How to Write About Innovative Business Models

Johan Jörgensen, Affärsvärlden

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Introduction

During the last decade, a new breed of companies have emerged. They work according to new business models that have been facilitated by the rise of the Internet. Enormous amounts of money have been poured into these companies, both by venture capitalists, and by the public in some subsequent initial public offerings (IPO). Huge amounts have been lost, but in many ways, the world has become richer due to increased efficiencies introduced by these new models.

This is the way it has always been. A business model is basically the method of which a company can generate revenue. It also says where in the value chain the company is positioned. This position isn't always easy to identify, especially not when the company exists in a complex network of producers, distributors, agents and customers. Further, it isn't easy to measure a business model. The don't come with specs, to borrow a term from the it-industry

Both the business model and the place in the value chain are constantly challenged. One part of the competitive environment of business is the constant rise of new business models. During more intense times of shifts; be they technology shifts, legal shifts, demographic shifts or any other shift that for the moment prevails, new business models arrive at a higher or lower pace.

To Schumpeterians (like myself), those are interesting times since they are full of what Joseph Schumpeter, the Austria born economist, named "creative destruction"[1].
To businesses those are challenging times because organizations are built in accordance with the business model it is set to implement. A new business model can mean a radically different organization. Sometimes so radical that the best way of handling the situation is to scrap the old organization and build a new one from scratch.

This, of course, means that the field of business models and value chain deconstruction is littered with innovation. This is an important notion, since innovation, by most, are seen to take place in the labs. However, if you look at the companies that went public in the last few years of the nineties, you will discover that many, not to say most, had their raison d'être in a business model innovation rather than in something patented. Anybody

[1] Joseph A. Schumpeter, "*Capitalism, Socialism, and Democracy*",

looking at innovation therefore must be careful not to end up in the “engineering trap”. It also means that innovation has become a field where managers and business school graduates can be partakers to the same extent as the engineers in the Research and Development (RnD) department.

The pure nature of being strategic to businesses, and at the same time promising to destroy old ways of doing things, puts new business models at an inflexion point where some people work for it, and others against. Complicating matters further are of course the fact that any business model operates in a context that gets increasingly more complicated due to facts like globalization and the tearing down of the corporate borders risen by the transaction cost theory.

Lets be clear about one thing. New business models appear whenever they are deemed fit to replace an older one, or to cater to completely new needs. This need can be real or perceived, and how the new business model succeeds depends on how well it can match what the customers want with delivering that in a timely and profitable way.

Even though technical innovations go hand in hand with innovations in business practice, this paper will be about the latter.

The last few years we have seen the rise of the Internet, or rather the Internet Protocol (IP), as a fundamental infrastructural change. The Internet has suddenly provided us with new means of reaching and serving customers. This has also led to the rapid rise of new business models. There is probably no other single factor that has affected business in our time as much as the Internet.

In this rapid development, media has a central role in disseminating new information. The spreading of new and more efficient methods of doing things can be beneficial both to the individual consumer, but also to the economy as a whole. And no one spreads information as well as the media. For journalists, identifying the winners and losers in this turbulent environment is therefore not only a critical ability in their profession, but also a critical factor for society.

This paper is a humble attempt to try to identify some tools – or rather bullet points – for journalists wanting to increase their chances of correctly assess the success – or failure – potential of a new business model. It focuses, naturally, on the last few and mad years of the Internet boom and bust. Some of the thoughts and ideas can be clearly generalized to also involve the upcoming boom for mobile data, but most of the time a new situation demands a new tool.

And still, many good angles are of course missing. It should be stressed that this paper is based on my own experiences from writing about and developing new business models over the last decade. I probably also have forgotten to mention a few lessons that I by now have internalized to the degree where they have become invisible to me.

But then again, that probably is the road you need to go down in order to be able to write about innovative business models.

That future lies in between technology and business and demands that the one trying to understand them are well versed in both. It also affects most aspects of the world as we know it. Please also forgive me for pointing out the obvious. To many of you reading this it won't make you any wiser than you already are, but, then again, for some it might provide some new information.

Context

The new and digital economy has given us a number of new "principles of nature", just to mention a few relevant to us:

- Everything that can be digital will be digital
- Everything digital will be transported and delivered digitally
- The marginal cost for production and fulfillment in a digital world goes towards zero
- This leads to increasing returns
- This upsets the relation between demand and supply, and alters relative pricing between complementary goods
- The value of the network rises exponentially with the number of nodes

There is no longer any doubt that the Internet has become a major factor in our daily lives. Broadband connections are proliferating, as are standards for interconnection between software and hardware. The nature of an international distribution network that is available at a neglectable cost, has led to an explosion in creativity concerning new businesses. People suddenly have a tool to experiment with, which has led to many new businesses or business models being tested than before.

And the audience is there. Some people even spend more time online than in front of the TV. In addition to this, new research from Pew Internet points to the fact that, at least in the U.S., the online inhabitants doesn't differ from their off-line colleagues.

This means that traditional business probably will move online more and more, thereby making the online business models and ways of doing things a more important and inherent part of the overall strategies of the company. This, plus the fact that we are only in the beginning of the digital revolution, will mean a challenge to everyone covering the latest developments. The list of the world's largest corporations 1950 looks very much different from today's list. In a couple of decades we will marvel at the changes that have taken place since Fortune presented its 500 list in 2004.

New Business Models

Luckily there aren't too many generic business models out there to choose from. Michael Rappa, professor of Technology Management at North Carolina State University have identified nine basic categories of business models[2] that can be observed on the Web.

- Brokerage
- Advertising
- Infomediary
- Merchant
- Manufacturer (direct)
- Affiliate
- Community
- Subscription
- Utility

As professor Rappa points out, the list is neither exhaustive nor definitive, since Internet business models continue to evolve.

But there are components of each model that can become more or less important due to new developments, and which can affect the validity of the model in it self. To take an example from the old economy, the existence of a vast distribution network, that only recently was seen as a major asset, has now dropped in value dramatically. Huge marketing budgets have also faded in comparative value due to new methods of viral marketing. The rise of the Internet companies Kazaa and Skype have both occurred without a cent being spent on marketing. Thus, various functions of a company can gain respectively loose in relative strength when transferring to a new business model, or when being exposed to new developments, for instance technological ones, within the business model itself.

Consider for instance the classic AIDA model for marketing:
A = Attention
I = Interest
D = Desire
A = Action

First you create attention. Once you have that, you try to get the customers interested in your product, in fact, so interested that a desire to buy whatever you are peddling starts to grow. And finally that transfers into an action on behalf of the buyer.

Internet transforms each of these steps and can indeed compress the whole process to a couple of seconds. Where once the "attention" creation took a lot of resources, not the least monetary ones for putting up billboards and advertising in the press, the "Action" might have happened in an agents network, i.e. in a shop, at a low cost for the manufacturer or brand owner. Today, attention might be created through viral marketing,

[2] For a closer definition please see http://www.digitalenterprise.org/models/models.html

at little or no cost, but a site that can persuade interested and prospective buyers into action can be both costly to build and maintain.

Globalization
New business models also rise with the help of globalization. For instance, the relative price of capital versus labor is being upset when moving production to foreign shores. An illustrative example is how one bank, cited by McKinsey Global Institute in a new report "New Horizons"[3], has been able to extend personal banking services to a new range of lower income clients by moving their customer support center to India. Thus, other types of customization suddenly become possible when the global economy is taken into account.

The same goes for legal/contractual differences, like the difference in added wage cost for people working late shifts. This means that factories in some locations can be operated 24 hours, with a more efficient use of capital as a result.

Points To Bear In Mind

So, business models and their effects are inherently hard to understand, not the least in a rapidly changing global environment. But once you're proficient in Internet business models, it will be highly interesting to start looking at traditional business models and traditional players. Trying to assess how they will be affected by a combination of factors like the Internet, globalization or just such an evident technology shift as the proliferation of broadband access, can be just as interesting as looking at new companies and new business models. The absence of change can be a clear signal of change to come. But then as nasty and unwelcome surprises.

The following are the bullet points I bear in mind whenever I see a new company or business model being introduced or even hailed, and for which there is a need to asses the potential, be it in terms of customers acquisition, revenue streams or profits.

Well Disguised In Novelty
A new business model is attractive. It is associated with positive change, more value for money, better service, etc. Many times it also shines like a new car and sings like a siren. It is thus easy to be lured to write about it. The lingering question if it will be successful or not can be hidden behind the novelty. The shortening of the news cycle in this case can act as a trap with novelty as the lure.

Asymmetric Information
A new business model is well understood by the ones presenting it (we hope at least). For everybody else it, and its effects, is often unknown. This asymmetry in information is a concern you have to deal with and puts a greater strain on finding the right people who can help you analyze it (see peer review below).

[3] The full report can be downloaded at http://mckinsey.com/knowledge/mgi/reports/newhorizons.asp

Untested
Most of the times a new business model is utterly untested. That means that the outcome is hard to predict. In some cases the development is close to “historically predicted” like in the music industry. But even in a such a wide open case as the delivery of digital music, a prevailing business model has yet to materialize, even though the success for Apple’s iTunes.

Continued Change
That brings us to the notion that business models, and especially digital ones, continue to evolve at a rapid pace. The best model today can be radically different tomorrow, to a great extent depending on the development of technology. For Internet access that was the case when we went from bandwidth being something expensive to being ubiquitous. Another example would be when a service becomes productified, for instance machine reading and analyzing of EEG, and thus possible to deliver much cheaper; at a fraction of the cost of having an experienced physician manually reading and analyzing it.

Can Be Affected By Strategic Decisions By Major Players
Take the music industry as an example; what will happen when Microsoft suddenly decides to offer a subscribed archive of all the music in the world for $10 per month? That could probably mean negative effects for a huge success like Apple’s iTunes. Businesses can take such strategic decisions not to make money out of it, but also for reasons like increasing the sales for another division, or to just hurt a weaker competitor. Much in the same way as Apple once took the decision not to make money out of selling music, but out of selling music players. Major players can also afford to wait before they adopt a new business model. Sometimes that means they will hurt themselves by allowing a new competitor to enter the market. But it can also mean a lower degree of risk.

Organization
One must bear in mind that a new business model can be stressful to the organization, where people might become worried about their jobs, and thus not perform their best in the company’s daily core activities. This is a common question raised in the board rooms when the transfer to new business models are discussed. In many occasions entrenched players hesitate to adopt new practices, and others, when they do, decide to confine them to a limited part of the business, or even set up a new subsidiary in order not to contaminate a successful and ongoing business. Sometimes a new business model can also be set up as a lip service in order to silence the critics. This can for an example be said about the music industry’s launch of Pressplay and MusicNet, two widely unsuccessful attempts of digital distribution of music.

Is The Business Model Primary Or Secondary?
Sometimes you give something away in order to sell something else. Since you can give away digital material almost for free, provided that you control the copyright, this opens up for severe competition in new fields. If two businesses meet where the business model is primary for one and secondary for the other, the one with the primary model might be struck on price, but probably also will invent ferociously in order to stay in business.

This is the playground of major companies who in the digital world better can afford to take strategic decisions in creating so called loss-leaders[4]. It might not always be a loss leader, but can also be a slim profit leader, or non-profit leader. When the borders between companies and their offerings are torn down, these strategies become increasingly common as well as confused.

The Notion That Selling Online Is The Same As Electronic Catalogues
Nothing can be more wrong, even though early e-commerce attempts on the Net were very similar to the traditional business of the catalogue companies, but without the experience and logistics of the latter. Today we see that online business has other and much more potent tools at hand when it comes to customer service and pushing sales. The former includes being able to identify what's in stock and what's not. The latter includes more-selling at a scale ranging from e-mail specials to Amazon's matching technologies (if you like this, you probably also like…).

Numbers
Almost everyone these days provide figures from various research institutes to support their ideas on how business should be conducted. In fact, a few years ago it seemed more common to start a research business for Internet related issues, than starting an Internet company. Needless to point out to journalists, the reports and numbers provided can be of an utterly poor quality, with the drawing of straight lines pointing to the sky as the main component. But even in the case where the predictions are well founded, the last few years have pointed out that a new business model can be trashed in an instant by new technology. So even if the numbers are correct, they might become wrong.

Market Dynamics
Many Internet companies launched their new business models with expectations based on them gaining and keeping world supremacy in their niche forever. Market dynamics predict something else. Once a niche is considered to support a business, people will start moving there, gradually reducing profits to normal levels, if not less (please see primary-secondary business models above).

First Mover Advantages
First mover advantages – a much touted word – has proven to be true in some cases, but then also very untrue in other. The truth is that the first mover incurs costs for educating the market, and since the broad majority is unlikely to switch over from an old to a new business model over night, you need to have a strong balance sheet in order to survive until business picks up. If you can do that, and if you enjoy lock-in effects and economies of scale (please see below), the first mover advantage can be turned into a cash cow.

Lock-in Effects
Lock-ins occur when someone gains a monopoly, or monopoly-like situation. Microsoft is one, Google is another, Ebay a third. If one is to analyze the potential of a new business or a new business model, lock-ins would be the thing to look for. But lock-ins

[4] The strategy of offering a product or a service at a considerable discount, thereby loosing money, in order to attract future business.

can go away too. Take the search engine market. In this specific segment one dominant has taken over from another at a regular interval. Once upon a time AltaVista was the almighty search king. Today it is Google. Tomorrow there might be another one.

Economies Of Scale
The digital phenomenon is interesting since every new copy comes with a marginal cost of almost zero. And with transportation over the Internet almost as cheap, it has become easier to overthrow an entrenched player. Before the digital era that was practically impossible since then economies of scale came with huge organizations and substantial amounts of capital invested. Today the players race to control the customer (to try to lock-in him/her, if you like) in every conceivable way, rather than controlling the distribution network, as used to be the case.

Content Is King, Distribution Is King Kong
That being said, this doesn't mean that distribution power has become irrelevant. On the other hand, major sites like Yahoo, Ebay, iTunes and Amazon has become increasingly important for companies, since that's where their customers are (people don't roam as widely and freely on the Internet as we are lured to believe). In addition to this we have sites where people with special interests gather, often in the form of virtual communities. If you don't manage to get your products out on such distribution networks, then you have to turn to the search engines. Or maybe utilize word of mouth/viral marketing. Or PR. Best is of course a combination. But if a company can't be specific on how to take care of distribution, it is a clear sign of problems. People won't come running to your door just because you've built a better mousetrap.

Technology
Technology can be a great asset, but you need to keep up with the developments. Once somebody has a success, many will be called to dethrone that company. And since technology is a field where a single individual can make a huge difference, risks are high for any company thriving on technology rather than on a customer base.

User Experience
In a static situation, it can be well enough to observe the current developments in order to be able to analyze it. In a more dynamic and unstable environment, you need to live it in order to understand it. In the case of new business models that involves using the services you are covering. Famed failures are companies like Boo.com, that wanted to sell clothing online in such a high tech fashion that even the most hard-core Internet users with the most bandwidth could barely access the site. Not to mention the ordinary folks making up the bulk of the customer base.

Complementary Products
The rise of computer gaming has all but killed the comic magazine industry. It turns out that these products are complementary – both aims at spare time that needs to be filled by something. With the Internet we suddenly have immediate access to an enormous variety of products and services, of which increasingly many have a competitor in a complementary product. So, what will happen to other businesses? Ebay has introduced

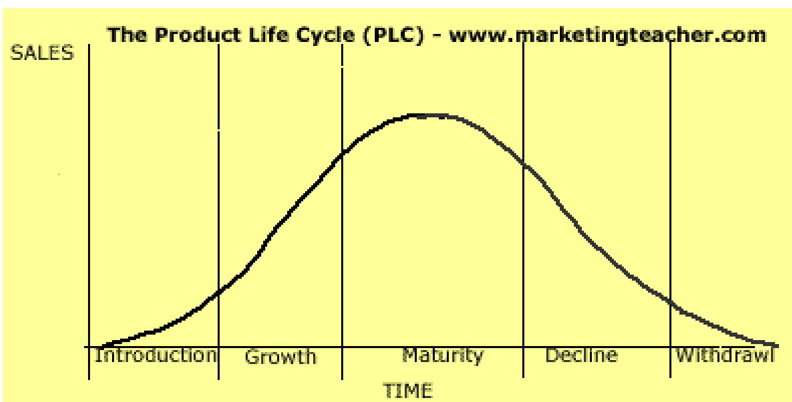
the auction as a way for people to sell stuff over the Internet. But they have also hurt the newspapers in out-competing their classifieds sections. It turns out that to many newspapers, classifieds are what they live from. Thereby Ebay threatens the newspapers industry.

Hidden Agendas

Do the owners and management of a new company try to build a sustainable business model; turnover, profits, cash flow or a brand? Or are they building the company for a trade sale or even an IPO? Are they in it for the long run or the short run? The last few years have proven dramatically that business can be about something completely different than we thought. Whenever huge sums of money are involved, agendas are subject to change.

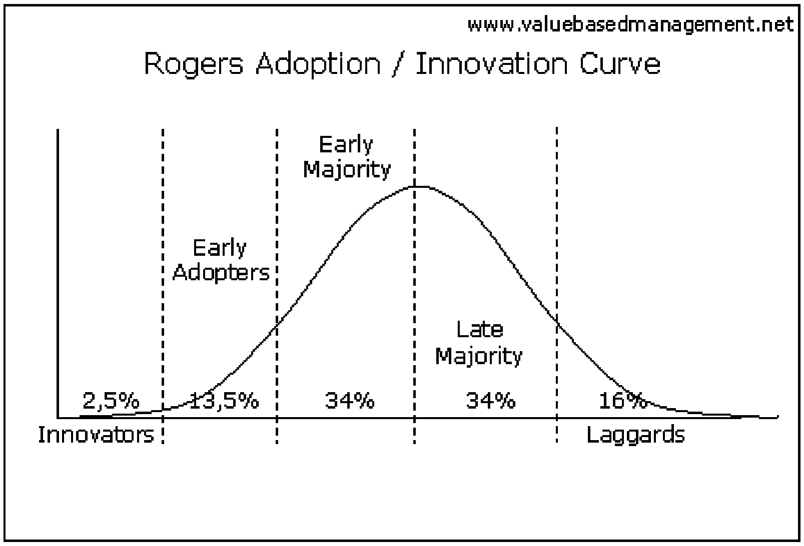
The Product Life Cycle

The nature of the Internet and the digital economy compresses the product life cycle. But to be able to assess the claims of a new company it is important to know when the respective stadium in the product life cycle will be achieved. And if they have the necessary organization in place to take advantage of the predicted developments.



The Innovation Adoption Curve

In order to do that it can be wise to bear in mind how technology is spread. Everett Rogers (1995) classified adopters of innovations into various categories, based on the idea that certain individuals are inevitably more open to adaptation than others.



source: www.valuebasedmanagement.net

- **Innovators:** Innovators jump on new ideas at the earliest possible moment.

- **Early Adopters :** Early adopters are opinion leaders who like to try out new ideas. They are more careful than innovators, though

- **Early Majority:** The early majority is more thoughtful, however they accept change more quickly than the average.

- **Late Majority:** The late majority are sceptics, and will only use new ideas when the majority is using it.

- **Laggards:** The laggards are critical to everything new, and will only accept it if the new idea has become mainstream or even tradition.

The innovation adoption curve is useful to keep in mind whenever you hear of someone trying to quickly and massively convince the mass of a new controversial idea. Usually it is a fruitless endeavor. It makes more sense in these circumstances to start with convincing innovators and early adopters first. Also the categories and percentages (here the ones used by www.valuebasedmanagement.net – but they can of course differ depending on product and situation) can be used as a first draft to estimate target groups for communication purposes.

Patents
Does the company have patents – the tangible asset in an intangible world? Today even business models can be protected. Those things are relatively easy to investigate.

People
Who runs the company? Have they done similar things before? Successfully? A general notion is that people go before business, that is; good management with an inferior product probably will beat inferior management with a good product. When the

entrepreneur Niclas Zennstrom launched his new Internet telephony company Skype, he could draw on the fact that he was the one creating Kazaa – the most downloaded program in the history f the Internet. The media will be very observant of such a fact. But even though being helped by media can take you far, only that can't take you all the way.

Strength Of The Balance Sheet
Predicting a new wave of heavy financing of Internet companies doesn't put you at a great risk of being pictured as a clown. It will happen. It will let some companies leap frog others. Not the least because a relatively limited amount of capital can build a huge corporation in the Internet era. Sometimes you wonder what would have happened if the bubble had leveled of in 2000 instead of bursting? Or if it had burst two years later? Then probably a lot of the companies that went under would have been able to prove their business model. Now, some only got a year or two in order to reach a positive cash flow. That is far to little. Companies that survived, like eBay, Amazon and Yahoo have gone on to become established, major corporations.

Don't Confuse Company With Business Model
Some business models have been ridiculed just because the company implementing it in the first place didn't succeed. That can have been due to many factors, none of which necessarily was the business model. Such factors can bee a weak balance sheet, weak performance of operations, overstrained organization due to feverish growth, etc. The business model can be perfectly solid, while the company fails. If that's the case, the business model likely will come back.

Don't Confuse The Great Bubble With The Business Models
The truth is that many, not to say the most, managers where well aware of the bubble they were blowing up. But at the same time those were the rules of the game at that time. It is a fact that a lot of money can let you leap frog the competition. All that money perhaps won't be wisely or optimally used, but on the other hand money *can* save you time. Sometimes that's of essence and clearly an objective. Not the least when you challenge entrenched business models of major competitors with very deep pockets.

Investors
Are there any Investors involved in the project? What's their proven track record? I must stress "proven", since multiplying one and the same business model in different sectors – which was a common play for e-commerce – doesn't necessarily mean anything as long as the success is more on the financial side than actual business.

Peer Review
A good thing is to listen to what smart people have to say. These should not be competitors, traditionalists or analysts possibly gaining from putting out certain types of analyses. Big names aren't always the smartest. And you'll be surprised to know how many people that have vested interests in something being a success. The latter was, if not before, painfully clarified in the investigations of the investment bank industry that recently was done by New York Attorney General Elliot Spitzer.

Look At Other Industries
There are a limited number of business models, and it is easy to borrow from other industries. Based on the success or failure of a specific business model in another industry (with the same customer properties) it is somewhat easier to be reasonably accurate in predicting success or failure.

Does Success Hinge On Other Factors Beyond Control?
If a new business model is based on people having access to a certain infrastructure or anything more complicated or expensive, any observer has to bear in mind that something else first needs to happen before the business model becomes valid. That is a tough proposition unless the proponents of the new business model can push that development. Otherwise they will be subject to matters out of their control, which seldom is good.

Megatrends
Does the business model hook into a mega trend of any kind? If so, chances improve substantially.

And, The OOM-Factor
Is the new product or company OOM, orders of magnitude, better in some or many aspects than what existed before? Then, chances increase substantially that we have a success on our hands. The OOM-factor is necessary to lure customers to rapidly switch to a new business model. Internet banking, digital distribution of music, e-mail, news on the web. Amazon, Yahoo, Ebay, Google. They all have a good portion of the OOM-factor. For a quick OOM analysis, look at an applicable model (like any of the ones listed below) and see if any of the points in the models are affected substantially. From my point of view the rude OOM-factor overrules most strategic positioning, at least if you are looking for evidence to claims of a swift success for a new business model.

Useful models

With the above bullet points in mind it can be valuable to do a little model exercise concerning the phenomena or company your analyzing. For those who are proficient in the language of business, terms like “the 4Ps”, “Porters Five Forces and Generic Strategies”, “SWOT” and “the Ansoff Matrix”, are familiar. To all others, it can be recommended to spend a few minutes learning the models that have shaped the minds you want to tap for information. A quick guide can be found at http://www.QuickMBA.com/strategy/.

Good luck

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Johan Jorgensen