network of capabilities drawn from

multiple stakeholders including customers, suppliers, and competitors. The authors indicate that there is a link between network configuration and value creation and that the locus of value creation may be the network rather than the firm. The potential alliance partners encompass suppliers, complementors, and customers with which the firm cooperates or competes. Customers, for instance, can play a critical role in value creation by working with the firm to better assess their needs and assist the firm to enhance their offerings to the customer (“prosumerism”, as discussed in section 3.3.6). Zineldin (1998) also indicates that it has become economically unsound to treat customers solely as buyers. Organizations should be able to consider final users as collaborators and partners in the value creation process; as value creators, and not merely as customers.

Therefore, companies seek to network with other organizations and entities to more effectively create, capture and provide value to customers (Bradley and Nolan, 1998). Allee (1999) also supports this view by explaining that a value network generates economic value through complex dynamic value exchanges between one or more enterprises, its customers, suppliers, strategic partners and the community. Within a value network there are many non-monetary exchanges of knowledge and benefits as well as revenue exchanges, and this is not addressed by the BSC.

Thus, in light of the limitations mentioned above, although the BSC is a viable approach for measuring performance in existing business models, it is insufficient for companies that create new business models or reinvent existing ones.

5.3 Systemic Business Model Tool for Measurement and Evaluation

The key elements of a business model are important sources of competitive advantage in the “new economy”. With a successful business model, an organization can create and deliver

value to customers and consequently confer a competitive advantage (Ethiraj *et al.*, 2000). The definition of a business model, therefore, is a useful basis for developing measurement and evaluation dimensions and tools for new business models. The definition of business models developed in the study is (see section 2.3):

The particular business concept (or “way of doing business”) as reflected by the business’s *core value proposition for customers*, its *configured value network* to provide that value, consisting of own strategic capabilities as well as other (e.g. outsourced/allianced) value networks, and its *leadership and governance enabling capabilities* to continually sustain and reinvent itself to satisfy the multiple objectives of its various stakeholders (including shareholders).

The above definition proposes that the main elements of a business model consists of three categories, viz.

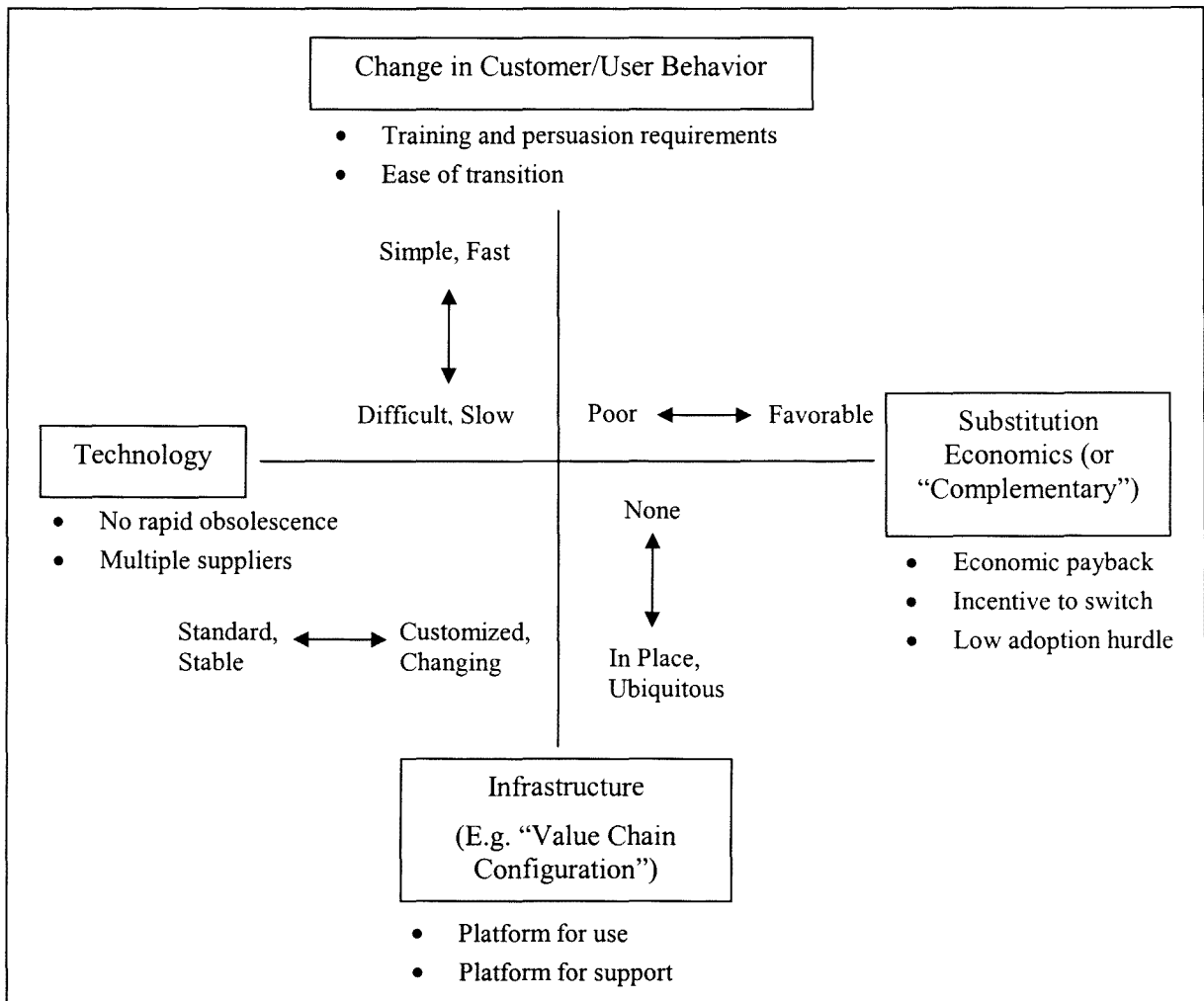
- new customer value proposition,
- a value network configuration for that value creation, and
- leadership capabilities that ensure the satisfaction of relevant stakeholders.

Figure 5.2 depicts the likelihood of a new business model and/or industry replacing an old (existing) one. As depicted in the figure, the probability to alter the old industry/business model increases as:

- the relative change in customer behaviour is simple and fast;
- the economic benefit, motivation to switch, and relative ease of use is favourable (substitution economics);
- the required infrastructure is in place and ubiquitous, facilitating the network configuration; and

- the existence of stable technological practices and standards minimize consumer investment risk.

Figure 5.2: Factors Determining Industry/Business Model Substitution



Adapted from: Bradley and Nolan (1998, p. 36). Sense & Respond – Capturing Value in the Network Era. Boston: Harvard Business School Press.

The arrows shown in the diagram represent the range within which companies are prepared to substitute the old business model for the new. The inner limits of the arrows represent the position where it is harder for the organization to change while the outer extremes indicate the ease with which they can easily reinvent themselves. In reality, companies may exist anywhere along the continuums depicted in the graph, and therefore, they should be able to assess where exactly they are positioned within these four dimensions.

The advantages in using this framework is it keeps in mind the dynamic nature of business models and, moreover, its consideration of critical dimensions, such as customer value creation, economic feasibility and the impact of technology and infrastructure. However, its envisaged limitation includes the need to have a deeper insight into the framework since it only illustrates the overall view of the dimensions.

Obviously, the above four aspects indicate only dimensions of measurement, and not particular tools or techniques. This should be further investigated as it falls outside the scope of this study.

5.4 Summary

Traditional performance measurement systems narrowly focus on short-term financial results. However, sustainable competitive advantage in today's business landscape is based more on intangible assets rather than on physical and financial capital. And since companies need timely measurements to control operations and get feedback on strategy achievement, the performance system they use should include both financial and non-financial measures.

The Balanced Scorecard is a dynamic performance management system that proposes management develops and uses a balanced set of financial and non-financial measures. This framework links the activities of an organization to its vision, mission, and strategy through the establishment of measurable goals and linked cause-and-effect performance indicators. The BSC, thereby, assists organizations to better serve their employees, customers, and shareholders.

Currently, although the BSC is an extensively used performance measurement framework for measuring existing business models, it falls short in evaluating new business models. This calls for the development of a measurement and evaluation framework that reflects the main

elements that comprise new business models. This chapter has proposed the dimensions of measurement that can be applied to construct the tools and techniques for measuring and evaluating new business models.

CHAPTER 6

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

6.1 Introduction

As indicated throughout this study, technological advancements, deregulation, and global competition have changed the business landscape within which companies operate. In order for these companies to have sustainable competitive advantage in the new, rapidly changing, and unpredictable environment, they should continuously renew or reinvent their business models. Nonetheless, the concept of “business models” is vaguely used and business publications do not offer a consistent definition and framework for the term.

This chapter provides a summary of the topics so far covered in this paper, and gives a synopsis of the main points put forward to offer an overall view of the study undertaken. Accordingly, the following section provides a condensed description of each chapter, followed by the conclusions derived from the course of the study, and the final section proposes relevant recommendations.

6.2 Summary

6.2.1 Chapter 1 – Introduction

Chapter 1 presented the background of the study where changes in the competitive landscape have led to the “new economy” with new rules of competition. In this new business environment, organizational strategic lifecycles are shorter, new business models continuously challenge existing and currently profitable ones, and unconventional thinking and imagination are the sources of wealth creation.

The study has pointed to the fact that the term “business model” lacks adequate definition and is used loosely and vaguely in academic literatures and publications. This often leads to confusion as to its use and application. In addition, there is lack of consensus about managerial approaches and techniques on the development of new business models. The problem statement follows from this observation. This, in turn, helped to delineate the objectives of the study, which are to identify the major components of business models, investigate the approaches and techniques in creating new business models, and examine the measurement and evaluation approaches applied to new business models. The subsequent sections discuss the method used for the study and an illustration of the overall structure of the study.

6.2.2 Chapter 2 – Business Models: Nature, Components and Working Definition

Chapter 2 highlights the inadequate definition for the term “business model” put forward in business literature. Although the term is widely used both in the academic and business world, and its importance rated as high, an analysis conducted by Schmid *et al.* (2001) revealed that there isn’t a comprehensive depiction of the dimensions and core components of business models. Consequently, Chapter 2 comprises a study of the nature and components of business models by examining a variety of established business model definitions, and ultimately provides a working definition of the concept.

The literature review reveals the various elements and components of business models offered by four publications, viz. Schmid *et al.* (2001), Viscio and Paternack (1996), Hamel (2000), and Ethiraj *et al.* (2000). The latter source has been used to describe the elements of e-business models. Overlapping and common elements have been extracted from the definitions proposed by these various authors to give a generic framework of business models for this study. Two points have been stressed in this section. Firstly, there isn’t a single set of business

model that applies to all companies and all industries, and secondly, a business model must generate a total system value that is higher than the sum total value of its individual components in order for value creation to take place.

6.2.3 Chapter 3 – The “New Economy” and New Business Models

Chapter 3 looks into the constantly and rapidly changing business environment and the relevance of creating new business models in such a new competitive landscape. Globalization, technology advancement and deregulation are the major driving forces behind this change that has led to what has been termed as the “new economy”. The new economy challenges the traditional rules of competition and has changed the nature of competitive advantage. In this newly emerged economy, companies have to be innovative, quickly adaptable and easily flexible to meet the demands of global competition. This chapter illustrates the numerous themes that distinguish the new economy from the old. It is important to understand these discontinuities and the impact they have on the successful transformation of businesses.

Chapter 3 further points out the significance of developing new business models in the new economy as the result of discontinuities occurring in the environment and the desperate head-to-head competition among companies operating with the same business model. This shows that despite the success of an existing business model, it is bound to be imitated by competitors and challenged by new business models. Therefore, a company should be able to change the rules within its industry and continuously reinvent its strategy if it is to survive and successfully compete in the globally competitive environment. Terms such as “non-linear/disruptive innovation” and “continuously changing the rules of the game” are used to describe ways to create wealth in the new economy by radically developing differentiated and unique business models.

An important differentiation is also made between efficiency and creating new business models. Customarily, as business models begin to lose their profitability and economic value, the reaction of most of companies is to optimize and improve the efficiency of existing business models. The competitive problems persist, however, because setbacks are viewed as a result of inefficiencies rather than of the changing competitive environment. Therefore, such hurdles should be resolved by reinventing the business/industry model in fundamental ways instead of merely improving inefficiencies.

The concept of first mover advantage is also touched upon where being a first mover in introducing new products/services helps to achieve high returns until competitors catch up and emulate the new strategy. Nevertheless, although early movers stand the chance of capturing certain competitive advantages, there are instances where they bear pioneering costs. In such cases, late followers learn from early movers' mistakes and successes, and acquire overlooked niches. Accordingly, it is critical for first movers to carefully consider their timing and the uncertainties they face when introducing their offerings.

Therefore, with shorter business model life cycles and a more intense competitive landscape, wealth creation in the new economy results from being unconventional, non-traditional, and radically innovative in creating new business models and/or reinventing existing ones.

6.2.4 Chapter 4 – Creating New Business Models: Approaches and Techniques

Chapter 4 builds on the understanding developed in Chapter 3 that it is vital for companies to get rid of industry orthodoxies and traditional ways of doing business. Adhering to established ways of doing business hinders the ability of a company to speedily and flexibly respond to changes in the business environment.

Chapter 4 primarily details the challenges incumbents face when competing in the new economy. The major dilemmas for established firms include: “good” management where managers unquestioningly follow the axioms of their industry; their incapacity to preemptively cannibalize established lucrative assets, investments and business models before competitors make their business obsolete; and lastly, which it all amounts to, their inability to unlearn past experience and success in order to learn to compete according to new rules of competition.

However, it is strongly emphasized that the obligation to avoid attachment to past successes and to recognize the necessity for continually creating new business models equally applies to both incumbents and insurgents. For this purpose, the approaches and techniques for creating new business models are discussed. These are Govindarajan and Gupta’s (2001) “extended value chain management” and Amit and Zott’s (2001) “drivers of customer value creation.” These two offer the framework and dimensions with which companies can reinvent themselves by creating new customer value proposition. Hamel’s (1998) “revolutionary thinking” and Youngblood’s (1997) “complexity management” approaches provide ways of establishing suitable environments that stimulate and encourage creativity, imaginativeness and innovativeness to assist and facilitate companies’ ability to renew themselves.

Chapter 4 also provides two case examples of Dell in the computer business and BRL Hardy in the wine industry. These cases illustrate how companies can reinvent themselves and the industry.

6.2.5 Chapter 5 – Evaluation and Measurement of New Business Models

Organizations evaluate the viability of their business models by using different measurement frameworks, such as Return on Investment, Intellectual Capital, and the Balanced Scorecard (BSC). Currently, the BSC is a prominent and widely used measurement framework, and

because of this, Chapter 5 deals with a detailed description of the BSC. The BSC is broadly discussed because it acknowledges and takes into account the significance of human capital and innovation to a company's competitive advantage, thereby complementing traditional financial measures with intangible assets. In addition, the BSC uses double-loop feedback and learning processes that continually review and update the system, ensuring that strategic goals of the company are in line with the changes that occur in the environment.

Chapter 5 also draws attention to some aspects that the BSC fails to address. Although the BSC is a major improvement to the evaluation methods that focus solely on short-term financial measures, it seems it is a feasible approach for measuring existing business models but inadequate for evaluating new business models. Its shortcomings include its strong emphasis on profitability; its focus on customer satisfaction and not new customer value proposition; its failure to take into account that competition and business models occur across traditional industry- and firm-specific boundaries; and its underestimation of the value creation that lies in the network configuration of firms. With these limitations in mind, and by drawing on the definition of business models proposed in Chapter 2, Chapter 5 has identified the measurement dimensions that could be used to create a framework that assist in evaluating new business models/industries. These dimensions merely reflect the core elements that define business models, and do not provide particular tools for measurement. Further investigation in this field is suggested.

6.2.6 Chapter 6 – Summary, Conclusions and Recommendations

Chapter 6 briefly outlines and recapitulates the relevant subject matters presented in this study. This is subsequently followed by conclusions made during the analysis. The final section provides recommendations for an enhanced understanding of the concept “new business models.”

6.3 Conclusions

The primary objectives of the research underlying this study were (1) to develop a conceptual structure for the term “business model” and identify its key components; (2) to investigate the different approaches and techniques in creating new business models; and (3) to analyze the measurement and evaluation instruments proposed for new business models. Given these objectives, and in view of the finding of the study, it is evident that all three of the objectives of the study have been satisfactorily achieved.

The conclusions that could be made on the basis of the problems indicated in Chapter 1 are as follows:

- (i) Firstly, from extant research evidence it is clear that the concept of a “business model” is one that is ambiguously used and little understood. Although the term is widely used, it is often without a clear and consistent definition that clarifies its core dimensions. However, a comprehensible and unambiguous definition is needed as a useful unit of analysis for organizational strategy.

Literature analysis has revealed that the few definitions put forward by various authors lack consensus on the elements that compose business models. Although it has been pointed out that there isn't a single set of business model that applies to all companies and industries, a cohesive definition was not discovered either in academic literature or strategic management publications. However, similarities and generic dimensions from published definitions have been used to arrive at a working definition of business models for this study. With this definition, it has been possible to propose the basic elements in business models. These are: new customer value proposition; a value network configuration to create that value; and leadership capabilities that ensure the satisfaction of relevant stakeholders.

- (ii) Companies are faced with the challenge of constantly reinventing their business model/industry in order to be competitive in a business environment that is rapidly changing and has become unpredictable. Although the importance of getting rid of traditional ways of doing business is widely discussed, it seems both incumbents and new entrants to an industry do not know how to go about in “continuously reinventing” themselves.

The study has discussed approaches that provide guidelines for creating new business models and the techniques that can be used to facilitate the organization’s innovativeness and imaginativeness. With these approaches and techniques, organizations can have the insight and awareness on how to set about reinventing themselves and keeping ahead of the competitive pack.

- (iii) The Balanced Scorecard is a major evaluation and performance measurement tool currently in use. This framework, however, is not sufficient to evaluate new or proposed business models. During the course of this study it has been shown that a measurement and evaluation tool for new business models is lacking. Consequently, a framework designed for determining the likelihood of an old industry (or business model) being substituted by a new one has been used. This framework takes into consideration the dynamic nature of business models and takes into account customer value proposition, economic feasibility, and the impact of technology and infrastructure. The proposed framework, however, does not provide specific tools for measurement and evaluation for new business models, but it presents a framework that can potentially be extended to develop a systemic measurement tool for new business models.

As a brief summary of the points so far mentioned above, the study has discovered that there are deficiencies, in relation to current literature, on the formulation of a clear definition of the

term “business model”, which in turn leads to insufficient understanding of the concept of new business models; inadequate pointers for providing approaches on how companies can constantly create and develop new business models; and lack of a measurement framework for evaluating new business models and/or industries. Hence, the following section provides recommendations to modify these shortcomings.

6.4 Recommendations

As extensively discussed in this study, there is a need for an enhanced understanding of the concept “business model”. A clear and cohesive definition provides clarity on the dimensions and scope of “new business models”. That is, a comprehensive, generic conceptualization of the term “business model” will aid in the understanding of the core elements that can be manipulated to help organizations compete in a business landscape where traditional means of competition have completely changed. The understanding of such a critical concept and an appreciation of the driving forces behind the discontinuities in and across industries (and the impact they have on the operations of an organization) would assist companies in realizing the significance of developing new business models in the new economy.

Moreover, existing evaluation and measurement frameworks, such as the BSC, assess the viability of current business models. These performance measurement tools, however, are inadequate for evaluating new business models and/or industries. This study has basically suggested four dimensions that could be expanded to develop a framework that could evaluate the performance of proposed business models and/or industries.

In view of a perceived lack of a clear definition of business models and of a measurement tool for new business models, there is a need for further research to develop a more consistent and comprehensive definition for business models and a systemic evaluation and measurement tool for new business models. The particular recommendations for future research are:

- The new working definition of a business model, resulting from this study, should be further refined, expanded and empirically tested in order to achieve wider validity of the term.
- The major issue of adaptation/change of business models by organizations should be a high priority in any further research efforts. Some guidelines and methodologies have been suggested in this study, but these should be further researched.
- The “preliminary dimensions” for measuring and evaluating the viability of a business model, as developed in this study, should be further investigated, refined and empirically tested, to move towards commonly accepted generic measures.

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