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THE VALUE POTENTIAL OF NEW BUSINESS MODELS

One attempt to regain the ground that strategy has recently lost, which was described in the first article, has been the introduction of "business models" as the precursor to competitive positioning within an industry. Understanding a business model provides a shorthand description of how value is created - although the business model, by itself, does not determine how profitable it will be for any firm: for that we need to examine the complete strategy landscape.

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

All companies will have some business model. But a business model is not company specific since any number of firms can adopt a given business model - think Lyft and Uber in ride sharing. Similarly, firms pursuing multiple business models can compete for the same customer –as with taxis and ride sharing companies. This recalls the earlier notion of "strategic groups" in that there can be different ways of competing within the same industry. A private label manufacturer is in a different "strategic group" from, or competes with a different "business model", than a branded CPG company.

In contrast, while every company should have a strategy, no two firms should have the same strategy. What determines the relative success of those pursuing the same business model, such as Lyft and Uber, is their specific strategy - how they translate the business model into their target product/customer (scope), and value proposition and activity set (competitive advantage).

I do not know how many entrepreneurial presentations I have seen that begin with the slide "We are the Uber / Blue Apron / Tinder….. (substitute your favourite new venture success here)… of the such and such industry." The analogy conveys an instantaneous picture of the market need to be satisfied and the broad set of resources required.

"Job to be done"

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

[1] See Christensen HBR, Pisano HBR, Eisenmann Note, Tushman FIND, Baden-Fuller, St Gallen …. Cf Ramon…

The target customer need not be identified in the business model because customer scope is a strategic choice. One way to see that is to recognize that an invalid choice of customer – women for ride sharing – can ruin a strategy, as Safr found out - but does not invalidate the business model per se. Similarly, if the job to be done by Soul Cycle is as much about building community as physical exercise, the business model need not define the target customer or the specific form of exercise. Soul Cycle can be spin classes for mothers on the Upper West Side of Manhattan, while Golds gym could be pursuing a very different strategy of weightlifting for twenty-something men within the same business model. Strategy is where the choice of scope clarifies exactly who the "job" is to be done for, and so identifies the addressable market and the **size** of the opportunity. [2]

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

Asset configuration

The asset configuration element of a business model describes the set of assets required to deliver the product or service to the end consumer. This includes, among others, manufacturing assets (if any), technology choices, as well as distribution channels and customer relationships. One obvious way to differentiate "job to be done" from asset configuration is to compare and contrast Uber and Lyft with taxi service. Each satisfies the exact same 'job to be done" – immediate transportation. The difference is entirely in the asset configuration. Uber and Lyft are asset light versions of the taxi business, with vehicles owned by drivers, not by the company itself.

It is important to realise that assets extend beyond the obvious physical assets. It is better to think of this as the **stock of resources and capabilities** that are involved in the fulfillment of the job to be done[3]. This might include a brand name – which distinguishes, for example, the branded CPG business model from the private label version; or distribution channels – which distinguishes a company like chain saw manufacturer Stihl that only distributes through servicing dealers, from a competitor, like Homelite, that distributes through broad channels including mass retailers; or the mastery of merchandising in the online space – a very different skill than merchandising within a physical store.

Note that it is a novel asset configuration that represents an "existential" threat to incumbents. Lost in the attention paid to disruption has been the classic way to supercede established competitors by exploiting a radical innovation, or asset architecture. If this occurs, it is not only organizational inertia that prevents the incumbent adopting the new approach but also the struggle to build or acquire the

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

[3] See Collis and Montgomery HBR "Resources"

novel set of skills, capabilities and, sometimes, technologies. The incumbent with the current business model literally becomes an entrant into the new model and likely fails as often as other entrants.

Revenue Model

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

Companies used to simply charge for each transaction. There were surely debates about how much to charge as "value pricing" and "demand elasticity" determined how to extract the maximum revenue from a customer (which highlights that this aspect of pricing concerns value capture). But there was little debate around **how** the customer was charged. Today there is enormous attention paid to the source of revenue and how that, in turn, affects customer value creation. This is not about choosing where along the demand curve to price, but the prior question of the method of charging that determines the shape of the demand curve itself.

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

The box describes the full set of revenue models that can be considered, but as with asset configuration the essence of the business model can be readily captured. As Mark Zuckerberg notoriously noted to a Senate committee, Facebook monetizes its service through advertising, and perhaps less visibly by selling data, not in charging for the application itself!

BOX **REVENUE MODELS**

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

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

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

The third, and certainly most interesting in terms of recent changes, is the dimension of **who** pays. While historically the direct beneficiary of the product or service was charged, today there are

many other participants who can contribute to monetization. The service might be free to the user because another party is charged for access to the user - as in the traditional newspaper business or the Google search engine which are paid for by the advertiser. Indeed any platform provider has to decide which side of the platform should pay. Should I charge men to list on a dating site, but let women join for free? Charge both equally[4]? The product or service can even be free for initial users and only paid for by those who buy additional features ("freemium"), or items (as in in-game purchases, or the paywall that hits once a user has visited a newspaper site a set number of times). Or it might be free because the private information generated by the user is sold on to third parties as data - the model of most internet platform companies, such as Facebook, and of a new coffee shop chain, Shiru Cafe, which offers free coffee to students in return for access to their data.

As you can see, the alternatives quickly expand (and I suspect I have not classified all the possible monetization schemes that creative minds can envisage) and have a dramatic impact on value creation and how to build a competitive advantage. Particularly when developing a new business model, the choice of monetisation scheme can have a radical effect on the viability of the opportunity.

END BOX

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

As an example, let's revisit WhatsApp which pioneered the simple, reliable, clean messaging app for smart phones and was bought by Facebook for $22 billion when it had about 600 million users, revenue of $20 million, and less than 100 employees. Talk about a valuation – 1000 times revenue! And the value potential of the business model is enormous. Within about ten years of the introduction of this and other similar apps, about half the world was using them! Unbelievable. Surely the fastest adoption rate of all time.

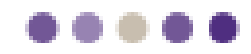
But that value potential inherent in the business model does not mean that WhatsApp will make vast amounts of money. Even if we set aside industry structure – the classic Five Forces – and debate whether network effects produce sustainable advantages for a first mover in a geography – which is not so apparent when users multi-home and can switch apps costlessly – there is still a business model question. To date, WhatsApp has barely earned any revenue because it is a free app, has no advertising, and maintains that no data is sold to third parties. A business model with zero revenue is not likely to be very profitable, however much value is created for the user! Note that Facebook is now planning

[4] Economic theory does have some useful guidance on this subject, see …. PRICING on PLatforms

fundamental change to the WhatsApp business model which has led to the co-founders and the most recent CEO leaving the company under protest.

Value Creation and Business Models

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



Value creation and new business models

Job to be done

Assets	Different	Better	Same	Inferior
New	**RADICAL INNOVATION** Polaroid, Xerox	PC, Amazon	**DISRUPTION** Uber, Airbnb	Netflix, Coursera
Same	**ONGOING OPTIMISATION** Cirque du Soleil	iPhone	**DON'T GO THERE** X	X

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In a simplification, the "job to de done" dimension in the figure ranges from inferior through better to "different", while the asset configuration dimension ranges from similar to novel combination of assets[5]. Note that a "better job" could either be a lower cost version of the same product or service (as in the case of Uber versus taxis), or a "higher willingness to pay" created through an improvement to the satisfaction of customer needs as in the latest, and most expensive, version of the i-phone. Note also that the "inferior" box can fold around to become "different" in ways that will be explained below[6].

RADICAL INNOVATION

The top left is the space of radical "innovation" and historic breakthrough business models that leverage, typically, a new technology to create a wonderful and completely novel product. Photocopying and the first Polaroid camera had enormous impact because they delivered something that did not previously exist from a new technology. Stories that the predicted total worldwide demand for

[5] The matrix is similar to the "What do, How do" of McDonald et al.

[6] The continuum along the two axes are intentionally ambiguous. A "better" job is increasing the pixels, and hence the resolution of a smartphone camera. But is adding a new feature, such as photo-shopping a snap, making that phone different or better? Similarly, while nearly all the technology was existing prior to the i-phone, some specific aspects of the phone did use novel technologies.

computers would only ever be for three units, illustrate just how inconceivable such a product was on its first appearance.

Similarly, the personal computer – even if it did not perform a novel function since word processors and calculators already existed – clearly performed those functions better than existing business models. Amazon uses a completely different asset configuration than brick and mortar retailers by selling online with a distinctive logistics system based on fulfillment centres and vans to pick and deliver individual items to the home. The success of both business models demonstrates the value created by performing a better job with novel assets.

Radical innovation, such as these examples, is the obvious way to create enormous value, even though its rarity shows how difficult it is to achieve in practice. Importantly, all incumbents usually pay attention to this avenue of improvement (even Walmart launched its version of online retailing just four years after Amazon started selling books online), typically by crafting product development portfolios that allocate adequate investment to Horizon 3 opportunities[7], and will embrace the market when it appears – if they can actually master the new technology themselves. Walmart, for example, has taken nearly twenty years to get its act together in online retailing.

DON'T GO THERE

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

ONGOING OPTIMISATION

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

Innovations here do create value, even if only slowly and steadily as incumbents try to push the frontiers of their product or service in the twin directions of improving performance and lowering cost. Both are aspects of the challenges faced each and every day, and which constitute 80% of the management task. Without the perennial drive for continuous quality improvements matched by operational attention to cost, a firm is condemned to failure, and yet achieving them is merely a sine qua non of staying in business. This is the red queen problem – running hard to stay in place – because all others with the same business model are also relentlessly driving improvements on both dimensions.

More creative, but still employing the existing business model to create value, is the far lower left quadrant. This is the domain of Blue Ocean strategy. Rather than trying to outperform existing products or services on criteria that are well known and demanded by customers, the business model seeks to introduce novel criteria that have previously been downplayed, underprovided, or

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[7] Ref to Horizons and bob Hayes et al new product development portfolios

undiscovered in the old “job to be done”. In this regard, Blue Ocean primarily operates within the space of “job to be done” for the customer rather than exploiting a novel asset base.

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

DISRUPTION

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

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

This explanation of disruption is really just an extension of “blue ocean strategy”. Find a set of purchase criteria that are currently over-satisfied and remove or reduce them (quality and speed to read in the two examples above) and/or find a few purchase criteria that are currently under-satisfied for a set of customers and add them into the offering (cost and size in the examples). Disruption makes the point that removing, minimizing, or failing to satisfy the needs of most existing customers is not the death knell of a new business model. If it is a superior offering in some ways to some customers, it can still be successful.

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

Thus, the greatest threat to incumbent business models comes from the threat posed by new asset configurations not the low end product offering. While it is true that there are good reasons why incumbents do not pursue low end versions of their offerings, the existential risk of not doing so is only present if the entrants exploit a different set of assets that incumbents find hard to replicate.

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

IMPLICATIONS

We can now posit a strategic mandate for mastering business model evolution which will depend on the threat or opportunity posed by changes in the opportunity set. First, every firm must strive to continuously improve by optimizing and exploiting opportunities in the bottom left quadrant, whether these are ongoing cost reductions, or value improvements or recombinations – the sine qua non of competition. In fact, actions here are the initiatives required to continually adapt the existing business model and strategy to the ever changing environment and opportunity set. This is the realm where most of the recent practice of strategy occurs and is vital to the ongoing realization of value (see third article).

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

Third, the bottom right quadrant should be avoided!

And finally, and this is the contribution of Christensen, the potential for innovation in the "inferior but different" quadrant cannot be ignored. When Intel CEO, Andy Grove, wrote "Only the Paranoid survive" it was this quadrant that he had in mind! Here the strategic mandate is to adopt skunk works and support new ventures to override the inherent conservative tendencies of successful organizations.

Consider again Edward Jones, the subject of my earlier article, "Can you Say what your Strategy is?" There I illustrated how successful the firm had been with a distinctive value proposition for a narrow set of customers delivered through its unique national network of one FA offices. This was the strategy pursued for the last forty years that has made it the largest brokerage firm in the US by number of financial advisors with over $1 trillion in assets under management. The firm is now changing. Why? Because the business model, not the strategy itself, is being reinvented.

The classic, and unique, Edward Jones business model (not the strategy) was "selling a conservative long term set of investments through a national network of one FA offices charging commissions on transactions". Note the three elements: job to be done is "conservative way to invest for the long term"; asset configuration is the network of one FA offices; and revenue model is a charge

for each transaction. This model worked beautifully and created a huge amount of value – both for clients and the firm.

Unfortunately the value that can be captured from this business model has disappeared (see the first article). The challenge for Edward Jones is therefore to shift from this product sale or "transactional" approach to a "solutions" business model that creates more value for customers, not to squeeze any further advantage by refining its strategy to extract the tiny margin left in the traditional business model. The monetization method becomes a fee charged as a percentage of assets under management (although in the long run this might shift to an hourly rate like other professional services firms). The "job to be done" expands to "providing personalized financial solutions" that starts from understanding the full range of customer needs and provides customised solutions for each of them.

The tricky question for Edward Jones to consider in the new business model is the asset base. The reliance on bricks and mortar individual offices as the foundation of the personal relationship could well be superceded by the willingness of millennial customers to comfortably engage in a personal relationship that is technologically mediated rather than face-to-face. A "Franchise" model of single FA offices, which is one way to characterize the traditional model, might not be capable of delivering the "professional services" model that is the future of the firm. Can Edward Jones continue to cost effectively deliver the new job to be done through the one FA office, or does it need to alter the asset configuration to incorporate technologically enabled channels, such as online and call center, while at the same time drawing on a broader set of capabilities than a single FA can master and deliver alone? If the latter is the case, and Edward Jones is now offering Connection – a service where a client's broker (who is still responsible for that individual's account) based in St Louis is contacted by phone – then all three elements of the business model will have changed, even though the strategy stays the same.

Where does this place Edward Jones on the business model grid? The approach is clearly to deliver a different and better job to be done to create more value for clients by, at least at the moment, exploiting the national single FA office network as the core asset. This might explain why there was little opposition to expanding the job to be done inside the firm. While the intent has been to build off the current asset configuration, if it turns out that effective delivery of the service requires more technology based solutions and more support from specialists at home office who have the relevant advanced expertise, the firm might have to shift the asset configuration. That will be a real challenge as altering the asset base is the existential threat to any firm adopting a new business model.

The matrix provides the framing for investigations of new business models. The challenge facing every firm can come from any of the four cells of the business model matrix. And yet none of those cells concerns strategic positioning to capture the defined value offered within any particular business model. The struggle is to find ways to create more value – to alter the size of the pie - not merely to position yourself to capture more of the current pie. Strategists have been offering partial solutions, but now the magnitude of the challenge – and the opportunity – can be made clear. Firms need to be looking to the future and developing ideas and responding to threats in at least three of the four cells – pursuing all options for value creation. Pitched this way, I think you can see why value creation is so important and why ignoring its potential has downgraded the efficacy of strategy as practiced in most firms for the last twenty years.