

# Chapter 8

## Business Innovation: Beyond Technology

**Don Scott-Kemmis**

*University of Technology, Sydney, Australia*

### ABSTRACT

*This chapter presents the case for a wider understanding of innovation beyond technology and beyond novel products and processes. It examines the dynamics of Business Model Innovation, which refers to fundamental changes to the total formula for business success. New approaches to value creation and appropriation through business model innovation are particularly vital in times of turbulence and realignment faced by firms in high cost operating environments. Business model innovation can create new and sustainable sources of competitive advantage for firms, securing their survival and growth. The chapter discusses the evidence for the role of business model innovation in the growth of leading firms and in the restructuring of markets. It provides an overview of the frameworks for characterising and analysing business models. The options for different types of business models likely to be successful in high cost environments are described.*

### INTRODUCTION

There are periods in history when necessity and opportunity drive a rapid exploration of new approaches to value creation and appropriation. Firms in high-cost environments are particularly vulnerable to these rapid realignments. But when they do pursue the new opportunities and design new approaches they find that they often have strong competitive advantages.

The transformation of markets and industry that is underway overturns the assumptions that

have underpinned many well established business models. Many analysts have sought to describe and raise awareness about these shifts. Marsh, for example, considers the fifth and current stage of industrial development is one characterised by ‘mass personalisation’ – the ability to produce near unique products to precise personal criteria in mass<sup>1</sup>.

At the same time there is a wealth of opportunity: the growth of the middle class in China, India and Indonesia opens major new markets; there are more channels to these and other markets;

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there is a rich array of new technologies with the potential for diverse applications; and there is an increasing range of capable firms with complementary capabilities.

In this context, driving greater cost reduction and product or service innovation in the current business model is unlikely to be a strategy for growth or survival. Experience shows that a commitment to an old business model is the cause for declining returns to investment and R&D in firms and the failure of others.

In Section 2 of this chapter we discuss the evidence for the role of business model innovation in the growth of leading firms and the re-structuring of markets. Many firms that have used innovative business models to enter mature markets have been extraordinarily successful. In the US, for example, both discount retailers and low cost airlines have captured the majority of the market, while Delta, Northwest, United, Continental, ATA, and USAir, among others, declared bankruptcy. This section also discusses the drivers of change that diminish the power of old business models, noting that these drivers are not transient but becoming stronger.

Section 3 provides a brief overview of frameworks for characterising and analysing business models. Many forms of innovation are vital for sustaining competitiveness in high cost environments: technological innovation in products and processes; service innovations based on IT applications; and organisational and managerial innovations based on lean production, continuous improvement and high performance workplaces. But these are most effective when integrated as components of a more systemic re-framing at the level of the business model. Section 4 is the core of this chapter and outlines three archetypal families of business models for firms in high cost environments: the ‘bookend’/outsourcing model; the product-service solutions model and the high value niche strategy.

Section 5 draws on firms’ experience of business model innovation to provide a roadmap for designing, testing, implementing and upgrading

a new business model. It emphasises gaining insight into market dynamics and often unexpressed customer preferences. The need for experiment and rapid learning while evolving a new business model has vital implications<sup>2</sup> for management capability and organisational culture. Analysing, planning, experimenting and learning must find a level of inevitably uncomfortable synergy. While the chapter recognises the challenges of business model innovation for established firms, this section also emphasises the advantages that most firms in high-cost environments have in accessing high quality human resources and research organisations, and in collaborating with leading edge users and capable suppliers. Of course public policy has a vital role in ensuring that high-cost is also high-opportunity – and also in assisting firms to identify and pursue those opportunities.

### **THE CHANGING CONTEXT: DRIVING THE NEED FOR NEW BUSINESS MODELS<sup>3</sup>**

The rapid growth of mass production in the mid-1900s centred on the growth of large factories, reaping economies of scale and clustered with their suppliers in a few regions and supplying domestic and export markets. The follower East Asian countries such as Japan and Korea sought to replicate this model, using protected home markets to build the full assembly of suppliers, eventually reaching the global frontier of efficiency, quality and innovation. However, the diffusion of ICT, more open markets and lower transport costs has led to unbundling these sectors, lowering the barriers to entry into these now mature industries. The evolution of global supply chains is summarised in Figure 1. To participate in the global supply chain, a firm does not need to master an entire production process, but to excel in a specific phase.

In this context a primary driver of business model innovation is the pervasive diffusion of information and communication technologies

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