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THE INNOVATION IS IN THE BUSINESS MODEL

When Roger and Linda Mason decided to start a child-care company in 1987, they couldn't have chosen a less attractive industry! The child-care industry in the United States was run as a commodity business, characterized by low margins, no barriers to entry, few economies of scale, massive labor intensity, and no brand distinction. Yet the Masons succeeded in building their new company—Bright Horizons—into the world's leading provider of employer-sponsored child care, early education, and work-life solutions, operating more than six hundred centers for the world's leading employers in the United States, Europe, and Canada. Plus, they did all this while delivering high returns—on average, a 50 percent return on invested capital per center. How did they do it?

The secret of their success lies in the business model that they developed to compete in this market.[1] Rather than target parents as prospective customers (as all other child-care centers did), Bright Horizons's founders focused on employers. Rather than build their own centers at locations of their choosing, they formed partnerships with employers who financed the building of centers on their premises. Rather than compete on cost, they differentiated themselves on quality. Rather than pay their teachers an average salary to control their costs, they offered 20–30 percent above average compensation along with comprehensive benefits. And rather than offer a standardized curriculum in every center, they customized the centers so that their design, hours of operation, and age-group configuration matched the requirements and needs of their clients. In short, Bright Horizons built and exploited a business model in the day-care industry that was fundamentally different from the business model that the established competitors were using.

Note that Bright Horizons did not discover a new product—what they offer is still child-care services, very much like all other competitors in this market. But they do so in a fundamentally different way and to a fundamentally different customer from the one all other competitors address. In other words, Bright Horizons innovated in its market, but the innovation is not in discovering new products or technologies—it is in discovering a new *business model.*

Numerous other companies that innovated in this manner spring to mind. For example, when Jeff Bezos founded Amazon in 1995, he introduced a new business model in the book retailing business that was manifestly different from the business model that traditional players like Borders and Barnes & Noble employed at the time. Similarly, companies such as Charles Schwab, easyJet, IKEA, Netflix, Home Depot, and Dell are all examples of innovators who attacked their competitors in their respective industries not by introducing new products or technologies but by applying different business models. New business models have been invading existing markets with increasing frequency, and Table 1.1 lists just a few of the industries that have been affected. Appendix A at the end of the book describes the stories of some less well-known business-model innovators of the last twenty years.

What Is a Business Model?

What exactly is a business model? Different people have given different answers to this question (for example, Casadesus-Masanell and Ricart, 2007; Hambrick and Fredrickson, 2001; Johnson and

Table 1.1. Examples of Business-Model Innovations.

Industry	*New Business Model*	*Innovator(s) and Date of Introduction*
General retailing (U.S.)	Online distribution • Books • Music	Amazon.com: • July 1995 • June 1998
Car rental industry (U.S.)	Focusing on a different type of customers, and operating an extensive network of car rental offices located in cities, rather than at major airports	Enterprise Rent-A-Car: 1957
Computer industry (U.S.)	Selling computers directly to customers	Dell Computer: 1983
Retail brokerage industry (U.S.)	Online trading	Aufhauser & Co.: 1994 E-Trade, Charles Schwab: 1996
Retail brokerage industry (U.S.)	Operating an extensive network of single-broker offices across the country as separate profit centers	Edward Jones & Co.: 1972 (when the company formally adopted the new business model)
Steel industry (U.S.)	Introduction of minimills (a low-cost production method to make flat-rolled sheet steel, a high-end steel product)	Nucor Corporation: 1969 (introduced the world's first continuous thin-slab casting facility for sheet steel)
Automobile industry (Europe)	Mass-customized cars	Smart car (by DaimlerChrysler): October 1998
Used car business (U.S.)	A new retail and distribution method for selling used cars (extensive refurbishing of cars, product guarantees, no-haggle pricing, and sophisticated use of in-house financing)	AutoNation USA, CarMax: 1996

(*Continued*)

Table 1.1. (continued)

Industry	*New Business Model*	*Innovator(s) and Date of Introduction*
Banking industry (U.K.)	Direct banking • Telephone banking • PC banking • Online banking	First Direct: • October 1989 • May 1996 • Summer 1997
General insurance industry (U.K.)	Direct insurance • Direct motor insurance • Direct home insurance	Direct Line Insurance • April 1985 • Autumn 1993
Life insurance and pensions industry (U.K.)	Direct life insurance and personal pensions	Virgin Direct: June 1996
Airline industry (Europe)	Low-cost, no-frills, point-to-point airline service	Ryanair: 1991 (routes between U.K. and Ireland only) easyJet: November 1995
Retail supermarket industry (U.K.)	Home-delivery grocery service	Food Ferry Co., Teleshop: Early 1990s (London area only)
	Online home-delivery grocery service	Tesco Direct: 1998 (now part of Tesco .com, launched in 2000)
Stock exchanges (Europe and North America)	Electronic communications networks (ECNs)	OM Exchange: 1984 (Recently, new ECNs such as Instinet, Island, and OptiMark were introduced in European and North American exchanges)

Suskewicz, 2007; Markides, 1997; Mitchell and Coles, 2003; Slywotzky, 1996; Slywotzky and Morrison, 2002; Voelpel, Leibold, Tekie, and Von Krogh, 2005). Consider just three of the definitions that have been provided in the business literature. Slywotzky (both independently and with Morrison) argued that a business model is made up of the decisions that a company makes on eleven dimensions:

- Fundamental assumptions about the business
- Customers selected
- Scope of activities
- Source of differentiation
- Value recapture
- Purchasing system
- Manufacturing system
- Capital intensity
- R&D and product development system
- Organizational configuration
- Go-to-market mechanism

On the other hand, Hambrick and Fredrickson identified five key elements that make up a business model:

- Where will we be active (and with how much emphasis)?
- How will we get there?
- How will we win?
- How will we obtain our returns?
- What will be our speed and sequence of moves?

And Mitchell and Coles (p. 3) provided a definition that includes six main elements, namely: "the who, what, when, where, why and how much a company uses to provide its goods and services and receive value for its efforts."

For the purposes of this book, I will use a simpler definition based on the pioneering work of Derek Abell (1980), who held that a business model is the sum of the answers that a company gives to these three interrelated questions:

- *Who* should I target as customers?
- *What* products or services should I be offering them and what should be my (differentiated) value proposition?
- *How* should I do this in an efficient way?

While I do not pretend that the definition adopted here is exhaustive or better than all the others proposed by other people, I do believe that it is adequate for the purposes of exploring business-model innovation.

The Who-What-How decisions define the parameters within which the company will operate. By definition, they also determine the terrain for which the company will *not* fight: the customers it will not pursue, the investments it will not finance, the competitors it will not respond to. As a result, these decisions are painful to make and are often preceded by internal arguments, disagreements, and politicking. But unless a decision is taken, the company will find itself spreading its limited resources too widely with no clear focus or direction.

The answers to the Who-What-How questions form the heart of the strategy of any company—in fact some will argue that the combined answer to these questions *is* the strategy of a company. One could enlarge this definition of strategy to incorporate the When-Where-Why questions as well, but the added complexity is not necessary to understand how and when companies pursue business-model innovation.

What Is an Innovation?

To qualify as an innovation, the new business model must not only be new to the innovating company but also *new to the world*. For this to happen, the new business model must be offering something that nobody else is currently offering. This might seem an unusually high hurdle to jump, but what it effectively means is that the innovation must not only steal market share from established competitors but *should also enlarge the existing economic pie*—either by attracting new customers into the market or by encouraging existing customers to consume more. In this sense, the innovation *creates value* rather than simply being a value transfer from one firm to another.

This implies that business-model innovation is much more than the discovery of a radical new strategy on the part of a firm. For example, IBM's change of strategy in the early 1990s, radical as it may have been, is not a business-model innovation. On the other hand, companies such as Amazon, Schwab, Dell, IKEA, Swatch, and Southwest are considered business-model innovators because they introduced new business models in their respective markets that attracted new consumers or got existing consumers to consume more (and so enlarged their markets).

It is important to note that business-model innovators do not discover new products or services—they simply redefine what an existing product or service is and how it is provided to the customer. For example, Amazon did not discover bookselling—it redefined what the service is all about, what the customer gets out of it, and how the service is provided to the customer. Similarly, Swatch did not discover the watch—it redefined what this product is and why the customer should buy it. In short, the innovation is in the discovery of a different business model (not product) in an existing industry.

Making an assessment whether a new business model is really different from an established one is, obviously, a very subjective exercise. Nevertheless, it is possible to measure the level of difference in a systematic way. For example, Table 1.2 uses the Slywotzky (1996) definition of a business model to list a number of questions that could be asked to assess whether a new business model in an industry is different to the existing one.

Table 1.2. Competitive Dimensions for New Business Models.

Competitive Dimension	*Key Questions*
Fundamental assumptions	Compared to the existing business, does the new strategic position aim to satisfy a different set of customers' priorities? Are the profit drivers for the new business different from those of the existing business?
Customer selection	Compared to the existing business, does the new strategic position aim to serve a different type of customer?
Scope	Compared to the existing business, does the new strategic position involve a different product or service? Does the new position require a different set of activities?
Differentiation	Compared to the existing business, does the new strategic position have a different basis for differentiation? Is the value proposition for the new business different from that offered by incumbent firms in the existing business?
Manufacturing and operating system	Compared to the existing business, does the new strategic position involve a different kind of manufacturing or service delivery economics and methods?
Organizational configuration	Compared to the existing business, does the new strategic position involve a different organizational structure?
Go-to-market mechanism	Compared to the existing business, does the new strategic position use a different distribution method to deliver the products or services to the market?

Source: Adapted from Slywotzky, 1996.

Characteristics of Business-Model Innovations

All business-model innovations share certain common characteristics. They tend to invade existing industries in a very specific way, grow in a specific manner, and display characteristics that make them disruptive to established firms. To illustrate these points, here's an example.

The Online Brokerage Market

In 1996, online trading emerged as a new way of doing business in the U.S. retail brokerage industry.[2] Companies such as E-Trade, Charles Schwab, Ameritrade, and Fidelity were among the first to offer low-cost online trading to customers, thereby creating a new customer segment and a new way of competing in the industry. Since then, online trading in the United States has experienced dramatic growth. A study by Morgan Stanley Dean Witter estimated that online accounts would increase from 5.7 million (or 9 percent of total retail accounts) in 1998 to approximately 44 million online accounts (or 50 percent of total retail accounts) by 2003.[3] Several other studies have estimated that online trading now represents a multibillion-dollar industry that accounts for more than 50 percent of all retail trades.

Compared to traditional brokerage, online trading represented a fundamentally different way of competing in this business. Whereas full-service brokerage houses relied on an extensive network of brokers and branch offices to build relationships with customers, online traders relied on impersonal transactions to execute trades. And whereas traditional brokerage houses based their fees on the research and advice that they provided to customers, the online traders' value proposition was low price and speed of execution.

Even though revenues per trade were lower for Internet brokers, increased usage (investors traded more frequently once they were online) as well as lower operating costs made these online services potentially highly profitable. The online brokers' lower operating cost base was reflected in the low prices (commissions) that they charge. But they offered much more than just lower prices. Increasingly, online brokers provided clients with a broad range of investment research from third-party sources, enabling private investors to make objective decisions and take investment actions on their own. These services included access to real-time, personalized market information and financial data, news, company research, market analysis, and other investment information services. Moreover, online tools for tracking portfolio performance could also help investors manage their accounts without having to seek advice from a broker. Therefore, online brokers had radically redefined the existing rules of the game in the retail brokerage industry by giving customers access to information and research once available only to brokerage professionals.

Not only was this way of doing business radically different from the traditional way, it also raised thorny issues for any established competitor contemplating adoption of online trading. A potential trade-off that a full-service brokerage house was likely to face was cannibalization of its existing full-service customer base. By offering online services, the company risked shifting some of its more independent-minded private investors from high-value, advisory-based activities to low-margin, execution-only services offered through the Internet. These investors could come to consider trade execution as a commodity and could therefore opt to use the company's online site to trade directly rather than use the help and advice of brokers and pay traditional broker commissions.

In addition, if the established brokerage house chose to embrace the new online trading business, it faced the challenge of what to do with its existing branch network and brokers. Should it divert much-needed resources from its traditional business to the online business, thereby undermining the value of its existing distribution channel? The decision was not an easy one. The very act of setting up an online operation would not only create competition for resources between the alternative distribution channels but would also undermine one of the core advantages of the full-service firms, namely the broker's role in providing sound advice to clients. Such a strategy could very easily alienate the firm's brokers.

Thus, by adopting an altogether different business model, online brokers were challenging the traditional full-service business model and threatening the long-standing competitive positions of incumbent firms in this industry. Their unorthodox tactics made it difficult to find an appropriate response. The underlying trade-offs between the two different ways of competing in the industry added to this difficulty considerably, and made the decision on whether or not to offer online trading a major dilemma for the established firms.

Some Common Themes

Certain themes emerge from the online brokerage example that are actually common to all business-model innovations.

First, new business models invade an existing market by *emphasizing product or service attributes that are different from those emphasized by the traditional business models of the established competitors*. For example, whereas traditional brokers sell their services on the basis of their research and advice to customers, online brokers sell on the back of a different value proposition, namely price and speed of execution. Similarly, whereas traditional airline companies sell their product on the basis of frequency, range of destinations, and quality of service on board, the low-cost, point-to-point operators emphasize price. And whereas traditional universities sell their product on the basis of quality and career placement, online schools like the Open University in the United Kingdom and University of Phoenix in the United States sell their education on the basis of flexibility and price. This point is made vividly clear in Table 1.3, which compares the performance attributes emphasized by established firms to those emphasized by innovators in a number of industries.

This is an important point to appreciate. Since innovators emphasize different dimensions of a product or service, their

Table 1.3. Critical Performance Attributes Emphasized by Established Firms and Innovators.

Industry	*Performance Attributes Emphasized by Established Firms*	*Performance Attributes Emphasized by Business-Model Innovators*
Banking	Extensive, nationwide branch network and personal service	24-hour access, convenience, price
Insurance	Personal, face-to-face advice through an extensive agent network	Convenience and low commission rates
Airlines	Hub-and-spoke system, premium service, meals, baggage checking	Price, no frills
Brokerage	Research and advice	Speed of execution and price
Photocopying	Speed of copying	Price, size, and quality
Watches	Accuracy and functionality	Design
Steel	Quality	Price
Motorcycles	Speed and power	Size and price
Bookstores	Chain of superstores offering nice environment and service	Wide selection, speed, price, convenience
Car rental	Location (airports) and quality of cars	Location (downtown) and price
Computer	Speed, memory capacity, power	Design and user-friendliness

products or services inevitably become attractive (at least originally) to a different customer base from the one that desires what the traditional competitors offer. As a result, the markets that get created around the new competitors tend to be composed of different customers and have different key success factors from the established competitors' markets.

This is a point that Christensen (1997) emphasizes in his own work on disruptive innovation. Based on his research, Christensen suggests that established players in an industry tend to focus on certain product or service attributes that their mainstream customers value. The established players invest aggressively to improve these performance attributes and thus retain their existing customers. In contrast, new companies enter the industry by emphasizing different product or service attributes. The newcomers bring to the market a very different value proposition from the one available previously. They typically offer different performance attributes from the ones mainstream customers historically valued and, at least at the outset, they almost always perform far worse along one or two dimensions that are particularly important to those customers. As a result, mainstream customers are usually unwilling to adopt these disruptive innovations since they do not meet their current needs.

This means that the innovation will succeed only if another set of customers—different from the mainstream customers—finds its offering attractive enough. In fact, this is exactly what happens. Even though the innovation generally underperforms mainstream products or services in the dimensions emphasized by the established players, it has other features and attributes that are superior to those of established firms and that a certain (and usually new) segment of customers values. The new customer segment becomes the platform from which the innovator will eventually grow and invade the mainstream customer base.

A second characteristic that all business-model innovations display is that they start out small relative to the main business. Often (but not always), they also start out as low-margin businesses. As a result, it is difficult to gain support or long-term commitment from the organization of the established competitors. Exactly because the innovations are so small relative to the mainstream business, they are not particularly attractive to big, established companies. Even managers in these established companies who want to do something about the new markets find it difficult to justify investment in these markets on economic grounds. As long as the incumbents are able to retain their mainstream customers in their existing business, they are unwilling to invest significant resources in the innovation. Not surprisingly, it is rare to find these types of innovations originating from big, established companies. It is usually an entrepreneur or a new market entrant that introduces business-model innovations in an existing market.

However, it is not long before the innovations start growing into viable businesses! This is the third characteristic common to all business-model innovations. The way this growth happens is also quite similar across industries and follows a predictable pattern.

Once innovators become established in their *new* (and small) segment, a series of improvements over time enhance not only their original value proposition but also the performance attributes that established companies emphasize (and mainstream customers value). In fact, these performance attributes improve at such a rapid rate that the innovators can soon enter the established market and sell their previously inferior product or service to the mainstream customers (Christensen, 1997). This is because they are able to deliver performance that is *good enough* in the old attributes (that established competitors emphasize) and *superior* in the new attributes. By accumulating experience and relevant expertise in the new market, the innovators can then use that commercial platform to attack the value networks of the established firms. In their constant effort to improve their products and services to beat the competition, these companies invest resources to the point where they can address the needs of mainstream customers. This is what ultimately leads to the growth of the innovation into a big business.

For example, consider again the U.S. retail brokerage industry. Online brokers such as Charles Schwab and E-Trade are now able to offer high-quality research and financial advice to their investors at much lower cost per trade compared to the established full-service brokerage houses. The online brokers offer access to real-time, personalized market information and financial data, market analysis, and other investment information services once provided only by traditional full-service companies. Similarly, Internet banks (such are First Direct in the United Kingdom) are now focusing on providing more customized personal services to their customers by expanding their range of products. In addition to offering online accounts, these banks are increasingly tailoring specific products for the Internet, like online billing or credit cards with instant online approval. They are also enhancing their level of service through online content by providing investment research and personal financial advice to customers, services that were previously available only through a retail branch network.

Inevitably, the growth of the innovator into the mainstream business attracts the attention of established players. As more customers (both existing and new ones) embrace the innovation, the new business receives increasing attention from both the media and the established players. A point is reached where established players cannot afford to ignore this new way of doing business and they therefore begin to consider ways to respond to it.

At this stage of deciding how to respond, established firms have to confront the fourth characteristic that all such innovations share: compared to the traditional business, the markets created by business-model innovations have different key success factors and as a result require a different combination of tailored activities on the part of the firm. For example, the value chain as well as the internal processes, structures, and cultures that Amazon needs to put in place to compete successfully in the online distribution of books is demonstrably different from the one that Borders or Barnes & Noble needs to compete in the same industry using their business model.

Not only are the new required activities different, they are often incompatible with a company's existing set of activities. This is because of various trade-offs or conflicts that exist between the two ways of doing business. For example, by selling its tickets through the Internet just like its low-cost competitors, British Airways risks alienating its existing distributors (the travel agents).

Similarly, if Unilever moves aggressively into lower-price private label brands, it risks damaging its existing brands and diluting the organization's strong culture for innovation and differentiation. The next box lists a few of the most serious conflicts and trade-offs that might exist between the new business model and the established one.

Potential Conflicts and Trade-offs Between the Established Business Model and the New One

- Risk of cannibalizing the existing customer base
- Risk of destroying or undermining the value of the existing distribution network
- Risk of compromising the quality of service offered to customers
- Risk of undermining the company's image or reputation and the value associated with it
- Risk of destroying the overall culture of the organization
- Risk of adding activities that may confuse employees and customers regarding the company's incentives and priorities
- Risk of defocusing the organization by trying to do everything for everybody
- Risk of shifting customers from high-value activities to low-margin ones
- Risk of legitimizing the new business, thus creating an incentive for still more companies to enter this market

The existence of such trade-offs and conflicts means that a company that tries to compete in both positions simultaneously risks paying a huge straddling cost and degrading the value of its existing activities (Porter, 1996). The task is obviously not impossible but it is certainly difficult. This is the logic that led Michael Porter to propose more than twenty years ago (1980) that a company could find itself "stuck in the middle" if it tried to compete with both low-cost and differentiation strategies.

Porter (1996) identified three main factors that give rise to these trade-offs. First, trade-offs arise from inconsistencies in a company's image or reputation. Firms that try to offer two different kinds of value that are not consistent with each other run the risk of jeopardizing their existing image and reputation. Second, trade-offs occur as a result of the particular set of activities that a company needs to compete successfully in its chosen position. A unique strategic position requires a particular set of tailored activities that are different from those needed in other positions in the industry. This set of activities may include different product configurations, different equipment, different employee behavior and skills, and different management systems. Many trade-offs occur because the tailored activities of a unique strategic position are incompatible with the activities of alternative positions in the industry.

Finally, trade-offs arise from the limits a firm faces when it tries to coordinate and control incompatible sets of activities. Companies that try to compete in two different strategic positions at the same time find it difficult to set the necessary organizational priorities and communicate them clearly to their employees. These companies then run the risk of losing focus through adding activities that may confuse their employees. In many cases, the latter are not clear about the overall incentives and priorities in the organization, and about what they need to do to achieve these goals. As a result, they often attempt to make day-to-day operating decisions without a clear framework and direction, which seriously undermines their performance (Porter, 1996).

The existence of trade-offs makes it extremely difficult for established firms to respond to a business-model innovation effectively. In most cases, they incur a straddling cost that far outweighs any potential benefits emerging from the new positioning. Put in a different way, a company cannot compete in both positions simultaneously without experiencing major inefficiencies. Any attempt to manage the innovation by utilizing its existing systems, processes, incentives, and mind-sets will only suffocate and kill the new business.

It is in this sense that business-model innovations are sometimes called strategic innovations (Markides, 1997). The term *strategic* is not used to mean "important" or "big." Consistent with the resource-based view of the firm, an innovation is considered strategic if it is difficult for competitors to imitate, substitute, or replicate quickly. And what makes it difficult to imitate is (among other things) the fact that the value-chain activities of the new business model are not only different from but also incompatible with an established company's existing set of activities.

Therefore, to summarize the discussion so far: business-model innovation is the discovery of a different and difficult-to-imitate business model in an existing industry that attracts new customers to the offerings of that industry and so enlarges the economic pie. It does, however, display certain characteristics that make it quite unpalatable to established firms (see box).

Who Wants to Be a Business-Model Innovator?

Given the characteristics of business-model innovations, it's not exactly clear why any self-respecting established company that already has a winning business model would want to discover another one! Sure, for new entrants and smaller companies, this is a no-brainer—the best way for smaller companies to attack big competitors is through guerrilla tactics (Porter, 1985, chapter 15). But why would any established company want to develop a new business model, especially if its existing one works fine? And why would the established firm want to get involved with a new business model that would most likely lead it to low-margin customers and create all kinds of conflicts with its existing business model?

The Characteristics of New Business Models That Make Them Unpalatable to Established Firms

- New business models emphasize different product or service attributes from those emphasized by the traditional business models of the established firms. As a result, their offerings are—at least initially—of no interest to the customers of the established firms.
- The markets created around the new business models start out as small and insignificant relative to the main markets of the established firms. As a result, it is difficult to generate entrepreneurial passion for the new markets within the established firm.
- The new markets take time to grow and take even longer to turn profitable enough for the established firms. As a result, they run into the "impatient capital" problem that all publicly traded companies face.
- The new business models create markets that have different key success factors from the ones in operation in the established firm's main market. This implies that the firm needs to put in place a different combination of tailored activities (such as value chain, structures, cultures, and internal processes) from the ones that it has in its established business.
- The new set of activities required for the new market is not only different from but often conflicts with the set of activities that the firm has in its main business. These conflicts encourage the managers of the established business not only to withdraw their support for the new business but even to sabotage and suffocate the innovation.
- New business models eventually invade the established market and cannibalize the existing business model. As a result, the managers of the organization view them more as a threat to repel than as an opportunity to exploit.

Furthermore, suppose that the established firm decides to go ahead with a new business model. The dilemma then is how can its people continue managing their existing business with one business model while at the same time serving another customer segment in the same business with a second business model. This challenge is not the same as trying to serve different customer segments with different brands, as Unilever or P&G or Volkswagen or General Motors or Mercedes do. Sure, VW sells its Audi brand to one customer segment, its VW Golf brand to another, and its SEAT brand to another—but the company still operates under the same business model no matter what customer segment it is serving. The issue with business-model innovation is not how to offer different brands to different customers but how to operate two different (and often conflicting) business models in the same business.

Not that the challenges for established firms end there. Suppose they decide that rather than operate with two business models, they'd rather migrate from their existing business model to the new one. How, then, could they manage the migration process? Or suppose that they'd rather focus on their existing business model—how then could they respond to the invading business model? Adopting the new business model is only one of the many options available to established firms—what else could they be doing and how?

I raise all these questions to make two important points. First, it should be clear that business-model innovations are not necessarily superior to the business models that established companies already employ. This means that it is not necessarily an optimal strategy for an established company to abandon its existing business model in favor of something new or to grow the new model alongside its existing business model. The decision should be based on a careful cost-benefit analysis and would depend on the specific circumstances of the firm as well as the nature of the innovation. The decision should also take on board any other growth opportunities that the established firm may have at its disposal—such as diversifying into adjacent markets or taking its existing business model internationally. Given the other growth options (and given its limited resources), the decision to invest in the new business model may rank low on a company's priority list.

Second and more important, bear in mind that the challenge that an established firm faces is not so much how to discover a new, game-changing business model as how to overcome some of the unpalatable characteristics that new business models display. What can the firm do to make these new business models less conflicting or more attractive to the existing business? Established firms can encounter endless advice on how to discover new business models, but they will take no action until they adopt organizational structures and processes that make these innovations more palatable. Therefore, my task in the chapters that follow is to propose the organizational solutions that a big firm must put in place to allow it to pursue business-model innovations.

It should be clear from the questions raised so far that I aim to examine business-model innovation primarily from the perspective of an established company. The established company already has a business to manage, operates a certain business model (or strategy), and competes within certain mind-sets, politics, and realities. These are the questions that this company's leadership might be thinking about:

- How could I discover a new business model in my business?
- How can I convince my organization (and win emotional commitment) to embark on such a journey?
- If I succeed in developing a new business model, how can I implement it in an efficient way?
- If I do succeed in implementing a new business model, how can I operate with two business models in the same industry simultaneously?
- If somebody else discovers a new model in my industry, how should I respond to it?

- When should I pursue business-model innovation in a proactive way?

This book aims to answer these questions. In the next chapter, I start the journey by answering the first question—how could a firm discover a new, game-changing business model in its industry? Specifically, how could it create the necessary organizational sense of urgency (or positive crisis) that would propel the organization out of its inertia and old mind-set?

Summary

- Business-model innovation is the discovery of a different business model in an existing industry. The innovation enlarges the market by attracting nonconsumers to the product or service or by encouraging existing consumers to consume more.
- New business models invade the market by offering a different value proposition from what the established players are offering. As a result, they attract different customers from those of the established firms. To serve these different customers, the innovators need to develop a business system that is not only different but also conflicts with the business systems used by the established players.
- These characteristics make business-model innovations unpalatable to most established firms. It is mostly new start-up firms who find this kind of innovation attractive. The established firms will actively pursue this kind of innovation only when they put in place organizational structures and processes that make the new business model less conflicting and more palatable to them.